

Personal current account banking services in Northern Ireland

The OFT's reasons for making a reference to the Competition Commission

May 2005

OFT796

- 1 The Office of Fair Trading (OFT) has made a reference to the Competition Commission (CC) under section 131 of the Enterprise Act 2002 (the Act) for an investigation into the supply of personal current account banking services in Northern Ireland (being part of the United Kingdom). For the purposes of this reference, a personal current account (PCA) means an account, marketed to individuals not businesses, which provides the facility to hold deposits, receive and make payments (cheques and debit cards) and use automated teller machine (ATM) facilities and to make regular payments (direct debit and standing orders).
- 2 Under section 131 of the Act, the OFT may make a market investigation reference to the CC where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts, or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. The OFT believes that this test is satisfied.
- 3 In addition, and in the light of our published guidance on market investigation references¹ (the Guidance), we have also considered the criteria set out at paragraph 2.1 of the Guidance and concluded that they are also satisfied.

¹ Market investigation references: Guidance about the making of references under Part 4 of the Enterprise Act – see www.oft.gov.uk

SECTOR OVERVIEW

- 4 There is a long-standing high level of concentration in the Northern Ireland PCA banking market. The four major banks (the big four²) between them provided around 74 per cent of current accounts in Northern Ireland by volume in 2004. While there has been some limited erosion of their market share by more recent entrants such as former building societies, direct banking providers have yet to make substantial inroads into the market.

- 5 No official figure for the value of total deposits held in current accounts is available for Northern Ireland, but it is estimated by industry sources to be in the region of £1.9 billion. The population of Northern Ireland at the 2001 census was recorded as 1.68 million, of whom it was estimated (in 2002-03) that 78 per cent had PCAs.

² Ulster Bank, Northern Bank, First Trust Bank and Bank of Ireland.

BACKGROUND TO THE REFERENCE, INVESTIGATION AND CONSULTATION

- 6 The OFT's consideration of this market follows receipt of a super-complaint made by Which? (formerly the Consumers' Association) on its own behalf and on behalf of the General Consumer Council for Northern Ireland (GCCNI) on 15 November 2004. A super-complaint is defined under section 11(1) of the Act as a complaint submitted by a designated body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. Which? is a designated body under section 11(5) of the Act.
- 7 The super-complaint said that the market for PCA banking in Northern Ireland did not appear to be functioning in the interests of consumers and that there was a lack of competition between the four largest Northern Irish banks. It alleged that:
- they paid considerably less interest than their rivals when accounts were in credit
 - they charged significant sums for activities that other banks did not charge for at all
 - their charges often lacked transparency, and
 - they displayed a striking degree of similarity in terms of what they charged for and the amount they charged.
- 8 Under section 11(2) of the Act the OFT must, within 90 days after the day on which it receives a super-complaint, publish a response stating how it proposes to deal with the complaint, and what action, if any, it proposes to take.
- 9 Under section 169 of the Act, before deciding to make a market investigation reference, the OFT must, so far as practicable, consult any person on whose interests a proposed reference is likely to have a substantial impact.
- 10 On receipt of the super-complaint, the OFT invited submissions from the big four banks and from other interested parties. During the course of investigating the super-complaint the OFT:
- reviewed the evidence on which the super-complaint had been based
 - sent a two-part questionnaire to the big four banks to collect data covering both profitability and market issues
 - met with the big four banks, and the GCCNI, and

