

Personal current accounts in the UK

Executive summary

October 2009

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1 EXECUTIVE SUMMARY

1.1 This report summarises the follow up work of the Office of Fair Trading (OFT) since the publication of its market study, Personal current accounts in the UK,¹ in July 2008. It sets out the initiatives agreed between the OFT, personal current account (PCA) providers² and Bacs³ to address the OFT's concerns about transparency and switching. These improvements to the market will assist consumers in shopping around for PCAs and increase competition in the market. In relation to unarranged overdraft charges⁴ – the third area of concern identified in the 2008 market study – we expect to make more substantive comments on our thinking on in due course after the judgment from the Supreme Court.

1.2 The £8 billion PCA market is the cornerstone of the UK's retail finance system and an essential service for 90 per cent of adult consumers. However, the OFT's market study concluded that the PCA market was not working well for consumers. The OFT was concerned that a combination of complexity and opacity made it extremely difficult for individual consumers to know how much their account could be costing them compared with others on offer. This, together with perceived difficulties in switching, had led to very low switching rates and thus reduced incentives for banks to compete on price or provide new products and services.

1.3 The OFT identified three particular problem areas within the market:

¹ www.offt.gov.uk/shared_offt/reports/financial_products/OFT1005.pdf. Alongside the report the OFT published a consultation paper to invite comments from stakeholders on the high level concerns identified in the report.

² In the context of this report, the term 'PCA provider' will refer to banks and building societies.

³ Bacs Payment Schemes Limited is the payment processor responsible for processing payments such as Direct Debits and Standing Orders.

⁴ In this report we use the term 'unarranged overdraft' to mean an overdraft which the bank grants to a consumer once either the arranged overdraft has been exceeded, or if there is no arranged overdraft, once the PCA is no longer in credit. Some PCA providers use different terminology.

- complexity in the way that unarranged overdraft charges were implemented, which made it hard for consumers to predict when they would be charged, coupled with a lack of mechanisms for consumers to exercise control or opt out of situations that incur high charges
- low levels of transparency on unarranged overdraft charges, forgone interest and other fees. These elements were the least visible⁵ to consumers and were not effectively competed on by PCA providers, and
- a perception amongst consumers that switching was both complex and risky with some real risk of the switching process going wrong.

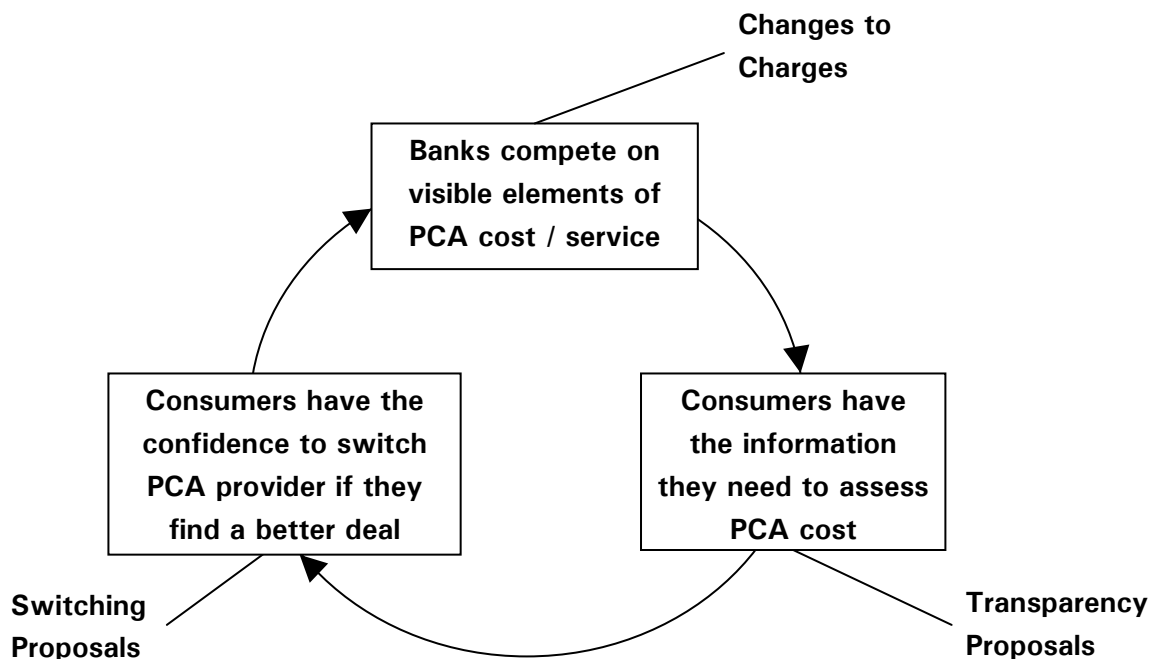
1.4 Collectively, we found these factors constrained the market's ability to deliver value for a significant proportion of consumers and reduced PCA providers' incentives to increase efficiency and provide new and innovative products. The market was stuck in an equilibrium that does not work well for consumers.

