

RETAIL BANKING MARKET INVESTIGATION

Summary of hearing with Clydesdale Bank PLC on 21 July 2015

Introduction

1. Clydesdale told the Competition and Markets Authority (CMA) of the intention of its parent company, National Australia Bank (NAB), to pursue a demerger and initial public offering (IPO) of Clydesdale. Clydesdale indicated that it was in a position to operate as a stand-alone business and the management team was refreshing its strategy going forward accordingly.
2. For example, Clydesdale said that there was a lot of investment into [redacted]. A lot of investment was also being made into Clydesdale's local community brands. Listening to customers about what they wanted from a bank had led to the development of new propositions that it was intended to launch into the market. Clydesdale said it had a clear strategy to grow its business and continued to focus on profitability.
3. Clydesdale said it believed that a well-functioning market that offered customers real choice but a diverse range of services was very important and thought it could play an important role in that context. The bank said it had put a lot of effort into being close to customers and connected to its communities. It also said that differentiating its service through the delivery of high quality services was considered very important, which was about combining new digital offerings with the opportunity for customers to come in to branches and Business Centres and, if they preferred, enjoy a face to face experience. Keeping pace with regulatory changes also absorbed financial and personnel resources which impacted proportionately more on smaller banks in terms of operational costs.
4. Clydesdale also mentioned the implications of existing capital requirements and operating under a standardised approach. Clydesdale was growing its mortgage business and considered it important that it was able to compete on a level playing field with bigger IRB-approved banks.

Finance and strategy

5. Clydesdale [redacted] rather focused on the broad customer relationships developed by the bank. Whether the bank acquired a new customer or had an

existing customer, it wanted to make sure that it knew the customer well and offered customer choice, and ensured that the customer made informed choices about the products they required.

6. Clydesdale said its personal current accounts (PCAs) and business current accounts (BCAs) were noted as important products to acquire new customers and to give Clydesdale an opportunity to deepen relationships with customers. Both products were also important sources of funding.
7. [REDACTED] Clydesdale said that in its experience, customers rather wanted a rounded service which dealt with all their needs, and BCAs and PCAs were an important part of that. In essence, these products needed to work in conjunction with all of the other products offered by the bank.
8. Clydesdale noted that, in many respects, current accounts were considered to be the most complex of banking products as they were the only products that moved between being an asset and a liability on a bank's balance sheet. Current accounts generated the highest volume of customer interactions and required a resilient payments infrastructure, the cost of which was significant.
9. In relation to PCA banking, Clydesdale said it had [REDACTED] target customer segments including, for example, [REDACTED]. It was also looking at other segments of the market in which to invest, such as the [REDACTED]. Clydesdale was not looking specifically at targeting [REDACTED] as this customer segment was [REDACTED].
10. Clydesdale said it focused on the SME market [REDACTED]. It said it had made a conscious decision [REDACTED].
11. [REDACTED]
12. Smaller businesses for Clydesdale had a turnover of [REDACTED]. Medium-sized SME customers were SMEs with a turnover of [REDACTED]. [REDACTED] of Clydesdale's total business loan balances were derived from specialist and acquisition finance and 'commercial' customers, ie those medium-sized SMEs.
13. Whilst overdrafts were considered as an important and integral part of its BCA and PCA offerings, Clydesdale said it priced overdrafts based on reasonable value for money and noted that it did not have a big overdraft book; only around [REDACTED] of its customers used an overdraft.
14. Yorkshire Bank and Clydesdale Bank were two separate brands within one bank, however the offers, terms and conditions and pricing were the same under both brands.

