

## **RETAIL BANKING MARKET INVESTIGATION**

### **Summary of hearing with Santander UK PLC on 7 July 2015**

#### **Entry to the PCA and SME markets**

1. Santander UK PLC (Santander) told us that it had entered the UK personal current account (PCA) market through its acquisition of Abbey National in 2004 and it had developed its business through organic and inorganic growth. Its strategy had included developing a competitive PCA offer and building a relationship-led small and medium-sized enterprise (SME) business.
2. Santander said that its PCA product was designed to offer clear value to all customers, with the aim of persuading customers to switch to it as their primary banking provider rather than just for one mortgage or saving product. In order to enter an agnostic market, it had to offer a game-changing competitive proposition – its 123 PCA. It was able to offer this because [redacted].
3. Santander had entered the SME market in 2009 when economic conditions meant that there was a reduction in lending to SME businesses by other providers. It had identified a gap in the SME market for a relationship-led banking model, observing that some competitors had moved towards a more transactional approach. It said that it gave its relationship managers the support and ability to get to know the business of their customers and to tailor the Santander offering to suit their needs.

#### **Customer engagement**

4. Santander had identified issues with consumer engagement in both the PCA and SME markets. It said PCA customers were generally passive and inert despite there being better offers that were more suited to their banking needs. For SME customers in particular, whilst customer segments varied, many valued their banking relationships and preferred to hold multiple products with one provider.

#### **Basic bank accounts**

5. Santander said that offering basic bank accounts was a legislative requirement for banks of a certain size. These basic accounts were not profit making and customers with these accounts could not use an overdraft. It said

that whilst some of these customers might migrate in time to other products, many would not. It said however that as a social need, it thought that on balance it was right for banks to provide them.

### **Santander 123 account**

6. Santander launched the 123 account in 2012 and the account attracted savings at an attractive rate for Santander. [✂]
7. Santander said that the CMA's pricing analysis in the updated issues statement had not taken into account Santander's 123 account cashback proposition and the profiles did not reflect the average balance held in the 123 account.

### **Brand awareness**

8. Santander said that in the PCA market, brand awareness was much more important than in the SME banking market. It said that the number of complaints it received had significantly reduced since three years ago, and its overall customer service performance put it comfortably in the top providers when compared with its peers.
9. Santander said that some incumbent banks had tried radio advertising to reach SME customers better but this had had limited success. SME customers were most interested in products and local relationships. Local intermediaries, such as lawyers and accountants, played a large role in influencing perceptions. Those actively seeking more information would spend time researching banks' websites, and so detailed material online could have a greater impact (for those customers) than short adverts.
10. Santander said that one of the more effective awareness campaigns it had run was a series of events based at the Breakthrough Moments Box. The Breakthrough Moments Box was a large red temporary structure which Santander used to tour the UK and engage with local businesses. It also helped to create 2,500 internships at SMEs which helped to raise its profile.
11. Santander suggested that one route to triggering SMEs to consider switching was for local accountants and/or lawyers advising companies to prompt when relevant for the business to consider its current banking arrangements.
12. Santander said that in the SME market, success of its individual business centres was a relatively local phenomenon. While brand was important nationally, success with individual businesses was due to the local

relationship manager and relationship director and other businesses' experiences of Santander.

## **SME banking**

13. Santander said that there were material differences in the characteristics and needs of medium-sized business customers compared to smaller-sized business customers. This was reflected in the services expected and products required by customers. It noted that, for example, sole traders would prefer to see personal and business accounts together, which would be inappropriate for a larger business.
14. Santander's target in most markets that it entered was to reach a 10% UK market share. Usually that share would place it in the top three competitors in a market, but that was not the case in the UK SME banking market. It had taken the view that it aimed to grow steadily and sustainably, using sensible risk and return dynamics.
15. Santander had a range of support for businesses: local business managers were available as required for smaller SMEs, and relationship managers and directors were available for larger SMEs with more complex needs.
16. Santander explained that in recent years, it had widened its product range and had been able to offer a full service SME proposition. This had helped lead to a change: previously, Santander would aim to win business on individual products, for example, a business current account (BCA). Now, it aimed to offer its prospective customers a relationship built around its full product capability.

