

RESPONSE OF SANTANDER UK PLC TO THE CMA UPDATED ISSUES STATEMENT

Santander UK plc
CMA Retail Banking Market Investigation

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11 June 2015

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1 Introduction

- 1.1 This response sets out San UK's views in relation to the Updated Issues Statement published by the Competition and Markets Authority (**CMA**) on 21 May 2015 (the **UIS**). As with our Response to the Issues Statement of 3 December 2014, we do not comment on all the matters discussed in the UIS, but focus on those areas where our experience as a scale challenger to the incumbent "Big Four" banks will be of value to the CMA. We intend to respond separately to the working papers which will be published by the CMA in due course.
- 1.2 In summary, we believe the main issue in the market is the lack of customer engagement. In our experience customers are generally passive rather than proactive and remain inert despite there being better offers which are more suited to their banking needs. We believe that relatively minor changes, such as the promotion of CASS and Midata, would result in a greater proportion of customers being proactive and this in turn would likely result in increased levels of switching (see Section 5).
- 1.3 Our key observations are as follows:
- (a) We broadly agree with the CMA's characterisation of the markets for the provision of PCAs and SME banking services. Additionally, for SME banking services in particular we would emphasise the need to take into account the wide customer diversity and the value that customers place on banking relationships (i.e. their preference for holding multiple products with one bank) which means that an important dimension of competition is for customer relationships rather than for individual products. Our position on the characteristics of the sector is set out in Section 2.
 - (b) We welcome the CMA's decision not to proceed with the market-wide profitability analysis. However, in relation to the CMA's proposed method of analysing profitability, we encourage the CMA to bear in mind the limitations that apply when comparing the financial information of different banks. Given the multitude of funding costs, organisational structures, cost allocation and funding transfer methodologies involved, it will be very difficult for the CMA to make "like for like" comparisons.
 - (c) Similarly we would invite the CMA to consider further its work in relation to pricing. In particular, we believe that in order to arrive at meaningful results, the CMA's analysis must factor in all of the relevant features of a particular product. This includes customer

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behaviour (such as their average balance) and benefits (such as cashback which is a key feature of the San UK 123 account and which we believe has erroneously not been recognised in the comparison tables in the UIS). Our observations on profitability and pricing are set out in Section 3.

- (d) We offer our views on innovation and its impact (or lack thereof) in the market in Section 4. In particular, as a scale challenger to the incumbent banks, we have been innovating and investing heavily to develop market leading propositions. While our market share has increased in both PCAs and SME banking, we consider that in a more dynamic and competitive market, these investments would have resulted in more significant market share movements.
 - (e) Our view is that despite reported high satisfaction levels, customer engagement and inertia is still a significant issue in both the provision of PCAs and of SME banking services, and this is reflected in low switching numbers. In responding to Theory of Harm 1 (**ToH1**) we have separately considered the difference between satisfaction and engagement (in Section 5) before making some observations about the effectiveness of existing tools in prompting customers to consider switching their banking arrangements and considering how they might be improved to increase customer engagement through the “access, assess, act” framework (in Section 6). We also note that the ability of customers to accurately assess products may be difficult in relation to some complex PCA products.
 - (f) As regards Theory of Harm 2 (**ToH2**), we agree that the ability to rely on a large and relatively passive back book of customers provides the larger banks with little incentive to lower their prices and try to win new customers. We believe that concentration in itself is not the cause but a symptom of the market not functioning well (see Section 7).
 - (g) Finally, in responding to Theory of Harm 3 (**ToH3**), there are several barriers to entry and growth that, in our experience, prevent the development of a more competitive market for retail banking services and which may warrant closer inspection by the CMA. We welcome the CMA’s work in this area and acknowledge that it is in its preliminary stages. We set out our position at this stage in Section 8 and we look forward to providing further comments in response to the relevant working papers.
- 1.4 We provide greater detail in relation to each of these key points below in the body of our response which, for ease of reference, follows the structure of the UIS.

2 Sector characteristics

- 2.1 While we broadly agree with the CMA’s characterisation of the market for the provision of PCAs, we consider that there are a number of key considerations that the CMA should bear in mind when conducting its analysis of the provision of SME banking services. In particular, there are material differences between smaller and larger SMEs and it is important for a challenger bank to be able to offer a wide range of SME products and services so as to enhance the scope for generating new, and retaining existing, customer relationships.

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PCA

- 2.2 We agree that the relevant product market is the provision of “personal current accounts”, and that to the extent that other products can substitute for particular elements of a PCA, they are relevant to the assessment of competition in the market rather than to the market definition itself.
- 2.3 We note that the indicative result of the CMA's aggregate PCA data request suggests that we have an [X] market share of PCAs. This is [X] than our understanding based on other sources. For example, according to [X], our market share in the provision of PCAs in December 2014 [X].¹ This lower figure was calculated using the overall number of active accounts, and does not distinguish “main” accounts.
- 2.4 We encourage the CMA to conduct a robust and thorough analysis of market shares on the basis of all active PCAs. To the extent that the CMA focuses on main accounts, we invite it to consider the definition of a main bank account. The CMA's current definition of a main bank account is one that has a monthly credit turnover of £500 or more. Our definition of a main bank account is one with a monthly credit turnover of at least £500 and at least two direct debits.² We believe this definition better reflects customers' actual usage of a main account.