Strategy and the future

15. Clydesdale said that NAB had announced its intention to pursue a demerger and IPO in relation to Clydesdale via a demerger of 70 to 80% of its shares to existing NAB shareholders and an IPO of approximately 20 to 30% of its shares to other institutional investors.
16. Clydesdale said its future strategy was to focus on its existing customer base, grow selectively in chosen segments and regions and continue to meet customer needs.
17. In the retail market, Clydesdale said it was targeting growth nationally in selected areas, such as in the mortgage market through mortgage brokers. Clydesdale was also committed to growing its digital proposition.
18. Clydesdale noted that it had a sizeable SME customer base and it believed that the market would be favourable in terms of increased customer demand, in particular for lending products. Another identified area of growth for Clydesdale was its invoice and asset finance businesses.
19. Clydesdale explained that the Business & Private Banking division within Clydesdale, which delivered SME services to customers, was in balance sheet terms larger on the deposit than the lending side, with approximately £8.5 billion compared to the lending side of £7.4 billion.
20. Clydesdale said it was also planning to progress a [REDACTED]. Clydesdale said it believed that, [REDACTED]. It saw itself as supporting the life cycle of SME customers from start-up through growth and considered that a key enabler of achieving this would be through [REDACTED]. This was likely to be crucial within the wider framework of the bank's multi-channel approach going forward.
21. Clydesdale said it did [REDACTED].
22. Clydesdale said that it estimated that around [REDACTED] of its business customers were using a PCA for their business banking.
23. Clydesdale said that it did not believe that, over the long term, [REDACTED]. Its focus was on delivering good quality customer service consistently through offering a wider choice and a combination of banking channels, including both branches and online banking.
24. Clydesdale explained that, whilst a digital offering needed to be provided in response to the expected customer demand, sustainability was a key issue and the investment return on [REDACTED]. It was therefore keen to build long-term customer relationships as well as utilise the right technology.

Challenges

25. Clydesdale noted that one of the challenges of being a small bank was achieving a 'share of voice' in marketing terms in competition with banks that held much larger marketing budgets. Clydesdale said customers should be informed about trust and advocacy measures (in which it scored well). However, Clydesdale said it was less able to capitalise on this due to constrained marketing budgets in relative terms.
26. From this perspective, [REDACTED].
27. Clydesdale said that a couple of years ago it launched a connect programme, whereby it asked about 600,000 customers what they wanted from a bank, as a way of demonstrating that it was listening to consumers. [REDACTED]
28. Clydesdale said that another example of fierce competition was experienced in relation to its [REDACTED].
29. Clydesdale indicated that, [REDACTED].

SME banking

30. Clydesdale highlighted disadvantages in working with the standardised approach for capital requirements. One important area [REDACTED]. Clydesdale said it was keen to compete [REDACTED]. A solution suggested by Clydesdale was to change the approach that regulators took in terms of accrediting standardised banks with IRB-approved status and make it more proportionate in terms of the cost and the process.
31. [REDACTED] There were a number of treatments for capital that had been agreed at the European level as part of the CRD IV arrangements but where national regulators had some flexibility, eg the ability to reduce the risk weighting for fully collateralised SME lending was an option that had not yet been pursued. Clydesdale highlighted that, if utilised, this would help to recognise and reduce the gap between standardised and IRB capital requirements for SME lending.
32. Clydesdale noted that the Basel Committee on Banking Supervision was reviewing the risk weightings for standardised banks, where there was the possibility for increased risk weightings, [REDACTED].
33. Clydesdale said it had a relationship management driven SME proposition and, therefore, the bank expected that customers would turn to Clydesdale first if they had a loan requirement, assuming they had a strong relationship

with their relationship manager, particularly as Clydesdale was able to provide a full-service offering to SMEs.