## **Branches**

17. Santander said that it had 921 branches, and that its branch network would probably [X] between [X] and [X] branches across the 771 prime financial centres (as defined by CACI Financial Footprint). Abbey National, Alliance & Leicester and Bradford & Bingley had had branches in the same towns. Santander noted that in some areas customers used the branch where they worked rather than where they lived. Location within financial centres was important and being located in particular streets or areas would have a material impact on the effectiveness of the branch.
18. Santander regarded itself as a scale challenger and its branch network was an important part of its strategy. However, for a hypothetical new entrant challenger bank it suggested that a branch network of around 500 branches

could provide proper coverage of the UK, provided those branches were not geographically concentrated.

19. Santander said that branches were a higher risk distribution channel than digital channels. Digital channels were customer driven and therefore lower risk from a conduct perspective.
20. Santander said that it was open-minded about branch sharing with other providers in the right circumstances.
21. Santander said that it measured branch performance in a number of ways, including quality assurance, customer engagement and customer satisfaction.
22. Santander said that the way branches operated had changed from a sales to a fulfilment channel. It said that customers mostly researched products and services online and entered a branch having already formed a view as to what they wanted. Fulfilling the needs of its customers made it more likely that customers would obtain future products and services from Santander. Branches also had a role in helping build brand awareness.
23. Santander said its business banking SME customers were serviced by its branches and its corporate and commercial SME customers were supported by its SME business centres. Its relationship directors had some flexibility to negotiate price with customers. Managers of business centres had a greater role in the financial management of their business centres than managers of branches. It said that, because some of its business centres were new, relationship directors in those business centres might not have had any customers on day one. By contrast, banks with an established presence in the same area would be able to offer existing portfolios of customers to its new business managers.
24. Santander had undertaken large scale investment in building a network of 70 corporate centres, hiring [redacted] bankers and investing around £[redacted] million in its corporate IT platform for SMEs.
25. Santander had estimated it would take [redacted] years to build a credible presence in the UK SME market. It said six to seven years on, it had achieved a number of strategic goals and it had built the infrastructure and the systems it required.

## **Overdrafts**

26. Santander said that its 123 PCA [redacted].

27. Santander said that it changed its overdraft pricing from interest rate charging to a daily charge (for example £1 per day for arranged, £6 per day for unarranged) to make it easy for its customers to understand the costs. On the Everyday account, it also had paid and unpaid items fees which were both £10. Although much simpler, in some cases the daily charges could [X].
28. Santander said that when it set the level of overdraft charges, it looked at the competitive context, the overall retail sector, and product level profitability. However, simplicity and transparency for customers was the first consideration.
29. Santander said its BCA charging structure was more traditional, with interest charged and with higher paid and unpaid item fees. The more complex the needs of the customer, the more bespoke and negotiated its charges and products were likely to be. [X]
30. Santander said that around [X]% of the fees incurred in arranged overdrafts were recovered from customers, compared to around [X]% for unarranged overdrafts. [X]
31. Santander said that there were two approaches to dealing with transactions that took the account over the arranged overdraft limit. The first was to approve additional funds up to a 'pencil limit' if the customer had a good risk rating, though the customer would be charged an unarranged fee. The second was to decline any payments that would take the account past the overdraft limit. Whilst this would avoid the customer paying a fee, it would mean that, for example, they would not be able to leave the supermarket with their shopping. It recognised advantages in both approaches. It aimed to identify an appropriate pencil limit for its customers, but at present there were some customers with low credit scores who did not have a pencil limit. It offered a Choice account, without any unarranged overdraft facility, for a fee of £10 per month.
32. Santander said that Current Account Switch Service (CASS) did not guarantee a customer could switch their current overdraft between providers. However, it did not suggest that banks should guarantee to provide the same overdraft as competitors, as requiring them to do so could drive some odd behaviour. Santander did suggest that there was scope for improvements in the provision of overdrafts across the industry. One solution would be to offer real-time processing of credit applications for customers wishing to switch. midata allowed for comparability of overdrafts by including this dimension within the price comparison.