SME banking

- 2.5 In the provision of SME banking services, we agree with the CMA's observation that the BCA and general purpose business loan (GPBL) markets are very concentrated and market shares have remained broadly static over time.³ These markets are still very much dominated by the Big Four banks. We do not believe the growth of our market share in the provision of SME banking services adequately reflects our significant investments in this space and the introduction of simple, competitive and value for money products. Our views on this issue are set out further in section 4 below.
- 2.6 The CMA refers to the diversity across SME customers and appears to recognise that smaller SMEs have different needs from larger SMEs.⁴ In particular, the CMA recognises that market shares for BCAs and GPBLs vary when looked at by size of SME⁵ and that there is a “greater heterogeneity” in BCAs than in PCAs.⁶ This is consistent with our Response to the Issues Statement:

“In our experience SMEs are a diverse group with a wide spectrum of sizes, product needs, growth trajectories and financial sophistication. In particular the complexity of banking needs evolve as SME businesses grow and there are material differences between smaller and larger SMEs. We would strongly encourage the CMA to differentiate between larger and smaller SMEs when reviewing competitive conditions. In our experience smaller SMEs have characteristics

¹

[X]

²

A further indication that an account is a main bank account is where there are debit card transactions.

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UIS para 21 (c) and (d)

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UIS para 21 (e) and (i) and 29 (c)

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UIS, para 21(d) and 21(i)

⁶

UIS Appendix C, Annex 4, paragraph 27

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which are in many respects similar to PCA customers while larger SMEs have different qualities.”⁷

- 2.7 In particular, a large proportion of our market share in BCAs is represented by an inherited legacy portfolio of smaller SME customers (typically with a turnover of less than £250,000) who have simple needs much like PCA customers and many of whom receive free banking for life. In contrast, larger SMEs serviced by our Commercial Banking segment tend to have more complex needs. For San UK and other challenger banks, acquiring banking relationships with this type of SME is difficult. As set out in our Response to the Issues Statement, switching for this larger SME segment is loan-led.⁸ Usually only after a trigger event (for example, being refused finance by their existing provider) will a larger SME customer test the service offered by a new or challenger bank through borrowing. The challenger bank then has an opportunity to try to win the whole relationship as the SME is triggered to consider a full switch or a transactional funding solution.
- 2.8 We believe that the diversity in the range of SME customers, and the different competitive dynamics which are relevant within this range, should be given greater scrutiny and consideration in the CMA’s analysis. For example, we would welcome the CMA’s consideration of market shares broken down by the size of the SME for both BCAs and GPBLs.
- 2.9 The CMA also notes that SME customers value their banking relationships.⁹ This view is supported by the FCA which has indicated that: *“For SMEs, there is a need and desire to build a relationship with the new bank and therefore it is a concern that choosing a new bank will be a lengthy process.”¹⁰*
- 2.10 We agree and would encourage the CMA to consider analysing competition for SME banking relationships as well as in respect of discrete products (BCAs and GPBLs). We believe it is a common aim for most banks to be the primary relationship bank for SME customers particularly as *“many businesses place a premium on all their accounts and finances being in one place.”¹¹* In our experience, many customers view the SME banking services they receive as a single service meeting their banking needs. Therefore, a collection of individual products from various standalone providers is, for many customers, not a close substitute for a complete service from one bank and the bank which owns the primary relationship is in a prime position to sell further products. As such, we do not believe that market participants offering one product (such as peer-to-peer lenders) can fully compete with banks offering a full range of services.
- 2.11 When examining the role of alternative finance, the CMA should be aware that peer-to-peer lending predominantly captures certain needs of customers which would otherwise not be well served by the banks. Alternative providers do not provide long term day-to-day support, instead providing a specific service that is supplementary to the core banking relationship. In our experience, alternative finance generally appeals to the smaller and niche end of the SME

⁷ San UK Response to the Issues Statement, para 6.1 – 6.2

⁸ San UK Response to the Issues Statement, para 4.11

⁹ UIS, paragraph 84(e). In this regard, we consider that the very high proportion of applications for new products, for example loans, that come from existing BCA customers is more significant than the actual proportion of BCA holders who hold any given additional product.

¹⁰ Current Account Switching CASS Review, March 2015, 5.26

¹¹ UIS para 85(f)

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market. It is not widely seen as a substitute source of finance by larger SMEs and awareness is low.¹² Therefore, to the extent that alternative finance providers compete with banks, we believe this is likely to be in relation to the challengers rather than the incumbents. Even then such competition is limited. We operate a customer signposting arrangement with Funding Circle, demonstrating that the two do not always compete. In our view, including alternative finance providers in the market definition for the provision of SME banking services risks overstating the level of competition in the market.

- 2.12 For both PCA and SME, we consider that the correct geographical market is UK-wide. We recognise that there may be regional variations. For example, RBS and Bank of Scotland are particularly strong in Scotland. However, we do not consider that competitive conditions are markedly different between regions, as the major banks operate across the UK, and particular regional strength is a remnant of historic market positions. Further, as the CMA recognises, to the extent there are narrower geographical markets, there may be local elements to consider. Nonetheless, it is our view that the key competition issues in the banking sector – customer inertia, lack of easy comparability and barriers to entry and expansion - are not local issues. As such, we would encourage the CMA to continue to use a UK-wide market definition.

