

## Retail Banking Market Investigation

### The Royal Bank of Scotland Group plc

#### Response to invitation to comment on additional remedy suggestions

#### 1 Introduction

This submission sets out the views of The Royal Bank of Scotland Group plc (**RBS**) in response to the Invitation to Comment on Additional Remedy Suggestions issued by the Competition and Markets Authority (**CMA**) on 18 December 2015 as part of its market investigation into the supply of personal current accounts (**PCAs**) and of banking services to small and medium-sized enterprises (**SME banking**) (the **Market Investigation** or **MIR**).

Sections 2 and 3 below provide commentary in relation to each of the additional remedies highlighted by the CMA covering PCA overdraft customers (Section 2) and other suggested remedies (Section 3).

RBS is available at the CMA's convenience to discuss in further detail any of its views below.

#### 2 PCA Overdraft Customers

RBS considers that the original proposed remedies include a number of helpful measures for overdraft customers. We do however consider that the remedies package could be supplemented further for overdraft customers through a requirement on banks to ensure customers opt-in to unarranged overdrafts, as part of nudging customers in need of an overdraft towards an arranged facility. We consider that this would improve customer understanding and would act as a lever to support lower costs of overdrafts and a move to more transparent and comparable arranged borrowing, fostering greater competition for this group of customers. In a similar vein, RBS would support further alerts to customers on their account usage to increase customer awareness of potential overdraft charges.<sup>1</sup>

##### *Additional proposals*

***Which? suggested several options, including that PCA providers should be prohibited from differentiating their charging structures for arranged and unarranged overdrafts; should cease applying unpaid item charges; and should be required to further clarify overdraft terms and conditions.***

As regards harmonising fee structures, RBS considers that it is unrealistic to expect unarranged and arranged overdrafts to incur the same charges and could indeed be counter-productive. They are different products and there are additional costs involved in providing unarranged overdrafts to customers, including carrying a greater risk of default than for an arranged overdraft. The credit characteristics of customers making payments over any pre-arranged limit also tend to be very different to those who manage their finances within such pre-arranged limits. The difference in credit quality needs to be priced in some way to avoid cross-subsidising less prudent financial behaviour at the expense of

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<sup>1</sup> RBS has already taken a number of steps to support further transparency for customers with regards their overdraft usage. For example, as previously highlighted to the CMA, RBS has launched an overdraft costs calculator on its website to help customers calculate the cost of using both arranged and unarranged services.

the more prudent. There is therefore a risk that this proposal will disadvantage the majority of customers (who do not normally go into unarranged overdraft).

We would also disagree with Which?'s assertion that banks are being inconsistent in allowing payments which lead to a customer entering unauthorised overdraft but blocking other payments (such as ATM withdrawals). Our research shows that when customers pay via direct debits for services received (e.g. utilities) they may well tend to prefer that these items are paid via an unarranged overdraft if they do not have the headroom within an arranged overdraft rather than for them to be rejected. The key difference is that items which are paid into unarranged overdraft are typically for services already incurred (e.g. direct debits) and not for assets not yet purchased (e.g. a point of sale or ATM transaction).

The behaviour of customers who use unarranged overdrafts also tends to differ to those that do not. As noted above there are additional costs associated with unarranged overdrafts which will result in a higher fee being applied on them. The higher fee also acts as a disincentive for the customer to use an unarranged overdraft regularly. RBS makes customers aware that they will be using an unarranged overdraft through text and e-mail alerts, a service which RBS considers that customers value.

With regard to clarifying terms and conditions, RBS is supportive of moves to further simplify overdraft terms and conditions and, as previously noted to the CMA, RBS has taken a number of steps to simplify its own terms and conditions.

In terms of ceasing unpaid item charges, RBS disagrees with this proposal. Costs are incurred for customers for whom we return items unpaid and these costs need to be covered through an unpaid item fee.

As reflected in its own proposal for an additional remedy, RBS considers that requiring customers to proactively opt-in to an unarranged overdraft facility provides a more efficient and proportionate approach with clear customer "buy-in" and acts as a lever towards more responsible use of arranged overdrafts, which allows for greater comparison and competition for overdraft customers. Rather than defaulting to an unarranged facility, in order to ensure access to funds, customers would be encouraged to set up an arranged overdraft and, as a result, be better placed to compare arranged overdraft offers facilitating enhanced switching among this customer group.