- conducted follow-up clarification with the banks, GCCNI and Which? on issues raised by examination of the evidence.
- 11 Taking into account all the evidence gathered during the course of our investigation, at the end of the 90-day period the OFT took the view that the section 131 test for a market investigation reference to the Competition Commission (CC) was satisfied.
- 12 On 11 February 2005 the OFT published its response to the super-complaint.³ Following on from discussions with parties involved in the market during our investigation of the super-complaint, we also published a consultation paper on a market investigation reference to the CC.⁴ In paragraphs 11 to 15 of the response document we summarised the features that we suspected may, in combination, be causing or contributing to a restriction of competition and also set these out in more detail in paragraphs 10 to 56 of the consultation paper.
- 13 We allowed a period of five weeks for the consultation, ending on 18 March. During the consultation period, we received written submissions from each of the big four banks and at their request held meetings with two of them. We also received shorter letters of comment from four of the smaller market players.
- 14 The super-complaint noted, at page 12, that 'the profitability per Northern Irish personal current account could also be reviewed against those in the rest of the UK.' Profitability was, however, not itself listed as a concern by the super-complainant. The Guidance⁵ states that information on pricing and profitability can sometimes be a useful supplement to the OFT's evidence on structural features of a market and on firms' market conduct in deciding whether the section 131 test in the Act has been met. Therefore, as background to our assessment of competition in the market, we asked the big four to supply profitability data for their PCA business. The response was varied. One bank supplied three years' data when first asked, while another provided none, on the grounds that it would be heavily reliant on estimation and therefore misleading. The remaining two each supplied one year's worth of data. There are inevitably complex cost and capital allocation issues involved in estimating PCA profitability. Due to the limitations imposed by the lack of data and the complex issues involved, our findings on profitability were inconclusive. Our consultation paper did not, therefore, include profitability analysis to supplement our assessment of the features of the market which we suspected were causing or contributing to a restriction of competition. This does not contradict our overall conclusion that competition appears limited. Our decision to make a market

³ OFT 771a

⁴ OFT 771b

⁵ Paragraph 4.5

investigation reference to the CC is not dependent upon it and provides an opportunity for the CC to examine this further.

- 15 In investigating the super-complaint we saw clear evidence in the time series for quarterly transaction charges of parallel pricing by the big four banks. They did not appear to compete on price or to compete effectively for switchers, preferring to target new-to-banking customers, particularly students. There appeared to be a pattern of consistent first mover price leadership by Northern Bank which in the past had been the market leader. There was clear consumer inertia among bank customers.
- 16 In their response to the consultation the big four banks provided marginally more up-to-date information and largely repeated views expressed during the initial investigation.
- 17 Our assessment of points made concerning the definition of the market is set out in paragraphs 23 to 32 below. The specific features of the market which give grounds for our suspicion are set out below at paragraphs 34 to 74, together with an account of recent developments in the market and our consideration of the points made in response to the consultation.
- 18 Northern Bank introduced a new PCA on 1 February 2005, which eliminates charges which, in respect of the market as a whole, were one of the triggers for the original super-complaint. It only does so, however, for Northern Bank customers who choose to switch to the new account, or for new customers who opt to open the new account. The same benefits could have been achieved for all of Northern Bank's current account customers by amending the existing current account terms and conditions. This would have offered competitive advantage in terms of being first mover and in aiding retention of existing customers. Instead Northern Bank has chosen the more time-consuming and, in development terms, more expensive route of creating a new account, presumably in the belief that this will confer some business advantage. The recent history of account switching within banks when new accounts are introduced suggests that considerable numbers of customers are likely to remain in the old accounts.
- 19 In addition to introducing a new PCA, Northern Bank has since 1 February abolished charges for setting up and amending standing orders and direct debits for all of its customers. While this is a welcome development, it only partially addresses the issues raised by the super-complaint and is not significant enough to allay our concerns on weak competition. The information supplied by Northern Bank concerning its promotional plans for the new PCA leaves us unconvinced that this will lead to the rapid development of improved competition. The purchase of Northern Bank by Danske Bank on 1 March 2005 will undoubtedly

result in some internal review of business priorities and the introduction of new supporting infrastructure. Whether this results in a more competitive stance by Northern Bank remains to be seen.

20 There were no offers of specific undertakings in lieu of a reference by any of the banks.

21 The evidence presented and representations made during the consultation were not sufficient to allay the suspicions, expressed in our consultation paper, that competition between the major suppliers of PCA banking in Northern Ireland is restricted and that the following features of the market appear to cause or contribute to this restriction of competition:

- there is a high level of concentration in the market
- an extensive branch network appears to be a barrier to entry and expansion
- there is clear evidence of parallel pricing among the big four, and Northern Bank appears to act as price leader
- the big four do not actively compete on price
- the big four do not actively compete for switching customers, and
- there is a high level of consumer inertia and the level of customer switching is low.