33. Santander said that quality was difficult to measure and compare. Customer satisfaction and service scores were useful but there was no industry standard, though it thought it was possible for the industry to develop. Some price comparison websites and consumer sites rated quality of service. Newspapers also tended to carry reasonably good comparative data on personal finance products.
34. Santander said that the Financial Conduct Authority was reviewing communication tools and options for the industry, including looking at whether the banks should contact customers, for example at the end of a savings product term. A similar service for current accounts would not be impossible, albeit that there were inherent difficulties with capturing all aspects of a product offering in a comparison communication.
35. Santander said that most SME customers had free banking for the first 12 to 24 months therefore a large number approached and used their PCA provider. There was a decision point for SMEs at the end of the free banking period to decide whether to take the rate at their current bank, or to shop around. It said that because most BCA tariff structures were based on 'per item' fees (rather than one monthly fee), it was difficult for the customer to compare without transactional data. Santander had experimented with a monthly fee which had worked well.
36. Santander had developed a comparison tool to help businesses calculate the cost of the tariffs. A key improvement would be the ability of businesses to extract their data to provide a basis for comparison. As businesses grew, price became less important and service quality became more important. It noted that calculator tools would be more useful for smaller SMEs. The extension of CASS to SMEs with a turnover up to £6.5 million was a positive step. SMEs would benefit more from credit passport initiatives which would bring together their own information but in a way that was portable and could be used for multiple providers and help streamline know your customer (KYC)/anti-money laundering (AML) processes.
37. Santander said that the Business Banking Insight survey was a good initiative though needed to be more widely supported to be effective.
38. [✂]

## **Profitability**

39. Santander said that banking was a 'maturity transformation' business where the profitability of the bank was derived from the gap between the assets it

lent out and the liabilities that it generated. It said that it looked at [✂]. When launching new products, [✂].

40. Santander said that its SME business [✂].
41. Santander said that very small businesses tended to be liability rather than asset led. From a return-on-capital perspective, these appeared to be attractive businesses because they did not absorb very much capital. The larger the SME customer, the more money it tended to borrow and the broader the range of services it required. Whilst profitability appeared to be lower than for the very small SMEs on a return-on-equity basis, this was reflecting a different profitability dimension. Santander noted that the value in liquidity was being able to redeploy it into assets, and it did not want to accumulate liquidity for liquidity's sake.
42. Santander said that different service models were appropriate for customers of different sizes. At the smaller end of the scale, if a bank was able to provide good direct and internet-based service (and so less branch-based services), [✂].
43. Santander said that more investment was required to serve medium and large SMEs compared to smaller businesses. It noted that a significant proportion of challenger banks were focused on the smaller end of the market and/or niche products, and were using intermediaries to provide a low-cost-to-market model.
44. Santander said that the larger banks were reducing or removing relationship management for their smaller SME customers and replacing it with more direct channels and encouraging self-service to drive up the banks' efficiency. However, Santander was investing in new business centres [✂].
45. Santander had inherited free-banking relationships when it had acquired Abbey National and Alliance and Leicester and the low-cost, self-service proposition was highly valued by those customers. As it developed its product offering, some customers were showing interest in upgrading to fee-paying accounts to benefit from the relationship manager service.

## **PCA profitability**

46. For PCA products, Santander said that [✂].
47. Santander said that it was important to understand that customers' account usage changed over time, and so too would their profitability.

48. Santander noted that student/graduate accounts required up-front investment to offer, for example, interest-free overdrafts and account incentives (Santander offered a railcard). Further, students were frequent, low-value users of ATMs. [✂]
49. However, it said that there was a strong probability that these customers would stay with their bank for some time, and after the initial three-year period, would often then open savings and mortgage products with the same bank. Over the longer term they became valuable customers to have. [✂]. It said that since it had become more competitive and assertive in the student market, it had seen customer quality improve and customers being more likely to stay. Moreover, it said that in 2008 it had around five university relationships, which it had now grown to approximately 79 relationships including about 55 branches on university campuses.