3 Profitability and pricing

Profitability

- 3.1 We welcome the CMA's decision not to conduct a market-wide profitability assessment, as any results would not be meaningful due to a number of factors specific to the assessment of profitability in the provision of PCAs and SME banking services. In particular, we believe that the problems with estimating a benchmark return on equity for stand-alone PCA and SME banking products which do not exist as independent businesses, and identifying the appropriate allocation of common and shared costs and equity capital, and adopting a consistent transfer pricing methodology across all of the relevant banks, would have been too difficult to overcome.
- 3.2 We believe that the CMA's revised proposals on assessing financial performance will not provide a robust like-for-like comparison across the banks and any results, therefore, should be interpreted carefully. We note that the CMA will use the financial information already provided by the banks, together with publicly available information and information to be gathered in a further data request, to assess the financial performance of the banks in relation to the provision of PCAs and SME banking services, as well as at a more aggregate level, for example retail banking. The same issues that render a meaningful market-wide profitability assessment unfeasible will also apply here. These problems, which apply not only to the provision of PCAs and SME banking services but also to retail banking at the aggregate level, include the following:
- (a) meaningful comparison across banks will not be possible due to the likelihood that (very) different approaches are taken by banks with respect to (among other things) the

¹² UIS para 44

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- allocation of costs to products/segments, the fund transfer pricing policy, credit provisioning methodologies, allocation of central items such as FCS and the Bank Levy;
- (b) the results of certain banks may be more affected by one-off costs than others, for example PPI liabilities are likely to skew the results;
 - (c) banks have different operational structures and segmentation models. Activities which fall under the remit of SME or retail banking in one bank may not in another;
 - (d) banks at different stages of development will not be readily comparable: recent entrants and challengers, having made significant and costly investments in recent years will appear very differently from the more established incumbents;
 - (e) cost of funding and sources of funding will vary across the different banks;
 - (f) the importance of any particular product within retail banking will differ across banks as will banks' different strategies concerning the use of "gateway" products;¹³
 - (g) the choice of the appropriate benchmark will remain an issue; and
 - (h) the relative proportions of assets to liabilities will vary greatly between banks, as BCAs and PCAs have both assets (in the form overdrafts) and liabilities (in the form of deposits) this will distort any comparisons of return on equity and return on risk weighted assets.¹⁴

Pricing

- 3.3 We acknowledge the CMA's intention to carry out a pricing analysis and believe that this should take full account of all relevant features that affect customer expenditure (as is required for a meaningful price comparison or a price-concentration analysis). For example, the analysis must take account of customers' actual behaviour (i.e. the average balance held in a given account) and the features of any given account. The "price" of an account is not a straightforward variable to calculate; it must be indicative of what customers actually pay.
- 3.4 We are particularly concerned about a price comparison that does not fully and properly account for the amount that customers place into an account (which affects the interest they receive) as well as the value of cashback they receive. For example, as we have explained, the average balance for a 123 account is higher than for other current accounts (the average balance is around [£]). At this level, the customer benefits substantially in relation to interest received which exceeds interest rates available on competing accounts. On average, a 123

¹³ By 'gateway products' we are referring to a situation where Bank A tries to capture customers by discounting loans but Bank B offers great deals on a BCA (in both cases with the view to cross selling afterwards). This is likely to distort a product-by-product price comparison.

¹⁴ For example, funds transfer pricing methodologies reward liabilities leading to increased returns when the liability grows and, therefore, a business that has a small asset and large liability will show higher returns which is misleading.

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customer receives [£<] per month in cashback.¹⁵ Given the scale of the monthly price/benefits of PCAs, ignoring the [£<] cashback per month is a significant distortion of actual pricing.¹⁶

- 3.5 Therefore, we believe that the CMA must include all features of accounts in any pricing analysis, to ensure that the customer profiles it uses to analyse price are representative of current account usage as a whole, and are consistent with usage of each individual current account. This assessment will necessarily involve looking at actual long term usage to gain an understanding of account turnover and spending patterns. Finally, a pricing analysis must be cognisant of any differences in quality between the products.

4 Innovation

- 4.1 As a scale challenger in the provision of PCAs and SME banking services, we are constantly looking to innovate, disrupt the status quo and further grow our market share. However, while our market share in both PCAs and SME banking services has increased over the last three years, our recent innovations – supported by substantial investments, have not delivered the increase in market share we would have expected in a well-functioning market.
- 4.2 In PCAs, we launched the market leading and innovative 123 current account in 2012 (the benefits of this are set out in detail in our Response to the Issues Statement).¹⁷ In three years, none of our competitors have yet introduced a product that matches the levels or the combination of in-credit interest and cashback which are the key features of the 123 current account. As we set out in our Response to the Issues Statement,¹⁸ it is due to the success of this account in attracting switchers that our market share in the provision of PCAs has grown. However, in a well-functioning market, where customers are engaged, we would have expected our market share growth to be significantly greater.
- 4.3 In recent years we have invested heavily to develop a full service proposition and relationship banking capability in the provision of SME banking services. We developed a range of market-leading products. We received recognition in the form of the following awards: 'Best Business Current Account Provider', 'Business Bank of the Year', 'Best International Solutions Provider' and 'Innovation in the SME Finance Sector' at the annual Business Moneyfacts Awards.¹⁹
- 4.4 We have put in place new platforms and are now able to deliver a broader product suite with a wider range of ancillary services. These new platforms have been developed specifically for corporate customers, building on the expertise and presence of the wider Banco Santander group. Through our 'Connect' platform, Trade Portal and Trade Club and the Santander

¹⁵ [£<] divided by [£<] divided by 12 to give a monthly figure.

¹⁶ Including the average amount received by a 123 customer in cashback per month changes the position of San UK in the six PCA pricing scenarios as follows: Profile 1 - from 3rd to [£<] place; Profile 2 - from 5th to [£<] place; Profile 3 - from 23rd to [£<] place; Profile 4 - from 9th most expensive to [£<]; Profile 5 - from 2nd most expensive to [£<]; Profile 6 - from 16th to [£<]. This does not include cashback offers of competitors.