MARKET DEFINITION

- 22 In making a market investigation reference to the CC the OFT must specify the goods or services for whose supply or acquisition competition is adversely affected. The Guidance states that this requires some consideration of the definition of the relevant market.⁶

Product market

- 23 The product market is defined for the purposes of this reference as the market for the supply of PCA banking services. A PCA is defined as an account marketed to individuals not businesses, which provides the facility to hold deposits, receive and make payments (cheques and debit cards) and use automated teller machine (ATM) facilities and to make regular payments (direct debit and standing orders).
- 24 A product market is typically defined as the smallest group of products for which a small but sustainable increase in price above the competitive level by a hypothetical monopolist would be profitable. Thus, if significant numbers of customers would switch to substitutes (known as demand-side substitution), the market definition should be widened to include the substitutes. There is, however, an important reservation, that, if the current price is already above competitive levels, a price rise might be more likely to induce substitution from other products than if it was not. If that were the case it would be wrong to argue that these products prevented the undertaking from exercising market power and on this basis to include them in the product market.
- 25 Similarly, substitution can also take place by suppliers (known as supply-side substitution). If firms which did not currently supply a product (but were active in an adjacent market) were able to supply that product at short notice this would prevent firms charging monopoly prices, so these supply-side substitutes should be included in the market. The timeframe for this is the short run (for example, within one year), whereas new entry into the market occurs over a longer timescale.
- 26 Demand- and supply-side substitution with respect to PCA banking in Northern Ireland are considered below.

⁶ Paragraphs 3.7, 4.8–4.12.

Demand-side substitution

- 27 Some of the big four banks have argued that instant access savings accounts, post office accounts and even credit unions are a substitute for PCAs and that they should be included in the product market definition. These products do not, however, offer the full range of services provided by PCAs, for example cheque books, debit cards and regular automated payment facilities, and are not therefore close substitutes for them. There is no evidence that PCA customers regard them as close substitutes. They should not therefore be included in the definition of the relevant product market.

Supply-side substitution

- 28 It is not feasible for alternative suppliers to switch into the PCA banking market in the short run since this would require the rapid creation of extensive and complex systems infrastructure and participation in several banking industry exchange payment schemes, which would take considerable time to complete. There is therefore no need to expand the product market definition beyond that adopted for this investigation.

Geographic market

- 29 As with the product market, the objective in defining the geographic market is to identify substitutes which are sufficiently close geographically that they would prevent a 'hypothetical monopolist' in one area from charging supra-competitive prices.
- 30 The geographic market is defined as the Province of Northern Ireland. Some banks have argued that growing internet usage invalidates this definition, and have cited the fact that the Cruickshank report⁷ considered the UK as a whole.
- 31 Our view is that while the Great British and Northern Irish markets show similar characteristics, and while internet access in Northern Ireland has increased over the past two years, uptake of direct internet banking is not sufficient to exercise a competitive restraint on the Northern Irish market. There is therefore no overlapping chain of substitution linking the market in Northern Ireland to that in Great Britain. This view is further supported by the importance to consumers of access to a local bank branch and of a personal banking service, as emphasised by both consumer organisations and the big four banks.

⁷ *Review of Banking Services in the UK (A Report to the Chancellor of the Exchequer)*, (20 March 2000)

32 Our view of geographic market definition has also previously been adopted by the CC, in its report on the Lloyds TSB/Abbey National merger.⁸ There is a clear geographical separation from Great Britain and a well-established history of different banks as the main suppliers. The Cruickshank report is not a relevant benchmark for this purpose as the report was commissioned specifically to consider banking across the UK.

⁸ *Lloyds TSB Group Plc and Abbey National Plc: A report on the proposed merger* (July 2001), paragraph 4.24

FEATURES OF THE MARKET WHICH PREVENT, RESTRICT OR DISTORT COMPETITION

- 33 The OFT has reasonable grounds for suspecting that there are particular features that prevent, restrict or distort competition in the market for the supply of PCA banking in Northern Ireland. These features relate to the structure of the market, the conduct of suppliers, and the conduct of customers and are discussed below. The concerns expressed relate to the big four banks.