***The Financial Services Consumer Panel suggested that unarranged overdrafts should be considered a form of high-cost short-term credit and hence made subject to the price cap for high-cost short-term credit that was introduced by the Financial Conduct Authority and has been in force since 2 January 2015.***

At the time of defining high-cost short-term credit (**HCSTC**), the Financial Conduct Authority (**FCA**) considered whether to include unarranged overdrafts in the definition but expressly excluded "a home credit loan agreement, a bill of sale loan agreement or a borrower-lender agreement enabling a borrower to overdraw on a current account or arising where the holder of a current account overdraws on the account without a pre-arranged overdraft or exceeds a pre-arranged overdraft limit."<sup>2</sup> This was done on the basis that "the products currently included in the HCSTC definition are a broadly similar set of products, which can be viewed together when considering the detriment they cause and the tools that can be used to deal with that detriment. Products currently excluded from the definition are quite distinct in the nature of the problems that they can cause for consumers

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<sup>2</sup> Proposals for a price cap on high-cost short-term credit Consultation Paper CP14/10, July 2014, paragraph 5.58.

*and the causes of those problems. Our evidence, supported by the CMA's provisional findings [in PPI], suggests that other credit products are not substitutes for HCSTC.*<sup>3</sup>

RBS agrees with the FCA's conclusion to exclude unarranged overdrafts from the scope of HCSTC given the distinct nature of the products involved and the fact they relate to services already received by the customer, rather than a future service or purpose seen with HCSTC. RBS therefore considers that it would be inappropriate and disproportionate to reverse the FCA's decision and to extend price caps in the manner proposed.

***First Trust Bank suggested a UK-wide extension of the requirement on certain Northern Ireland banks under the Northern Ireland PCA Banking Market Investigation Order 2008 (as varied in 2011) (the NI Order) to provide customers with relevant information including information about charges and interests. The CMA notes, for example, paragraph 6 of the NI Order in which the relevant banks undertake a duty to notify a customer before deducting overdraft charges and debit interest.***

As noted in previous submissions, RBS supports the review of the NI Order and urges the CMA to avoid any inconsistencies or overlaps as between any eventual remedy package emerging from the MIR and the provisions of the NI Order.<sup>4</sup>

That said, with regard to the specific provisions of the NI Order highlighted in the First Trust Bank proposal, the requirement to provide customers with information in relation to charges and interest does not serve to act to nudge customers away from unarranged overdrafts but rather serves as a pre-notification of pending charges for their account.

By contrast, RBS's proposed remedy to require an opt-in to unarranged overdrafts responds directly to where it considers that any remedial efforts should focus. In addition, RBS notes that its Act Now Alert scheme already provides customers with an opportunity to avoid unarranged overdraft fees on the day the charge is due to accrue. Since mid-2015, RBS has been auto-enrolling new and existing PCA customers into the scheme.<sup>5</sup>

Further, unarranged overdraft fees are already publicly available. However, calculating such a fee over a given period is difficult regardless of whether fees are public given that the nature of an unauthorised overdraft is difficult to predict and is usually of a very short term nature. It is impossible to produce an annual percentage rate (APR) other than for a defined scenario which will, of course, not be "typical" but merely an illustration.

***Lloyds Banking Group suggested additional behavioural remedies aimed at encouraging customers to engage more with how they use their accounts so that they may reduce their costs of banking, regardless of whether they switch provider. The CMA considers such remedies would be variants on the proposed prompts to overdraft customers described in paragraph 5(a) [prompts as part of Remedy 1], where these prompts could potentially be accompanied by opportunities for customers to actively engage to avoid the charge, such as grace periods before the charge is applied, requirements to pre-authorise the charge, or the ability to automate or trigger the transfer of funds from a nominated account.***

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<sup>3</sup> Proposals for a price cap on high-cost short-term credit Consultation Paper CP14/10, July 2014, paragraphs 5.61-5.62.