¹⁷ San UK Response to the Issues Statement para 2.9(b)

¹⁸ San UK Response to the Issues Statement para 3.1(a)

¹⁹ Moneyfacts awards, March 2015

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Passport service, and with the extensive network provided by Banco Santander, we are able to offer a broad range of international financial services to our SME customers.²⁰

- 4.5 We have created a number of innovative initiatives including our pioneering Breakthrough programme.²¹ Breakthrough supports SME growth across the UK expanding the range of services offered to these businesses and enhancing our workshop and master class programmes, to grow company skills and reach new markets. The programme is based upon providing SMEs with the knowledge, connections and finance to grow and succeed. The programme has also held [x] Executive Round Table events for more than [x] companies; provided [x] master classes involving over [x] fast-growth SMEs with companies including Google, Saatchi Masius and McLaren; and taken [x] SMEs on trade missions to major international markets such as Brazil, Mexico, the UAE and the USA.
- 4.6 We have established a network of highly skilled business relationship managers, which continues to grow. We are aiming for a total of [x] relationship managers (we currently have [x] Relationship Directors and [x] Local Business Managers), and [x] Corporate Business Centres (currently [x]), by the end of 2015.
- 4.7 We are innovating and investing to be able to offer new digital channels in order to make it easier for customers to use our services. This results from a major shift in attitudes to online and mobile banking. Accelerated growth here has been driven by both the customer demand to do more via mobile and the rapid increase in technological capability/capacity of smartphones and tablets.²² The BBA article “Digital Disruption” in March 2015 highlighted that San UK’s technological innovations in the provision of SME banking services, for example, tie ups with disruptors like iZettle and Funding Circle, “provide useful examples of how banks can seize the digital opportunity.” It further notes that this not only leads to increased revenue but also happier customers.
- 4.8 It is important to recognise that when it comes to innovation in products, services and other initiatives PCA customers usually have relatively simple needs. Smaller SME customers’ needs are similar to PCA customers.²³ More complex SMEs inevitably have more complicated needs. We have seen this through our Connect platform development, where we have had to build functionality to meet the needs of businesses such as multiple user access, multiple payment types and statements.
- 4.9 While we plan to make further investments in developing new products and improving existing ones, a more dynamic environment with higher switching levels (as would be expected in a well-functioning market) would provide challengers with greater incentives to make new investments.

²⁰ Santander Connect and Trade Portal were introduced in H1 2014.

²¹ Described in detail in our response to question 23 of the SME Market Questionnaire SME Response 60.4.

²³ This helps explain why more than half of all SMEs hold their BCA at the same bank as their PCA. UIS, Appendix E, Figure 3. We consider that this cross-holding is more common among smaller SMEs.

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5 ToH1: Satisfaction as distinct from engagement

- 5.1 The UIS recognises the distinction between customer satisfaction and customer engagement.²⁴ In our view, the position is similar across both the provision of PCAs and SME banking services: customers are generally passive rather than proactive, and inert despite better offers being available.²⁵ There is no necessary correlation between satisfaction and engagement, and engagement is a pre-requisite to switching.
- 5.2 It is important that the CMA does not simply consider engagement “*at each stage of the ‘access, assess, act’ framework*”,²⁶ as engagement also matters before those stages are reached. There may be accessible and assessable information, but as we describe below, some customers are simply not motivated to look to it.²⁷
- 5.3 The CMA may wish to consider whether this engagement, prior to “access, assess, act”, is in fact a stage in itself worthy of investigation. We consider that measures taken to prompt customers to consider their banking arrangements may help raise the level of engagement. In PCAs, this may be a prompt in annual statements to consider using Midata; for SMEs, it may be prompts from third parties such as accountants.

PCAs

- 5.4 With regard to PCAs, it is significant that the results of the CMA’s research show 91% of PCA customers to be fairly or very satisfied, with little variation between banks on overall customer satisfaction.²⁸ However, the results of the CMA survey show that being satisfied is not the same as being engaged:
- (a) Although only 4% of customers described themselves as “dissatisfied”, it is striking that even fewer - only 3% - switched banks last year, which suggests that even for some dissatisfied customers, they are not sufficiently engaged to move banks;
 - (b) It is notable that 19% of PCA holders considered switching in the last 12 months, which is significantly greater than the number of respondents who described themselves as dissatisfied (4%). We consider that this population of 19% represents potentially “engaged” customers. Such customers would be likely to consider switching to a different account if they were reasonably able to discern that new account better met their needs or resulted in benefits or lower costs, even if they were generally satisfied with their

²⁴ UIS para 58.

²⁵ San UK Response to the Issues Statement para 5.2

²⁶ UIS, paragraph 53.

²⁷ [§<]

²⁸ While the CMA indicates that survey-stated satisfaction rates also need to be considered in light of the 2014 GfK FRS net promoter score (NPS) for PCAs of 6% (UIS, paragraph 59), San UK notes that this is not a like-for-like comparison. The apparently lower percentage is a construct of the way that NPS are measured. As the CMA states: “Respondents were asked the question ‘how likely is it that you would recommend [bank] to a relative, friend or colleague in the next 12 months for current account banking’ and choose a score between 10 (extremely likely) and 0 (not at all likely). The NPS is the difference between the percentage of respondents who are ‘promoters’ (ie choosing a score of 9 or 10 and the percentage who are ‘detractors’ (ie scoring 0 to 6)” (UIS, note 37). It is hardly surprising that the NPS measure is lower than the satisfaction measure in the CMA survey given that the former treats only ratings of 10 and 9 as positive, while treating scores of 0 to 6 to be negative. San UK does not therefore consider that lower NPS percentage indicates a material level of dissatisfaction.