Structure of the market

- 34 There is a high level of concentration in the Northern Irish PCA banking market, with four banks historically providing a strong core and a number of other institutions, including building societies and banks which were formerly building societies, making up a competitive fringe. Estimates of market share provided by the big four banks indicate that they provided between them around 74 per cent of current accounts by volume in 2004, a fall of 3 per cent compared with 2003. They claim that this shows that their market share has been eroded by recent entrants. Real switching data between the big four and their competitors has not been available, making it difficult to estimate the rate at which the big four's joint share has actually been eroded.
- 35 In any event this small reduction in estimated combined market share at a time of intense public debate on bank charges in Northern Ireland demonstrates the degree of inertia present in the market, and that erosion has been limited compared with the share of the big four. We also note that direct banking providers have yet to make substantial inroads into the market.
- 36 The flow of new-to-banking business compared with the total stock of existing accounts appears to be fairly small, and the competition that takes place for new-to-banking customers is aimed largely at the student market where accounts with special terms are offered. It therefore has a limited impact on an apparently inert existing standard PCA customer base. Furthermore, only a very small percentage of existing standard PCA customers have migrated to the newer more attractive PCAs, illustrating both inertia and a lack of competition.

Barriers to entry and expansion based upon the importance of an extensive branch network

- 37 The big four banks maintain that there are no barriers to entry to the Northern Irish PCA banking market. However, they all highlight the importance of a branch

network to their customers and the relatively high density of branches per capita in Northern Ireland. They also cite research data which supports their view that customers value the presence of a wide and evenly distributed branch network affording easy access in both urban and rural areas.

- 38 As noted at paragraph 15 of the consultation paper, the presence of the Link ATM network in Northern Ireland reduces the need to own a dedicated branch network to provide cash withdrawal services and may therefore lessen to some degree its importance as a barrier to entry.
- 39 We also note that direct providers have managed to enter the market, although their market penetration has been very limited.
- 40 In responding to our consultation the big four all restated their commitment to maintaining a wide branch network, and mentioned its impact on their own cost structure. We can only conclude that they are willing to bear these costs because they confer some competitive business advantage.
- 41 In assessing the importance of a branch network as a feature of the market which restricts competition, we observe that the competitive fringe who do not have such extensive networks have in the past five years or so managed to make only limited headway in growing their market share despite some aggressive campaigning targeted at switchers.
- 42 The presence of high entry costs does not necessarily imply high entry barriers. Depending on the context, the presence of sunk costs, however, can sometimes deter entry. The high rise in property prices, for example, means that costs to new entrants will in some cases be substantially different than those previously incurred by incumbents. Other costs such as refurbishment, technical investment are also examples of costs which are not fully recoverable on exit. We suspect that some of these costs play a role as barriers to entry and expansion.

Conduct of suppliers

Charging practices

- 43 The big four make a number of charges when customers are in credit and overdrawn which are not found in the rest of the UK, and there are no offsetting advantages such as higher interest payments on positive balances. A comparison of interest paid on positive balances between the Northern Irish big four and the major banks in Great Britain indicates that they are similar, i.e. low, compared with their rivals. Paying modest interest on credit balances provides the banks with a cheap source of funds (relative, for example, to the rate they would have to pay on their savings accounts) which can be used in their lending business.

This means that while customers incur charges in times of overdraft they do not seem to benefit greatly, if at all, when they are in credit.