## Competition

50. For the personal market, Santander said that it was a much more crowded marketplace as it was possible to come to market with an entirely digital proposition, for example savings or PCAs. It said offerings ranged from the Post Office with 11,000 branches to entirely digital propositions with no branches. Price was a key factor for customers but despite the large number of participants, customers still did not switch that much.
51. Santander broadly categorised banks in the PCA market into three groups: challengers; scale challengers; and incumbents. Its main source of competition for the switcher market and new customers came from the other scale challengers such as Halifax, Nationwide, and TSB. However, it considered that [✂], with HSBC, Lloyds Banking Group (LBG) and Barclays all offering new reward programmes. These initiatives appeared to be designed more for retention of existing customers than to attract new switchers.
52. Santander considered that Metro was competing primarily on customer experience (long opening hours and branch functionality), rather than on having the best priced product.
53. Santander said that the emerging scale challengers faced regulatory and prudential burdens, and large investment would be required to develop digital and physical capabilities and therefore they would struggle to earn a return on equity in excess of their cost of equity.
54. For the SME market, Santander said its main competitors were the four large incumbent banks (RBS Group, LBG, HSBC Group and Barclays).

Occasionally it also competed with other, smaller banks, although they tended to specialise in specific segments of the market.

55. Santander said that its success in [✂].
56. Santander said there was potentially less competition in the SME market than there was in 2005 because European banks, including three Irish banks, had withdrawn. Counterintuitively, the financial crisis might therefore have strengthened the incumbent banks as other providers left the market.
57. Santander said that smaller SME providers could offer competitive products but that competing on relationships across a full range of products and geographic reach was more difficult. It said that there was a range of banks focusing on niche products, such as invoice financing (eg Bibby), asset finance (eg Aldermore), secured lending (eg Shawbrook) and real estate (eg Handelsbanken). The only banks offering the full range were the big four incumbent banks and Santander.
58. Santander said that Clydesdale and its parent National Australia Bank Group were strong in their local markets of Scotland and Yorkshire, and it expected Williams & Glyn to have a north-west orientation given its likely branch network inheritance.
59. Santander said that the big four banks had previously tended to focus more on their global businesses rather than the UK. However, since the financial crisis, the renewed UK focus of these banks had meant they were being more competitive in the UK market. This applied both to acquiring new customers and retaining existing ones.
60. One way in which Santander said that it had sought to win an edge in service was developing a dedicated corporate service centre. Customer satisfaction scores seemed to reflect that this had had the desired impact.

## **Switching**

61. Santander said that bank accounts were less engaging for consumers than, for example, mobile phones where customers actively switched. People would upgrade their mobile phone if they were attracted by new technology, or if they broke their current handset. Bank accounts, by contrast, did not have exciting features, and there was no real stimulus to consider switching bank accounts. It said it took several months after launching its 123 PCA before customers started switching to that account, and that was only once external commentators had validated its benefits.

62. Santander said that midata was a powerful tool, but there were some complications (including comparison involving packaged accounts). The success of midata required more price comparison websites to adopt it (currently only Gocompare.com offered this service) and this would make it more effective.
63. Santander said that some customers wanted the security of having their old account stay open for a period when they switched rather than closing automatically as was currently the case. It said however that you could currently switch back using CASS and the same seven-day guarantee applied.
64. [✂]
65. Santander said that in order for a customer to switch its business banking from its existing provider, Santander needed to prove that it was going to do a better job than the current bank. Push factors were important too. Different businesses placed different emphases on price and the wider business advice a bank could offer to businesses. It was important to get the banking basics right as well as the more complex service offerings.
66. Santander said that one of the findings from its Breakthrough initiative (a programme supporting ambitious businesses to grow) was that businesses that rated themselves as highly ambitious were more likely to switch.
67. Santander said that bringing some uniformity to SME credit risk data, and making this widely available, would be a positive step. However, there were issues. For example, the customers who were happy to have data in this format might be those who had already been rejected for finance, and so would create a pool of customers perceived to be in a greater risk category. Whilst personal credit scoring was quite reliable in assessing risk, applying it to SMEs was unlikely to be as robust. For example, the role of the management team was very important; it said a good management team could turn an average business into a great business, and equally a poor management team could destroy a good business.
68. Santander said that whilst a more consistent measure of risk would be valuable, it was inevitable that a pass or fail metric would be derived and this would have negative consequences for those businesses that did not pass the relevant benchmark.
69. Santander said that the availability of credit data would enable alternative or new lenders to target a niche, or part of a, product proposition where an SME had a particular funding requirement. However, while it had supported the right of SMEs to appeal an adverse lending decision, this requirement on

banks to reconsider a decision not to offer a product might reduce the likelihood of the customer moving to a different provider and therefore reduce the number of SMEs that had to look elsewhere.