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current bank. The fact that relatively few customers in fact switch banks suggests the “access, assess, act” framework could be improved (as we describe in section 6 below); and

- (c) We recognise that for some PCA customers it may be of limited relevance to access, assess and potentially act on information about different PCA products. For those with low credit balances, for example, there is a limit to the gain they could achieve by switching. Other customers will have broader financial portfolios, and more consideration may be given to investments (for example) than to their current account.²⁹ It is not realistic that all customers would actively consider their PCA each year. However, the fact that fewer than one in five of the banking population might be described as “engaged” suggests that there is much that could be done to agitate customers to increase these levels.

5.5 In terms of assessing the best way to increase levels of engagement, the CMA will be aware from its appreciation of behavioural economics that simply giving customers access to further information is not a panacea. Bombarding customers with excessive amounts of information is likely to create confusion and possibly result in even less engagement.³⁰ It is necessary that information is kept simple, and is limited to what is necessary for the customer to understand and compare products. In order to disrupt the “evergreen” nature of PCAs,³¹ it may be appropriate to require all banks to provide details about Midata in the annual statement, so as to prompt customers to engage and thereby increase the prospects of them using Midata to access, assess and act on that information.

SME banking

5.6 In our Response to the Issues Statement, we described the difficulties of encouraging SME customer engagement and switching: “*where existing banking relationships are simple and straightforward and operating reasonably efficiently, banking is not a high priority.*”³²

5.7 [redacted]

(a) [redacted]³³

(b) [redacted]³⁴

(c) [redacted]³⁵

(d) [redacted]³⁶

²⁹ This is borne out by the CMA’s own research which shows a greater proportion of switchers in savings accounts and cash ISAs (13% in three years) than in current accounts (8%).

³⁰ For example, we note Lord Currie’s observations in *Homo economicus and Homo sapiens: The CMA experience of behavioural economics*, his speech of 21 April 2015, that consumers tend not to read full terms and conditions of sale.

³¹ The CMA expressly mentioned the evergreen aspect of PCAs in the Issues Statement, when considering the “act” element of “access, assess, act” (paragraph 40). We consider that the lack of prompts to customers to consider their banking requirements does have an impact on engagement.

³² San UK Response to the Issues Statement paras 5.6 - 5.7

³³ [redacted]

³⁴ [redacted]

³⁵ [redacted]

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(e) [redacted]³⁷

(f) [redacted]³⁸

- 5.8 SME customers in our experience are only likely to think about switching when they experience a serious trigger event, for example being declined finance from their existing provider. As with PCA customers, this may not be unreasonable particularly for small business owners focusing on the more pressing issues of running their business. However, the fact that so few SME businesses even take the first step of accessing the information that is potentially available to them suggests that a fundamental problem is the failure to engage.
- 5.9 In our view, the CMA should consider the following measures to address this failure to engage:
- (a) More emphasis on the role of intermediaries and their potential to introduce customers to new banks and lenders. We agree with the CMA that intermediaries have a role in recommending banks³⁹ and we believe that intermediaries such as accountants could play a much greater role in stimulating SME engagement (and therefore prompt SMEs to access, assess, and act to switch). In particular, we believe that intermediaries could and should prompt SMEs to review the level of banking charges they are currently facing and consider alternative options, and that there are points in the business life-cycle where this would be appropriate (e.g. annual reporting, seeking finance or investment, expansion). This does not require the intermediary to give advice, or even to have an in-depth knowledge of the offers available in the market. To give an idea of the considerable reach of intermediaries and the potential for them to agitate the market, there are approximately 400,000 accountants in the UK, compared to around 10,000 banking relationship managers.
- (b) At the point where companies are being set up, HMRC and/or Companies House could be required to prompt SMEs to consider their banking arrangements. Again, there would be no obligation on HMRC or Companies House to provide any advice as to the most suitable banking arrangements for the SME, but rather it might act as a prompt for SMEs to look at the available options.
- 5.10 In our view, for both the provision of PCAs and SME banking services, the “access, assess, act” framework is relevant to engagement insofar as the easier it is for customers to access and assess information and act on it, the more likely it is that engagement will increase over time. We consider measures that could be taken in relation to the “access, assess, act” framework, including promoting the tools already available, and prompting customers to use them, in section 6 below.

³⁶

[redacted]

³⁷

[redacted]

³⁸

[redacted]

³⁹

UIS para 84(e)

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6 ToH1: Switching levels

- 6.1 In addition to the discrete measures to increase levels of engagement described in section 5 above, it is of course important for customers to then be able to access and assess information and to act on it to switch where a better deal is available to them.