- 44 While in Great Britain competitive pressure has led to these types of charges disappearing, three types of charges remain in Northern Ireland:
- various transaction charges levied each time a transaction occurs when an account falls into overdraft at any point during the charging quarter
 - certain ancillary charges which relate to setting up, amending, or cancelling a direct debit or standing order, and
 - account maintenance charges (monthly or quarterly, in some cases in addition to transaction charges and in others instead of them) levied on accounts in overdraft by arrangement.
- 45 Account maintenance charges are not widespread among the big four banks' rivals in Northern Ireland or among banks in Great Britain, and in the single case we have encountered where they are levied by a smaller competitor the charge is lower. These charges are in addition to overdraft arrangement or renewal fees.
- 46 The big four banks contend that the pricing model they have adopted in Northern Ireland is the result of competition and reflects their strategy of providing service through many branches in a small market of 1.1 to 1.2 million potential customers. It has been argued that any elimination or reduction in charges (i.e. in transaction, ancillary charges and account maintenance fees) will need to be balanced by an increase in other charges, specifically penalty charges for unauthorised overdrafts. They have stated that their cost structures and scale of operation require them to generate income from these additional charges and appear to regard their current cost structures and scale as being a given.
- 47 In our view, if the competitive process is working effectively, sellers would not expect to be able automatically to recoup income lost by price reduction through levying of other charges for the same service. The simple reassertion offered by the banks that the nature of the market is the result of vigorous competition is unsupported by any new evidence, beyond reference to the small change in market share noted in paragraph 34.
- 48 When investigating the super-complaint, we did not find a lack of price transparency in this market. PCA prices are made available to customers in Northern Ireland in accordance with the provisions of the Banking Code. However three of the big four banks negotiate APRs for overdrafts on some of their PCAs individually. Although it may be argued that customers can negotiate in the knowledge that standard interest rates for overdrafts are generally

published by the banks, overdrawn customers may feel themselves to be in a weak bargaining position relative to the banks when negotiating an annual rate.

Parallel pricing

- 49 Movement in current account prices appears to have been steadily upwards in the period 1999 to 2004. The banks have told us that their prices are not directly cost derived, so that this upward trend cannot simply be attributed to cost increases. They have also said that price is not their main focus of competition. Instead they claim to compete on the basis of service delivery and product quality, although in the time available it has not been possible to examine this in detail.
- 50 Many of the features that make tacit collusion a feasible strategy appear to be present in the Northern Irish PCA banking market. The big four banks do not appear to compete to attract customers from each others' customer bases. Furthermore the banks do not appear to see each other as close competitors but instead named the former building societies as their major competitive threat. This combination of factors might suggest that the big four banks are not actively competing with each other.
- 51 We requested price data from the big four banks for the period 1999 to 2004 in order to examine the movements and patterns of price changes over time with a view to establishing the degree of parallelism. This covered transaction and ancillary charges and account maintenance charges, as well as interest rates paid on positive balances.

Transaction charges

- 52 Examination of the various charges under this category shows little real differentiation by the big four banks in their pricing over the period for which information is available. While there were brief periods where the price difference between the banks widened, this was typically by a very small amount. For most of the period, however, the banks charged the same or almost identical prices for the same current account services when a customer is in overdraft.
- 53 On every PCA product there were five major price movements over the period and Northern Bank appeared to initiate the price changes. The rest of the big four appeared to move in step with Northern Bank's price movements, raising their prices in succeeding quarters, or at times within the same quarterly period as Northern Bank. The patterns of prices suggest that the banks track each

others' prices very closely. The banks mostly adjusted their prices to match Northern Bank's price increases but sometimes responded to the price increase to maintain a small price differential.

Ancillary charges

- 54 The banks exhibited wider price margins on fees for services such as setting up and amending standing orders and direct debits than was the case for transaction charges. For some services they seldom matched each others' prices. For some services Northern Bank appeared to lead on price changes over the period examined. Bank of Ireland typically matched Northern Bank's price increases after a lag of two quarters. Ulster Bank and First Trust Bank generally reacted to Northern Bank's price changes either during the same quarter or after a lag of two to three quarters. Typically they matched Northern Bank's increases, although at times they narrowed the margin between themselves and Northern Bank.

Account maintenance charges

- 55 The banks' account maintenance charges appeared to move in step with each other and to be adjusted to maintain price differential rather than to match price rises, and there was greater variation in these fees with no discernable price leader. The existence of these fees is indicative of a lack of price competition but there is no evidence of parallelism on these particular charges.