34. Clydesdale said that the quality of relationships with its customers was really important, and so it put a lot of effort into building those relationships. In a survey conducted by Clydesdale, [REDACTED] of SME customers viewed it as a trusted adviser.
35. Clydesdale said it was committed to investing in long-term relationships with its BCA customers. For example, to attract new BCA customers, it offered 25 months of free banking, [REDACTED].
36. [REDACTED]

Searching and switching

37. Clydesdale said there was still a perception among UK consumers that it was difficult to switch current accounts. For example, it had found that when consumers opened a new account, they would often not close their old PCA due to that fear factor and the desire to test the new provider.
38. Clydesdale said customers wanted a balance between price and quality of service. Customers also wanted banks to advise them on which products they should be buying or those that were suitable for them. Clydesdale suggested that within the industry in general, banks had perhaps moved too far away from such advice, as they sought to avoid being seen as 'pushing' products on to customers and had possibly become overly cautious.
39. Clydesdale suggested that digital banking had an important part to play in overall customer engagement, as customers would now check their balances on mobile phones several times a day.
40. Clydesdale noted that inertia was thought to be an important factor behind low levels of switching across the industry, as well as a common perception that all banks offered the same thing.
41. [REDACTED]
42. Clydesdale said it had been working on an important initiative [REDACTED], which allowed it to have personalised conversations with customers by better understanding their transaction and credit behaviours; and, on that basis, offer them appropriate products, pricing or changes to their relationship with the bank on a timely basis.
43. [REDACTED]

44. Clydesdale believed that there were opportunities to improve ways by which product offerings could be compared, particularly in the SME market where there was not the same type of focus on aggregator sites as for PCAs. Clydesdale strongly believed, however, that there were other ways to assess banks, not just in relation to price, but also through customer service indicators and more generic ratings, and thereby improve comparability with bigger banks' offerings.
45. Clydesdale said that customers might potentially default to price as the key determinant when considering what account to use, when perhaps they should also consider the quality of the day-to-day service.
46. Clydesdale agreed that Business Banking Insight Monitor was a tool that SMEs could use as a starting point in this regard, as it measured the quality of service satisfaction across a number of organisations.
47. Clydesdale said that new SME customers were being attracted to it through a range of niche sector propositions. This was supported by Clydesdale's relationship management proposition.
48. [✂]
49. Clydesdale believed it had to offer the choice of banking through multiple channels, eg digital, branches and telephone; and it would be up to the customer to make the final choice. Clydesdale advised that maintaining high service levels and a good customer experience were crucial to maintaining customer satisfaction levels.
50. [✂]
51. In relation to personal customers seeking overdrafts, Clydesdale said it [✂]. Clydesdale said it made sure that each customer was informed of the implications of any overdraft decision.
52. Clydesdale said that its experience of the Customer Account Switch Service (CASS) was that it was very effective. Clydesdale said its service level performance was over 99%. However, it believed that awareness of CASS had fallen. A suggestion was made that before any further changes were made to CASS, reinvigorating awareness about the service would be a solution, and also to ensure that information about customer experiences and the service offered by different banks was shared with customers alongside the price.

53. Clydesdale considered that there was a responsibility on the banks to educate customers on CASS at the point of sale. Once customers understood how the systems operated, it had seen higher rates of switching using CASS.
54. Clydesdale said that SME customers were thought to be more cautious when it came to switching using CASS, as their relationships tended to be more complicated and more reassurance was required.
55. [✂] Clydesdale said it did not consider that account opening was an area that needed industry solutions but believed that banks could change it themselves with good technology, investment and staff.
56. [✂]
57. Clydesdale said that account number portability was thought to be enormously complex for banks to implement, and having to change an account number was not thought to be a primary reason why consumers did not switch.
58. Clydesdale said that as it had been [✂], it did a lot of research into product pricing and found that large segments of consumers really valued the free-if-in-credit model.
59. Clydesdale said that the costs of running a fully functioning current account were high due to its complexity as a product which had many facets, and where innovation and technology were constantly moving. [✂]
60. Clydesdale said it had also changed its payment structure for PCAs. It had put in buffers and made it even clearer to customers when they would be charged. When a customer was charged, they were alerted about the charges in advance. Other changes it had made included proactively contacting a PCA customer whose account may not have been working for them to suggest an alternative, better product for them.
61. [✂]
62. Clydesdale suggested that a banking model that did not include a free-if-in-credit banking offering would likely be hard to sustain in the longer term. Clydesdale also noted that [✂].