70. Santander said that the Business Data Initiative or credit passport initiatives had potential to enable SMEs to have a more comprehensive information pack in preparation both for an application but equally for a conversation with the relationship manager and would enable a business to approach a number of new providers in addition to its current provider. It would then be up to the bank to consider the application in regard to more bank-specific issues (sectors of interest, risk parameters, etc). The automated production of these passports, in such a way that the data was owned by the people that it was about, would increase the SME's mobility.
71. Santander had considered whether a contract period might provide the necessary stimulus though thought this would probably be more relevant to business customers than personal customers.

## **Innovation**

72. Santander had invested heavily in innovation, including in products (eg the 123 account), marketing (eg the Breakthrough programme), and service offering (eg international support in SME banking), and had expected greater market share growth than it had achieved. It put this down to the market being less dynamic and less competitive than expected.
73. Santander aimed to follow its strategy of being simple, personal and fair and was investing heavily in improving the customer experience, for example developing the ability for customers to view all of their accounts and products through one application.
74. Santander said that innovation was occurring in payments services and applications, such as Apple Pay, and that customer expectations had driven its early adoption of this system. Whilst it would focus on improving the basic functions to its customers, it also offered other innovations such as KiTTi (allowing friends to create a collective pot of money) and SmartBank (a student app that provided detail on account expenditure).
75. Santander's strategy was to have a simple and user-friendly mobile platform for managing all products in one place, including the ability to open, transact, and close accounts. It was also putting in place a combination of payments services to cover the large majority of transactions.

76. Santander's digital spend per year was around £[redacted] million which it considered was [redacted]. It spent [redacted] on regulatory-led changes per year [redacted]. Most of its digital spend was dedicated to delivering its customer strategy. Finding comparable information was difficult as competitors tended to include business as usual costs that distorted the figures.
77. Santander procured its IT services and equipment from its Spanish parent company. It said however that the digital challenge for all established banks was the same, and one of trying to pull information from a large number of systems into one place. Something that seemed straightforward to the customer was in practice complex for banks to deliver. The cost of the actual interface (an application or app) was relatively cheap, but the costs of systems integration required to populate it with customer data costs were substantial. New banks could start from a blank piece of paper and therefore faced many fewer challenges than banks with legacy systems.
78. Santander kept abreast of changes in the market including the innovations of competitors, though it focused on what its customers valued. It had developed an SME digital banking service and said that the challenge was to keep the user experience current.
79. Santander had a wide customer base with some customers preferring to manage their account primarily through digital portals and some valuing personal service and seeing the branch as their primary interface with the bank. Whilst the future may move towards digital, the current period was one of transition.
80. Santander said that students were an interesting customer category as they were high users of both bank technology and branches. It had invested in branches on university campuses as they were valued by students [redacted].
81. For SMEs, Santander said that digital capabilities were being used to offer greater execution functionality and were designed to be used alongside its relationship manager capability. There were also partners such as Elavon which helped SME customers to understand more about their customers using payment technology. It also said that it had worked to deliver innovation in SME businesses for the SME's customers, such as at-table payment via iPad.
82. Santander said innovation in technology, such as [redacted], was also key in identifying businesses to approach. It cited external figures which suggested that 40% of SME customers were using internet banking everyday compared to 30 to 35% of personal customers using it once per month.

## Big data

83. Santander said that retail banking was evolving towards the intelligent use of the data it held to build customer relationships through more relevant and targeted conversations. In future it aimed to be able to use the data to be able to interact with customers in more innovative ways, more akin to the approach of Amazon, which was able to use past sales data to offer other products.
84. Santander utilised a customer relationship management system in the UK, but said that its operations in other countries, for example in Chile, used a more sophisticated system and it was looking to see whether it could be adapted for the UK. It said it would also consider how best to [redacted].
85. Santander wanted to achieve the brand success of companies such as John Lewis, which it viewed as having a strong and trusted brand that transcended generations and where customers were confident they would always get a good product, service and price.