Interest rates on current accounts

- 56 Overall there is little to differentiate the banks on interest paid on positive balances. We examined those accounts that appeared to have the greatest number of current account customers in them. Looking at the interest paid on £1, £500 and £1000, the banks altered the rates very modestly over the period examined. While Ulster Bank appeared to compete on price by offering a relatively favourable rate of interest in its Dual Account, the other current accounts remained stable and within the range 0 per cent - 0.25 per cent.

Price leadership

- 57 Price leadership can facilitate tacit collusion by allowing oligopolists who wish to move to a tacitly collusive equilibrium to communicate or signal their intentions and coordinate their actions. Northern Bank appears to act as price leader: price

data over time suggests that it frequently appears to initiate price changes followed by the other members of the big four at varying lags.

- 58 Price signalling and tacit collusion are denied by all of the banks. None of the banks has been able to supply information to demonstrate that the pricing patterns observed in the data are explained by competition rather than some form of parallelism. Many of the features which would make tacit collusion a feasible strategy appear to be present in Northern Ireland. There is clear evidence of weak price competition between the big four as demonstrated in the pricing data supplied by the banks and discussed above.
- 59 Northern Bank has told us that it has been its practice for over ten years to publish price changes in newspapers across Northern Ireland, 30 days in advance of changes being made. This could constitute a facilitating practice, potentially signalling intentions to the other banks (who typically write to their customers to inform them of price changes) thus making it easier for tacit coordination to occur. Since Northern Bank appears to lead price changes, this raises a further suspicion of parallel conduct arising as a result of non-competitive behaviour between the big four.
- 60 In response to representations made during the consultation period we have examined the 'Banking Code Guidance for Subscribers' published by the British Bankers' Association. Under section 5.3 covering changes to day to day banking charges for the running of an account,⁹ the code suggests a variety of means by which banks can inform their customers of changes. No reference is made here to using newspaper advertisements. Northern Bank however also refer to section 4.4 on changes to interest rates¹⁰ which gives as illustrative text ...'the requirement to keep you informed of changes to the interest rates on your accounts will be fulfilled by either: telling customers personally within 30 days of the change; or within three working days of the change, put notices in our branches and in the newspapers we usually use.'
- 61 We have not implied that there is active collusion between the banks, merely that the patterns in the time series data on prices and the structural features of the market make tacit collusion a possibility and raise reasonable suspicions which would benefit from more detailed investigation.
- 62 Parallel price increases can occur in both competitive and collusive situations. The observation that prices are similar, and even that they tend to move together, does not therefore by itself demonstrate tacit collusion. One way of determining whether price patterns reflect competitive or non-competitive behaviour is to analyse profitability. As noted at paragraph 14 above, due to the

⁹ The Banking Code Guidance for Subscribers (March 2005), paragraph 5.3

¹⁰ Paragraph 4.4

limitations imposed by the lack of data and the complex issues involved, our profitability findings are inconclusive. This does not contradict our overall conclusion that competition appears limited, and our decision to make a market investigation reference provides the opportunity for the CC to examine profitability further.

Competition for switchers

- 63 Despite establishing internal systems to enable them to comply with the switching standards of the Banking Code, the big four told us during our initial investigation of the super-complaint that they do not count the number of switchers. This implies that they consider it to be unimportant, possibly because they believe it to be low. Low switching could partly explain why entrants have shown little expansion in their market share (it thus acts as a barrier to expansion) and why there appears to be weak price competition between the big four, while of course weak price competition offers little incentive to switch.
- 64 The evidence that we saw in our initial investigation suggested that the big four banks do not actively compete for switchers. Survey data quoted by the big four indicates very low levels of switching, of 2.3 per cent over the past year. Only one bank provided details of specific switching campaigns. These were, however, aimed mostly at promoting a particular range of recently launched current accounts which are not fee-free.
- 65 None of the big four banks can demonstrate that they price specifically to attract switchers from each others' customer base. One has told us that it does not 'offer financial incentives to customers to switch' and another stated that when marketing for new business it did not differentiate between customers who had no bank account and those who banked with a competitor. A third bank cited only promotional campaigns aimed at the '11-18 year old market and Student and Graduate markets' to 'encourage customers to switch to them'. We regard these types of customers as new-to-banking customers and not switchers from other banks.
- 66 In their responses to the consultation the big four all claimed either that they had been vigorously targeting switchers or were considering launching new campaigns to do so. However, to date their efforts to attract switchers appear principally to amount to training staff to retain their existing customers through customer relationship and service programmes and in-branch advertising. The banks appear to attach greater importance to winning new-to-banking business than to winning customers from other banks.