Concentration

63. Clydesdale said that its customer research continued to indicate that one of the primary reasons that customers chose their bank was due to the branch network, and it had a relatively dense branch network throughout Scotland,

due to its more than 170 years of history. Clydesdale estimated that it had a [X] share of SME customers in Scotland and a [X] share in Yorkshire.

64. Clydesdale said that the SME market was often associated with specific needs and Clydesdale had a long history within some sectors, for example within agriculture, and was [X]. The Yorkshire Bank brand also targeted [X].
65. In Scotland, Clydesdale said it [X].
66. Clydesdale said it embraced competition and noted that, whilst the big four were important players, there were also other niche players in the banking industry, for instance Shawbrook, which provided competition in the SME market. Clydesdale said that it felt that the best way for it to deliver a credible and sustainable alternative to the big four was still to offer the full-service SME proposition that it did.
67. Clydesdale said that it did not consider that the merger between Lloyds and HBOS had specifically made a difference to Clydesdale at the time. However, Clydesdale thought that, because of the scale of Lloyds/HBOS, it could perhaps target segments through individual brands more cheaply in the future than it had done pre-merger.
68. Clydesdale explained that the creation of Santander UK through the merger of three smaller players had likely enabled it to make the required level of investment for its launch of the 123 account, an investment which would probably have been very difficult for smaller niche players to replicate.
69. Clydesdale thought that TSB was quite similar in size to Clydesdale, and generally operated in similar markets. Clydesdale thought that divestment of TSB was good for customer choice and that the takeover by Sabadell might increase TSB's ability to invest and further develop its infrastructure.
70. Clydesdale agreed that size enabled a bank to run its infrastructure more cost-effectively. Clydesdale's infrastructure was mature, and it had been a full-service Retail and SME clearing bank for a long time.
71. One of the things that differentiated Clydesdale from the large incumbent banks was that it was both capable and agile with an ability to identify customer needs and respond to them quickly.
72. Clydesdale also mentioned that it produced bank notes and, as an example of recent innovation, had developed the £5 polymer banknote in Scotland, which was delivered ahead of the Bank of England and the two other note issuers in Scotland.

Barriers to entry and expansion

73. Historically, Clydesdale said that the infrastructure investment required to be a clearing bank was regarded as being considerable. However, it said there were now many different ways to access payment services that were more efficient. Clydesdale's perception was that access to payment systems was becoming less of an issue.
74. Clydesdale said that new entrants in payment services, such as Apple Pay, had a role to play but banks also had an opportunity to provide innovation in this area.
75. Clydesdale thought that very large-scale players with very large back books of customers had an advantage in terms of funding, but unless these customers were well served it was equally possible to lose those customers and therefore that advantage. It considered that funding from savings and current accounts was the most valuable funding and also the most valuable because of the relationships that could be built with those customers.
76. Clydesdale said that most retail banks targeted a deposit-to-loan ratio somewhere above 80%, and some even above 100%. By comparison, the wholesale market was either very short term or very expensive.
77. In Clydesdale's view, reliance on legacy IT systems was not necessarily problematic, as – in many cases – these established and 'old' systems were often stable and reliable. Clydesdale said that what had rather been the issue was that some incumbent banks may have insufficiently invested in upgrading such systems, particularly in keeping with the developments on the business side, for example as regards incorporating inherited businesses and IT systems.
78. Clydesdale said that branches were an important element of the overall customer experience, and were still relevant and important for customer acquisition but their role was also changing. Historically, branches had been very transaction-focused; now customers often preferred to undertake transactions digitally over the internet or on mobile devices. However, when customers were about to make important decisions, taking a loan or a mortgage for example, they often wanted to have a conversation face-to-face for reassurance that they were making the right decision.
79. Clydesdale said that branches were also important for vulnerable customers who often preferred to use a branch and to be able to speak with someone, or because they did not feel comfortable using digital channels.

Review of 2002 SME Undertakings

80. Clydesdale said that all banks should be subject to the undertakings and the focus should be on effective implementation.