PCA

- 6.2 Giving customers access to relevant, accurate and easily comparable information is imperative in enabling both engagement and switching. The notion of giving customers the correct information to assess and act has been a key aspect of previous competition reviews in the banking sector, even as far back as the Cruickshank Report: *“Knowledgeable consumers provide the best incentive to effective competition. With the right information, consumers can take responsibility for their own financial well-being”*.⁴⁰
- 6.3 In the PCA market, in contrast to 2000 when the Cruickshank Report was published, there is a wealth of accessible information about pricing and service, available from providers themselves, price comparison websites and third party analysts. The internet provides a great resource for those considering switching. In this regard, it is not surprising that those without internet access are less likely to consider switching than those who are confident using the internet.⁴¹ The one area in which we believe more information could be made available is information relating to service levels, although a number of price comparison websites already cover service in their reviews of accounts.
- 6.4 While we agree with the CMA that some of the information that is available is complex, the issue then is not around accessing that information, but rather in assessing it. We consider that, subject to some improvements around its ease of usability, Midata could address the issues around assessing PCAs, and that there is no better possible tool for assessing PCAs than one that calculates the cost or benefit to a customer based on their own account usage. We note that the CMA considers that *“it is too early to judge the extent of [Midata’s] impact”* in assessing accounts.⁴² Nevertheless, we consider that Midata should be given every chance to succeed, both by making the tool function as well as is possible, and by promoting the service. In terms of enhancing functionality, this may mean refining and simplifying the process for customers to download, upload and compare accounts; and ensuring that price comparison websites highlight the Midata feature and display results in a useful and realistic way (we note that Gocompare.com has a default view that assumes PCAs are held for one year which may produce distortive results when introductory switcher bonuses are included).
- 6.5 However, we note that some PCA products are sufficiently complex that, even armed with Midata, a consumer would find it difficult to accurately assess the value they were receiving in

⁴⁰ Competition in UK Banking 2000 (The Cruickshank Report), para 50. We note that while ensuring consumers are informed has been the focus of previous interventions in the market, engagement, “widely documented” now, has not been. We note the wording in the Cruickshank report expects customers to take some “responsibility” for their position, which accords with our view that customers cannot be forced to be engaged.

⁴¹ A report for the Competition and Markets Authority by GfK NOP, paragraph 181. 91% of those who are not confident using the internet did not look around in the last year to compare PCAs.

⁴² UIS, para 64.

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comparison with other accounts. Added Value Accounts (**AVAs**) (i.e. accounts that include ancillary products like insurance) are particularly difficult for customers to compare, as they require the customer to separate the value of the banking proposition from the value of the ancillary products. We believe AVAs significantly impair the ability of customers to compare PCAs effectively, even with sophisticated comparison tools like Midata.⁴³

- 6.6 Indeed, AVAs may be a greater impediment to assessment than the free-if-in-credit (FIIC) banking model that the CMA considers in paragraph 67 of the UIS. We consider that FIIC banking is not particularly hard for customers to assess; in particular, for a customer using Midata or price comparison websites. Moreover, recent research by PwC shows that the majority of customers are aware that FIIC products tend to have higher charges and/or lower interest rates.⁴⁴ This shows that customers are aware that FIIC does not equate to “free”, and that fee-paying accounts may be better value in some circumstances. Instead, while we appreciate that FIIC banking meets the needs of some customers, we consider that it potentially reduces customers’ engagement to the extent that they may perceive that because there is no direct fee (and so the service feels free) they should not have high expectations. As a consequence, more customers are likely to view themselves as receiving a satisfactory service. In such circumstances, it takes a prompt (for example a bad customer service experience) to encourage a customer to look at other options.
- 6.7 We consider that awareness and confidence in the Midata service should be monitored, much as the FCA has done with CASS. The FCA has found that awareness of CASS is only 41%.⁴⁵ It is therefore unsurprising that CASS has not had the “transformative effect” envisioned by the Vickers report.⁴⁶ We note the FCA’s findings that that the closure of the customers’ old account and the limited duration of the redirection services currently offered may deter switchers. We would encourage the CMA to bear in mind the FCA’s suggestions in this area, such as giving the option of partial switching (keeping the old account open) and lengthening the period in which redirection services are offered. However, overall we agree with the FCA that CASS works well but that more could be done to promote it.⁴⁷
- 6.8 Likewise, for Midata to have a chance of working effectively, and so to justify the investment made in it, it has to be promoted to consumers, for example through advertising campaigns. A further option would be to require banks to include a prompt in annual statements for customers to consider using the Midata tool (as described in paragraph 5.1 above, as a way of increasing

⁴³ Santander ceased supplying AVA accounts in 2013 as we considered them to be too complex and that customers may end up paying for additional benefits that they do not need. We also believe that the lack of transparency around pricing of AVA add-ons and benefits leads to a false sense of value for the customer – leading them to believe they are getting a better deal than is actually the case.

⁴⁴ PwC “There’s no such thing as a free lunch: Why fees are the future for current accounts, January 2015.” Of a base of 2015 adults, 66% responded yes to the following question: *The most commonly held types of current accounts in the UK are ‘free’ in that you do not pay a monthly fee. Were you aware these types of accounts sometimes have additional charges such as higher penalty charges or lower interest rates than fee paying accounts?*

⁴⁵ FCA “Making current account switching easier: The effectiveness of the Current Account Switch Service (CASS) and evidence on account number portability” March 2015, 1.11.

⁴⁶ Independent Commission on Banking – final report/recommendations, September 2011 at 6.21. Any tool may not be seen to have a transformative effect to the extent that deep-seated customer inertia remains.