Conduct of consumers

Low level of switching

- 67 The main barrier to switching appears to be customer inertia. A large majority of PCA customers appear to have held their account at the same bank for more than five years.
- 68 The big four have all signed up to the Banking Code including the provisions on switching, introduced in March 2003, which are designed to improve the PCA switching process. The big four state that there is nothing to stop a customer switching from one bank to another. They point out that there are no costs incurred by customers in transferring their accounts between banks and argue that PCA switching is a completely cost-free process for customers.
- 69 The big four argue that the switching rate in Northern Ireland compares favourably with that in Great Britain, and use this in support of their view that there is a relatively healthy degree of switching in the Northern Irish market. However both figures are associated with significant margins of error and switching rates in both Great Britain and Northern Ireland are low. The big four told us that they do not track switching directly. Instead they provided evidence to show that, while they still collectively held a very large share of the existing market, they were losing a disproportionate share of new business to other providers. The banks claimed that this shows that there has been considerable switching; however, these flows of new business include new-to-banking customers and not just switching activity, and are not a measure of switching. The combination of low switching and consumer inertia, together with the other features of the market which are apparent in Northern Ireland, differentiate the situation from that in Great Britain.
- 70 During the consultation the big four banks argued that low levels of switching reflect highly successful and competitive customer retention activity and some quote high levels of customer satisfaction as recorded in their own customer surveys.
- 71 One of the competitive fringe banks said that it monitored switching levels in Northern Ireland and found them to be low. Although it was gaining customers in Northern Ireland, its branches there did less well than those in Great Britain in terms of customer growth. It supported the OFT view on customer inertia expressed in the consultation paper.
- 72 We do not accept that low switching necessarily reflects high levels of customer satisfaction. High customer satisfaction readings can be consistent with inertia,

since customers would not proactively evaluate or compare products of rival banks.

Low levels of internet uptake

- 73 Two of the big four banks argued that the OFT had underestimated internet usage in Northern Ireland. They quoted Mori figures recently available showing that 12 per cent of all current account holders in Northern Ireland have used internet banking, up 2 per cent from 2003. Mori data also indicates that 15 per cent of current account customers have used telephone banking. There is however no new information in this on the market share of direct banking providers.
- 74 We cannot gauge from the new figures how many of these consumers are regular internet users or even how many are banked with direct banking providers as opposed to the big four and the other branch based banks. As such, it is difficult to gauge the strength of any competitive constraint, although since the big four do not appear to have been prompted into aggressive competition in the recent past, we can conclude that internet/telephone banking is not yet constraining their behaviour.

Summary

- 75 Overall we conclude that the features we have identified above (high levels of concentration, significant entry barriers, price parallelism and consumer inertia) appear in combination to result in limited price competition and weak switching competition between the big four banks in Northern Ireland.

APPROPRIATENESS, PROPORTIONALITY AND REMEDIES

- 76 In the Guidance the OFT says that it will exercise its discretion to make references to the CC when the reference test set out in section 131 of the Act and, in our view, each of the following criteria, has been met:
- it would not be more appropriate to deal with the competition issues identified by applying the Competition Act 1998 (CA98) or using other powers available to the OFT
 - it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference
 - the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response to it, and
 - there is a reasonable chance that appropriate remedies will be available.¹¹