## Products

86. Santander said that [redacted]. For example, its 123 PCA [redacted].
87. Santander said that it was difficult to reconcile different demographics around all of its branches with a centralised product offering. It was considering the impact of the move to 123 PCA product and what impact this might have on its branch network.
88. Santander had chosen to focus on building a relationship with customers. The 123 PCA broke the mould of free-if-in-credit current accounts and was intended to be difficult for the incumbent banks to match. The 123 PCA offered a transparent assessment of value for customers, who could see what they were paying, and what interest and cashback benefits they were earning. This had proved successful in reducing [redacted] the number of customers leaving Santander [redacted].
89. Santander had tried to [redacted]. Santander said its overall strategy was to [redacted].
90. Santander faced competition in the SME market around the point of offering a proposition to a potential new customer. It said that despite its investments in product capabilities, relationship teams, and even arranging terms with potential customers and reaching a commitment from the customer to move to Santander, the incumbent bank sometimes would match the price of Santander's product and encourage the customer to stay. It said customers

valued continuity and consistency and this barrier to switching existed due to customers' fear that change could be disruptive to their business.

## **Barriers to entry**

91. Santander said that the greatest high-level challenge it faced was the [✂].
92. Santander said that as a challenger bank that was classed as systemically important, it had to manage all the same challenges as larger banks, but with less resources. It noted that there were many different competition investigations and capital initiatives currently taking place, which demanded a lot of senior management time diverting resource away from running the bank.
93. Santander said that the UK implementation of EU prudential requirements went further than was necessary, or was 'super equivalent'.
94. Santander said there was a lot of regulatory, prudential, competition and conduct intervention and suggested the regulators coordinate their approaches.
95. Santander said that AML and KYC requirements were relatively simple for personal customers. However, the data passports holding an individual's voting registration, utility bills, and other personal information would be helpful and would feed into lots of different services as well as switching bank accounts.
96. For larger SMEs, the issue became more complicated. Generally, it said KYC and AML worked well, but there was scope to improve it, possibly in the context of credit history pass-porting.
97. Santander said that one issue for PCAs that affected challenger banks was having to clear transactions through a larger bank. This lost them a day in the clearing cycle and meant they were dependent on the service of the other bank.
98. Santander said that Account Number Portability might make the switching process easier but that it would not be a game changer. It said the costs involved would be substantial and there were wider issues that Account Number Portability would not address, such as customer inertia.

## **Multi-banking**

99. Santander said that multi-banking was one way in which SMEs could manage the risk that one provider changed its approach and could no longer provide the services it required. The events of 2008 demonstrated that in the worst

cases, good businesses suffered simply because their bank could not provide the liquidity required. It said that some people and businesses preferred to spread their accounts and services, whereas others preferred to consolidate them with one provider. In personal banking, Santander said that multi-banking was more likely to reflect staged switching.

100. Santander said that, for SMEs, given that switching a whole relationship could involve moving multiple products, it often had to [redacted] to assist a business in the transition period of unwinding some or all of its financial relationships with its previous provider. It employed [redacted] customer implementation managers to assist with [redacted] switching a business banking relationship.

### **Free-if-in-credit**

101. Santander did not identify any reasons (from a product perspective) that would suggest the end of free-if-in-credit current accounts, despite differentiated products such as the 123 PCA. However, changes to the wider retail banking model around reduction of interchange fees, reduced footfall in branches, and challenges to the traditional sales channels would mean that banks would have to consider whether they continue to afford to offer 'free' banking.

### **Concentration and market power**

102. Santander said that Scotland and Northern Ireland were both distinct markets from Wales and England. In Northern Ireland, competition was largely between the Irish banks rather than the main UK competitors. Santander had [redacted] business in Scotland and Northern Ireland. RBS Group had a strong presence in Scotland, along with LBG, and to a lesser extent Clydesdale. It said that it had developed an SME presence in Scotland [redacted]. It saw a greater competitive dynamic in the PCA market in Northern Ireland and Scotland than in the SME market.
103. Santander said that the number of branches in a particular location was no longer necessarily an indication of strength (as more people used non-branch channels).
104. Santander said that awareness of the brand was a key factor in customer perceptions and that well-placed investment in marketing gave banks more ability to influence a market. Advertising spend and the effect it had was more powerful than the branch networks.
105. Santander had launched its 123 PCA as it considered there was a good risk reward balance in doing something different. It said that incumbent banks had

more to lose by changing their product propositions and that large organisations generally were more resistant to doing something different. It said that this dynamic potentially stifled innovation.