⁴⁷ FCA “Making current account switching easier: The effectiveness of the Current Account Switch Service (CASS) and evidence on account number portability” March 2015, 1.6

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levels of engagement). We would welcome steps to increase awareness of CASS and Midata and consider that the two services should be promoted together, wherever possible.⁴⁸

SME banking

- 6.9 Switching levels for SMEs are low at around only 4% per annum.⁴⁹ We believe that to improve this situation changes are necessary to make the act of switching easier and change current perceptions about the costs risks and involved.
- 6.10 As set out above in section 5, banking is not a high day-to-day priority for busy business owners. When and if SMEs come to consider switching, there is no easy method of comparing SME banking services across providers, and the perceived costs of switching are high (particularly the risk of errors in the switching process, and the time involved in switching). Making it easier for customers to access and assess information and act can increase engagement as well as helping those customers who are engaged, and considering switching, to in fact switch. Our suggestions for facilitating comparison and switching in the provision of SME banking services include:
- (a) Extending and promoting CASS: there is scope for important improvements to the application of CASS in the SME market, for example, as regards extending the closure of the existing bank account to one month to provide greater reassurance to SME customers.⁵⁰ More could be done to promote and increase confidence in using CASS - whilst the FCA has indicated that 91% of small and medium sized enterprises (SMEs) that used CASS were satisfied with their experience,⁵¹ the results of the Payments Council survey⁵² in relation to confidence in an error free process were consistent with our own survey results which showed only 42% of SME customers were fairly or very confident that a switch would be error free. We would welcome a coordinated and impactful campaign to reduce the pejorative perception of CASS and help to reassure and encourage potential switchers.
 - (b) Credit profile passporting: We would welcome any coordinated and impactful initiative that enabled customers to share their credit profile data quickly, securely and easily with third parties including banks.⁵³ While we welcome the draft Small and Medium Sized Businesses (Credit Information) Regulations, we do not think that the regulations as they stand will significantly improve current processes, in part because the data sharing will be based on existing processes, involving credit reference agencies and limited to those customers turned down by their existing bank. We believe that all SMEs should be given greater control and ownership of their data to prepare and enable them to shop around

⁴⁸ We note that the FCA CASS review “Making current account switching easier: The effectiveness of the Current Account Switch Service (CASS) and evidence on account number portability” makes clear that raising awareness of CASS should be a priority (see 9.12). This recommendation received support in the HM Treasury paper “Banking for the 21st Century: driving competition and choice” (see 7.4).

⁴⁹ UIS para 78

⁵⁰ We believe this would give SME customers more reassurance.

⁵¹ FCA, “Making current account switching easier”, March 2015, 4.15

⁵² Payments Council, “The Current Account Switching Service: One Year On”

⁵³ By “credit profile” we mean not only credit history but all the information needed to support their applications for finance.

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easily and cost effectively, thus facilitating better decision making as well as speeding up the switching process.⁵⁴

- (c) AML passporting: AML/KYC procedures often require the time and effort of the customer to complete thus, creating an administrative burden and making the prospect of switching less attractive. This is notwithstanding that Electronic ID (EID) checks are possible. We support the CMA's intention to investigate ways of making the AML process less cumbersome for customers, including the transferability of AML checks between providers. This would be complementary to credit profile passporting.
- (d) Removing or capping exit fees.⁵⁵
- (e) Expediting transfer of securities.⁵⁶
- (f) Increasing awareness of and access to the results of the Business Banking Insight survey: the most recent data was published in November 2014 and the next data will be published by the end of June 2015. The results of this survey are in the public domain and greater awareness could assist customers in comparing providers (although the survey currently includes no information on pricing or terms and conditions, therefore to be of greater use, the scope and content of the survey could be improved).
- (g) Introducing a calculator tool for BCAs: as the CMA recognises, there is complexity in BCA tariffs and some other SME products which make it difficult for customers to compare them. The creation of a user friendly comparison tool would allow customers to better assess the information available to them. Principally for SME (but also for PCA), more could be done to develop user friendly comparison tools that help customers to identify the product or products most suited to their banking needs (over the lifetime of the product). We support measures to facilitate comparison. In particular, we view API as having the potential to allow for the sharing of bank data and we support its use for non-confidential customer data. If each bank were to develop an API, we believe that this could be an effective mechanism through which generic pricing or T&Cs being shared allowing third parties to create price and service comparison sites. Customers could then go to one site rather than having to shop around.

6.11 The CMA will be aware that our suggestions in (d) and (e) are directed towards larger SMEs which are more likely to have more complex finance arrangements in place. On the other hand, our suggestion in (a) is relevant only for the smaller SMEs which have access to CASS.

7 ToH2: Concentration giving rise to market power of some banks leading to worse outcomes for customers

7.1 We consider that concentration in itself is not the cause but a symptom of any failure of the market to function well. The relative stability in shares for the Big Four is primarily a symptom of

⁵⁴ Rather than relying on credit reference agencies or governmental bodies.

⁵⁵ See San UK's response to the Issues Statement, para 7.11.

⁵⁶ See San UK's response to the Issues Statement, para 7.12.

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certain features, such as the low levels of engagement among customers, the correspondingly low rates of switching, and certain barriers to expansion (especially in the case of SMEs). While we have gained market share over the past few years, these features have affected our ability to grow more quickly despite offering innovative products.