Appropriateness of a reference

- 77 The Guidance states that, when dealing with a suspected competition problem, the OFT will only consider a reference to the CC in one of two circumstances: first, when it has reasonable grounds for suspecting that there are market features which prevent, restrict or distort competition but not to establish a breach of the CA98 prohibitions, or secondly when action under CA98 has been or is likely to be ineffective for dealing with the adverse effect on competition identified.¹²
- 78 We have not found evidence of agreements that could be addressed by action under either the Chapter I prohibition in CA98 or Article 81 of the EC Treaty on the basis that they might prevent, restrict or distort competition in this market. The features which we suspect are preventing, restricting or distorting competition in the Northern Irish PCA banking market include aspects of the structure of the market and of the conduct of both customers and suppliers.
- 79 We consider that other powers available to the OFT would not adequately address the competition issues we have identified. Other possible OFT action includes a market study, which could be used to collect additional information that would be needed to test our suspicions as to the level of competition in this market. The OFT has concluded that a CC reference would be more appropriate

¹¹ Paragraph 2.1.

¹² Paragraph 2.3.

at this point because, if such a market study confirmed our concerns, our powers to effect the kind of remedies which would be likely to be necessary would be limited. The CC has substantive powers to seek undertakings and make Orders that are binding on any person operating in a market. Where the test for a market investigation reference under section 131 has been satisfied, and there is a reasonable chance that appropriate remedies will be available to the CC, we consider that a market investigation reference is more appropriate than conducting a market study.

- 80 The OFT has a power under section 154 of the Act to accept undertakings in lieu of a market investigation reference to the CC (UIL). No specific UIL have been offered by the banks in this case.

Proportionality

- 81 The Guidance identifies three factors as relevant to whether an adverse effect on competition is significant, and thus whether a reference to the CC is appropriate, and these three criteria are met by the market for the supply of PCAs in Northern Ireland:¹³

- firstly, the size of the market is significant, estimated at approximately £1.9bn per year in deposits
- secondly, a significant proportion of the market is affected by the features suspected of preventing, restricting or distorting competition
- thirdly, in the light of the history of this market and the high levels of consumer inertia which are evident the features identified as adversely affecting competition are unlikely to be short-lived.

- 82 The OFT has considered the possibility that the concerns which it has identified might be mitigated as a consequence of changes in the market, in particular partial price reductions and the new account introduced by Northern Bank on 1 February and the estimated 3 per cent erosion of the big four's combined share during 2004. There has been only a small change in the past year in a climate of considerable press and public focus on these issues, and the limited response of the big four banks does not convince us that sufficient change is likely to occur in the near future.

¹³ Paragraph 2.28.

Remedies

- 83 If the CC decides that there is an adverse effect on competition it must take action to 'remedy, mitigate or prevent' the adverse effect on competition and to 'remedy, mitigate or prevent any detrimental effects on customers' so far as those effects have resulted from the adverse effect.¹⁴ In order to achieve that, the CC may accept undertakings from appropriate persons or may make an Order under section 161 of the Act. Such an Order may contain anything permitted under Schedule 8 of the Act, as well as supplemental provisions. Schedule 8 provides the CC with wide-ranging powers falling within the following general areas: general restrictions on conduct, general obligations to be performed, acquisitions and divisions, and the supply and publication of information.
- 84 The OFT therefore believes there is a reasonable prospect that the wide range of remedial powers available to the CC, with or without any 'supplementary consequential or incidental provisions' will allow the CC to put in place appropriate remedies to the range of concerns raised, in the event that it finds there is an adverse effect on competition. The extensive powers available to the CC, we believe, provide the best means of remedying any adverse effect on competition, and any detrimental effects on customers, and of making the supply of PCAs in Northern Ireland more competitive.

¹⁴ Section 138 of the Act.

CONCLUSION

- 85 We remain of the view that the test for a reference to the CC has been met. We believe that a reference to the CC is the most appropriate step to ensure both that this market is investigated with the thoroughness we believe is needed to come to a definitive view and, in the event of an adverse finding, that appropriate remedies are put into effect.
- 86 Following the consultation carried out in accordance with section 169 of the Act, the OFT has therefore decided to make a market investigation reference to the CC under section 131 of the Act.