<sup>4</sup> See Ulster Bank's Response to the CMA Consultation on the Northern Ireland PCA Market Investigation Order 2008 dated 11 June 2015 and Ulster Bank's Response to the CMA Review of the Northern Ireland PCA Market Investigation Order 2008 dated 18 September 2015

<sup>5</sup> [CONFIDENTIAL]

While RBS does not support the use of switching prompts at the time overdraft charges are about to be levied (for the reasons given in its response to the CMA's Provisional Findings and Notice of Possible Remedies<sup>6</sup>), it is in favour of initiatives which make customers more aware of their account usage, including the charges incurred from unarranged overdrafts (which are different from the switching prompts currently proposed in Remedy 1).

As noted in previous submissions, RBS already offers a range of tools to its customers to encourage awareness of account usage.<sup>7</sup> Notwithstanding these current initiatives, RBS agrees that, in conjunction with other proposals in the CMA's draft remedies package, additional customer prompts on the issue of account usage could have a substantial positive impact. The focus of any such alerts should be on providing the customer with sufficient time to remedy their situation to avoid any charge (rather than merely informing them of the charge).

***TSB suggested the development of a "credit passport", where PCA providers should be required to provide a centralised resource, such as an existing credit agency, with customers' account usage and transactional histories. The credit agency, when requested by the consumer, would make the data available, in a usable format, to any prospective alternative PCA provider thereby assisting them to better assess the credit risk and affordability of new customers and increase the likelihood of the alternative provider matching the customer's existing overdraft limit.***

As a preliminary point, RBS notes that loans to personal customers do not form part of the CMA's terms of reference for the MIR. As such, proposed remedies relating to the exchange of data with credit agencies in this context should be limited to PCA overdrafts. Accordingly, RBS understands the TSB proposal to apply only to overdrafts.

Against this background, RBS queries what this proposed remedy would add to Remedy 3 (facilitating price comparisons), Remedy 7 (facilitating PCA customers finding out if overdraft facilities are available at other providers) and Remedy 9 (requiring banks to retain and provide ex-customers on demand historic data) which in RBS's view are sufficient to tackle any information asymmetries arising. RBS also notes that MiData provides a framework which could be used (and improved/extended upon as necessary) to facilitate data transmission between providers.

Moreover, RBS notes that the transactional data/account usage information necessary for credit "decisioning" of PCA customers around the availability and size of an overdraft facility is limited and not onerous to obtain.<sup>8</sup>

Taking all of this into account, RBS considers that it would be disproportionate to impose such a remedy for the purposes of addressing overdraft issues, especially since it would not help nudge customers away from overdraft charges (or enable them to compare costs between providers).

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<sup>6</sup> See Annex 2 of The Royal Bank of Scotland Group plc Response to Provisional Findings Report and Notice of Possible Remedies dated 20 November 2015

<sup>7</sup> See Section 2.3 of RBS's Response to the CMA's Retail Banking Market Investigation Statement of Issues dated 12 November 2014 and [CONFIDENTIAL]

<sup>8</sup> As explained in Section 3.9(c) of Annex 2 of The Royal Bank of Scotland Group plc Response to Provisional Findings Report and Notice of Possible Remedies dated 20 November 2015, [CONFIDENTIAL]

### 3 Other suggested PCA remedies

***Tesco suggested requiring a standardised labelling approach for PCAs, using traffic light colour-coding to make it clear to customers both the cost of their account, and how it compares to others in the market.***

RBS questions the need for this proposed remedy given Remedy 3 (facilitating price comparisons between providers).

In addition, RBS has serious concerns about the robustness and accuracy of the scheme envisaged. Not only does it over-simplify pricing considerations for accounts which may need to be compared in detail for a customer to truly understand their cost<sup>9</sup>, but it also fails to reflect non-pricing quality factors which, as RBS has submitted previously, are key differentiators between competitors. This model could therefore prejudice those who compete on non-price factors or even constrain such competition and further innovation.

In addition, from an implementation perspective, any such arrangement would raise serious difficulties in terms of setting effective criteria, ensuring consistency of application along with implementation and maintenance costs.

***TSB suggested requiring banks to provide PCA customers with a standardised monthly bill, which would set out all the costs associated with the services provided to the customer (including interest forgone), the charges incurred and the rewards earned each month, in a clear, standardised format. TSB considered that this would improve pricing transparency for customers and could help periodically to prompt them to take action.***

As noted during the Retail Banking Roundtable Discussion dated 26 November 2015, RBS is concerned both about the content and the frequency of standardised monthly bills.