106. Santander said that its Corporate Current Account (CCA) and CCA Plus propositions were the best in the market as rated by Moneyfacts for the past 12 years, but it had not seen any sizeable move of businesses away from the main four banks.
107. Santander said that dividing up the big banks was not the answer as the results would be two or three smaller versions of the same bank.
108. Santander said that generally in the SME banking market, the economic return was derived from long-standing relationships with multiple product holdings, rather than from a specific product line. SME customers with the big four banks could be paying more across their bundle of products than if they banked elsewhere.

## **Prudential requirements**

109. Santander said that, due to Prudential Regulation Authority regulations, it had to hold more capital than the big banks for each unit of lending, which resulted in it having to accept lower profit for lending at the same rate. Therefore that higher concentration and larger market share translated into lower cost and therefore higher profit for big banks.

## **Ring-fencing**

110. Santander had estimated the cost of implementing ring-fencing over the next three years would be over £[redacted] million. It involved splitting the bank in two, duplicating functions, building new IT platforms, and rationalising location structure. [redacted]
111. Santander said that the banking reform might create a competitive distortion in SME banking. Larger corporates would be able to elect to bank with a non-ring-fenced bank, but only if they made a 'qualifying declaration'. This could introduce a bias for those customers to stay banking with a ring-fenced bank, regardless of size or sophistication. This might move away from a level playing field and favour some business models over others, and therefore could be anti-competitive.
112. Santander said that if such a bias was created, which caused a significant number of SMEs not to use non-ring-fenced banks, non-ring-fenced

challenger banks might exit the market, and that would be detrimental to competition.

## **Possible remedies**

113. Santander said that possible remedies should ensure that challenger banks have the ability to compete on the same level as the big four banks, particularly around capital holding requirements.

## **Challengers**

114. Santander said that a challenger with £20–25 billion in assets would have limited competitive impact. A bank would require around £50–75 billion in assets to be an effective UK-wide challenger. That would enable it to have a 500-branch network, decent distribution channels and the ability to invest and to withstand the regulatory requirements, and probably still allow it to achieve a return on equity ahead of its cost of equity.

## **Payment systems**

115. Santander said that it had experience of direct and indirect access to payment systems and that indirect users faced longer clearing cycles and pricing strategy constraints. It said however that having everyone directly accessing the systems would require upheaval of the existing system.

## **IT**

116. Santander said that it had cost around £[redacted] million to migrate Abbey National to the Santander business. It had not bought Williams & Glyn in 2012 due to the difficulty in trying to move from one steady state system to another. It had built the platforms to receive Williams & Glyn [redacted]. It had spent around £[redacted] million on its SME platform, [redacted].
117. Santander said that, whilst its IT was provided centrally, it saw the advantages of ‘bank in a box’ IT solutions. The problems established banks faced with legacy IT infrastructure would become more problematic as digital became more prevalent.

## **Customer engagement**

118. Santander would like to see further measures taken to increase the level of engagement in PCA and SME banking. For PCA, it said it believed the area of greatest impact would be in the increased awareness of and confidence in CASS and midata. It said both initiatives needed to be brought to the forefront

of people's consciousness and the benefits understood. It noted that advertising of the launch of the CASS service had resulted in a positive effect on switching.

119. For SMEs, Santander believed there was a role for intermediaries to play in stimulating more SME engagement. SMEs valued trusted relationships, and if their accountant or solicitor prompted them to consider alternative banking services, this could greatly improve switching.
120. Santander said that one way to make the process of switching BCAs simpler was to address perceptions of the costs and risks involved in changing banks. This could include removing or capping exit fees, accelerating the transfer of security between one bank and another, and improving processes around credit history and KYC pass-porting.