- 7.2 We have considered the two mechanisms developed by the CMA through which there may be a link between concentration and poor outcomes.⁵⁷ These are:
- (a) “The ability of banks with higher market share to differentiate products and exercise market power” (the **first mechanism**); and
 - (b) “the difficulty in discriminating between active and inactive customers” (the **second mechanism**).
- 7.3 We do not consider that the first mechanism properly describes or reflects competitive reality in the market for the provision of PCAs and SME banking services. In our experience, differentiation is not affected by scale nor is it used as a means of limiting competition. Differentiation in and of itself is not a sign of market power or a market that is not functioning well.⁵⁸ Indeed, we welcome the ability to differentiate our offering from other banks through market leading products, such as the 123 account. If the CMA is concerned that there is deliberate obfuscation that causes complexity via differentiation (which is the opposite of the San UK model which favours simplicity for customers) then in our view that matter should be assessed under ToH1.
- 7.4 We do not consider that the CMA should presume that higher concentration itself leads to higher margins or lower innovation. As explained above, the critical issue is to ensure that where better products are offered, customers are able and willing to switch to them. The market for the provision of PCAs has improved in this regard, albeit further improvements could be made. On the SME side, while we have innovated, we consider that the level of innovation in the market for the provision of SME banking services is still some way behind.
- 7.5 However, we do agree with the CMA’s second mechanism which sets out a theory that: larger banks may have weaker incentives to lower prices or improve services than smaller banks because, where they cannot discriminate between new and existing customers, larger banks may lose more revenue than smaller banks from price reductions or incur greater costs through service improvements. In particular, a larger bank may set relatively high prices in order to earn greater profits from its existing customer base and accept a lower share of new customers. We would encourage the CMA to investigate this theory further.
- 7.6 We would also note that:
- (a) San UK and other challenger banks are not faced with the same situation because in order to grow we must induce customers to switch from other banks; as a consequence the customer base of challenger banks is likely to be made up of a pool of more engaged

⁵⁷ UIS para 99.

⁵⁸ Indeed, our experience, particularly in the provision of SME banking services, is that the range of BCAs offered by the Big Four are very similar in terms of pricing and tariff design and the types of services offered.

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customers compared to the Big Four banks who are able to profit from a large degree of “back book customer inertia”;

- (b) We therefore make all of our innovative offers available to our entire customer base. For example, the 123 current account (and benefits through 123 World) is available to all customers; and
- (c) A symptom of the mechanism that the CMA describes is that, where large banks occasionally do differentiate between new and existing customers, and make offers to attract switchers, these tend not to be extended to the back book because of the costs involved. In such a scenario the larger banks are relying on the lack of engagement and the inertia of back book customers not to seek better deals elsewhere.

7.7 In addition, as the larger banks hold the majority of main banking relationships, they are in a better position to cross-sell and bundle products (such as through AVAs) and benefit from the customer’s preference to have their banking all in one place, even if challengers have objectively better products.

7.8 Finally, for both the provision of PCAs and SME banking services, we note that the CMA proposes to test ToH2 using price and/or concentration analysis. In this respect, we have set out a number of significant reservations as regards the value of such exercises in section 3 above. In particular, we would emphasise the need to calculate the “price” appropriately, taking into account actual customer behaviour and the value of cash-back. We consider that any assessment of consumer outcomes must be based on an accurate and necessarily nuanced understanding of the various products.

8 ToH3: Barriers to entry and expansion

8.1 There are a number of barriers to entry and growth that in our experience, as a scale challenger, prevent the development of a more competitive market for retail banking services and which in our view warrant closer inspection by the CMA. As outlined in our Response to the Issues Statement, we consider that capital requirements and a heavy and changing regulatory burden form barriers to entry and expansion in both the provision of PCAs and SME banking services, as they have a disproportionately high impact on smaller banks.

8.2 [REDACTED]

8.3 In relation to regulation, we agree with the CMA that the regulatory burden faced by banks has the potential effect of “chilling innovation”. In particular, we note that the recent measures around ring fencing, potential European structural reform and other regulatory initiatives⁵⁹ are resource intensive and, particularly for challengers, can act as a brake on other non-business critical investments which may otherwise have led to innovation and greater competition. We welcome the CMA’s intention to look at AML requirements in more detail.

⁵⁹ For example, recent, ongoing and upcoming investigations by the FCA and PSR into cash savings, credit cards, ownership and competitiveness in payment systems, indirect access to payment systems, corporate and investment banking and mortgages.

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- 8.4 With particular reference to the provision of SME banking services, the barriers to entry and expansion that we have faced include:
- (a) limited access to customer credit information – we welcome changes brought by the draft Small and Medium Sized Businesses (Credit Information) Regulations, but consider that these do not go far enough (see section 6 above);
 - (b) substantial initial investment, the development of a network of corporate business centres and relationship managers and IT platforms;
 - (c) the requirement for a full service proposition (in order to effectively compete with the incumbents as opposed to operating in a niche); and
 - (d) the creation of switching costs in relation to exit fees and transfer of securities.
- 8.5 As to payment systems, we welcome the reviews being conducted by the PSR in relation to indirect access and infrastructure ownership and we are analysing the terms of reference and engaging with the PSR. We await the outcome of these inquiries. Given the nature and scope of the PSR's proposed market studies, we would welcome a coordinated approach between the CMA and PSR.
- 8.6 We intend to provide more detailed views in response to the CMA's working paper in relation to barriers to entry and expansion once we have a better understanding of the CMA's position in this area.

9 Conclusion

- 9.1 We believe that understanding and addressing the causes of lack of engagement among PCA and SME customers is critical to the success of the investigation. This will inevitably involve consideration of proportionate and effective measures to overcome customer inertia.
- 9.2 We are supportive of the CMA's further proposed analysis in relation to barriers to switching, the incentives of incumbent banks to lower prices or improve quality/innovation, and barriers to entry and expansion.
- 9.3 It is widely accepted that the issues in the investigation are inter-locking. Therefore, in considering whether features of the market prevent, restrict or distort competition, we would encourage a holistic and proportionate approach to their analysis.