RBS supports efforts to provide greater transparency to customers to facilitate comparison between providers and ensure customers make informed decisions. However, RBS is concerned that the monthly bill could effectively reduce competition to a single economic point which would not represent the breadth of the relationship or reflect non-price competitive parameters (such as service, quality/availability of mobile bank apps). RBS's own business model is based on building trust, improving the customer relationship with a service focus and supplying customers with banking products tailored to their needs. By focusing primarily, if not purely, on transactional elements, RBS is concerned that this proposed remedy fails to recognise the significance of these non-transactional aspects to customers and would prejudice providers who do focus on non-price elements and/or have the effect of dampening competition and innovation.<sup>10</sup>

As regards the proposal to include interest foregone, transparency is not improved by providing customers with detailed information on values such as interest (foregone). Instead, the inclusion of interest foregone values would, in RBS's view, add to the confusion of customers who would be expected to differentiate between and compare charges actually incurred (e.g. overdrafts) with benefits (e.g. interest) foregone.<sup>11</sup> It would

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<sup>9</sup> Such a system could end up misleading customers as well (for example, if a customer considers that all "red" accounts carry the same charges and fees where this is not the case).

<sup>10</sup> See Overarching Comment made in Annex 2 of The Royal Bank of Scotland Group plc Response to Provisional Findings Report and Notice of Possible Remedies dated 20 November 2015 (page 10)

<sup>11</sup> As discussed during the Retail Banking Roundtable Discussion dated 26 November 2015. RBS would also query what would such an interest foregone comparison be against. For example would this be against savings account provided by a particular PCA provider or against all providers (which would be impractical).

also call into question whether other benefits foregone should be included, e.g. “bounties foregone” or “reward savings foregone”. If anything, RBS would support statements reflecting actual benefits (e.g. certain current account providers do offer their clients interest) rather than deducting benefits forgone as this would make comparisons between providers easier for customers.

To the extent that the monthly bill is also aimed at eliminating customers’ pre-conceptions that current accounts are “free”, RBS notes the CMA’s own conclusions on the extent to which the free-if-in-credit model (**FIIC**) gives rise to significant anti-competitive effects. While RBS remains of the view that FIIC does have a distortive impact,<sup>12</sup> it submits that such an impact is better managed by nudging customers towards arranged overdrafts rather than overloading customers with financial information about their accounts, which they are unlikely to be in a position to digest and react effectively.

As regards frequency, notwithstanding the comments above, RBS considers that monthly statements would expose customers to prompts too frequently causing their impact, individually and as a whole, to diminish considerably. As a result, the prompts could become counterproductive and potentially lead to customer disengagement.<sup>13</sup>

***Virgin Money suggested that PCA providers should be required to pay their customers credit interest on PCAs at or above a minimum level.***

RBS notes that a PCA is a product in essence designed for making and receiving payments with the added benefit that a borrowing facility can be attached to it (i.e. an overdraft). It is not designed to be a savings account on which credit interest is paid. To fulfil the latter requirement, there is a range of deposit products available on the market. These products are easily accessible (via the PCA provider or other providers) and transfers between a PCA and a deposit account can be made automatically or manually using simple channels such as mobile apps or online banking. The use of specific savings accounts also encourages customers to develop a savings culture which could be undermined by this proposal.

Furthermore, in the context of the Virgin Money proposal, RBS is concerned that requiring banks to pay minimum credit interest without the outright banning of the FIIC model, will not necessarily result in the anticipated objective of increasing pricing transparency. Banks could “cross-subsidise” PCAs from other sources of income (e.g. from overdraft fees) so as to avoid charging for PCAs. In this context, challenger banks may be at more of a disadvantage than larger banks due to an inability to cross-subsidise the provision of PCAs to the same extent.

In summary, short of banning the FIIC model, RBS is sceptical that this measure will address the AECs identified by the CMA.

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<sup>12</sup> See Section 2 of Annex 1 of The Royal Bank of Scotland Group plc Response to Provisional Findings Report and Notice of Possible Remedies dated 20 November 2015

<sup>13</sup> See further RBS’s comments on the cumulative impact of prompts in Section 3.1 of Annex 2 of The Royal Bank of Scotland Group plc Response to Provisional Findings Report and Notice of Possible Remedies dated 20 November 2015