An effective market outcome

1.5 If consumers were to become more aware of the costs of their current account and more confident in switching as a means to get better service, so PCA providers would need to offer more competitive products and innovative services to attract custom. This is illustrated in diagram 1, the 'virtuous circle'. In a market displaying these characteristics, more efficient firms gain market share at the expense of less efficient providers which is good for consumer welfare and, by providing pressure to reduce costs, is good for UK productivity.

⁵ Our market study found that competition concentrated predominantly on the more 'visible' aspects of PCAs, such as monthly and core transaction fees.

Diagram 1: the pro-competitive 'virtuous circle'



Unarranged overdraft charges

- 1.6 The market study found that, during 2006, PCA providers earned £2.6 billion from charges associated with unarranged overdrafts, which represented approximately 30 per cent of their revenue from PCAs. Amongst consumers who incurred these charges – often low income, low savings consumers – the average amount incurred was £205 per year and £500 or more was not uncommon.
- 1.7 These charges are complex for consumers to understand, predict and control, and as a result it is difficult for consumers to drive effective competition in this part of the PCA market. For example, during the market study we asked the PCA providers to calculate how much a hypothetical consumer would have to pay in a specified scenario (which included exceeding an agreed overdraft limit). The reported charges ranged from £0 to £260.
- 1.8 We believe that the concerns regarding bank charges need to be addressed by a significant change in the way PCA providers' charges operate.
- 1.9 Alongside our market study work the OFT is pursuing a separate investigation into the fairness of PCA unarranged overdraft charging

terms under the Unfair Terms in Consumer Contract Regulations 1999 (UTCCRs). At time of publication (October 2009) the OFT is expecting a judgment from the Supreme Court following the banks' appeal to the House of Lords which will determine whether these charges are assessable for fairness under the UTCCRs.

- 1.10 We expect to make more substantive comments on our thinking on unarranged overdraft charges in due course after the judgment from the Supreme Court.
- 1.11 Further detail on our concerns about PCA providers' charging structure and the UTCCRs test case can found in chapter 3 of this report.

Greater transparency of charges, interest rates and fees

- 1.12 Research carried out for the market study found that:
- 67 per cent of all consumers did not know the level of unarranged overdraft charges at their bank
 - 25 per cent of those who had incurred a charge still did not know the level of their bank's charges
 - 80 per cent of consumers did not know the credit interest rate applied to their PCA, and
 - in 2006, when the base rate was significantly higher than its current level, nearly 90 per cent of accounts had an annual interest rate of less than 0.5 per cent.
- 1.13 Many consumers are therefore not familiar with the key prices associated with their current account and so are not well placed to determine whether they are getting value for money, assess the potential gains from switching, or decide how to manage their account better. Even if consumers know key prices such as credit interest rate, most do not have the information necessary to calculate total cost easily, for example their average balance.
- 1.14 The OFT has worked with the industry and consumer groups to develop initiatives to improve the ability of all consumers to assess the costs and benefits of their PCA. These are designed to enable them to improve the

way they use their PCA, to consider whether or not they should switch PCA and to make comparisons between different providers and therefore to secure value for money.

- 1.15 To increase transparency, most PCA providers⁶ have agreed to:
- provide enhanced monthly information
 - provide consumers with an annual summary of the cost of their PCA
 - provide information on average credit and average debit balances, and
 - provide illustrative scenarios showing unarranged overdraft costs.
- 1.16 The OFT is also taking steps to help consumers understand and compare the costs of PCAs through new advice and tools on our Consumer Direct website. In addition, the Financial Services Authority (FSA) will launch a feasibility study on the introduction of a PCA price comparison section on its 'moneymadeclear'⁷ website.
- 1.17 These improvements to the transparency of PCA costs are discussed in more detail in chapter 4 of this report.

Improving the perception and process of switching

- 1.18 Our market study identified that the UK has below average rates of switching between PCAs when compared with other EU countries. Only six per cent of PCA holders had switched accounts in the year of our analysis.
- 1.19 A low switching rate is not necessarily indicative of a market that is not working well and achieving a high switching rate is not an end in itself. However, the competitive process works better when consumers

⁶ With the exception of certain aspects of the enhanced monthly information, PCA providers representing over 90 per cent of the PCA market have agreed to implement these initiatives.

⁷ www.moneymadeclear.fsa.gov.uk

actively shop around and make informed choices to secure value for money. This does not necessarily require high levels of switching - a credible threat that enough consumers are able and willing to switch in response to a better offer will sometimes be sufficient to ensure providers remain competitive.

- 1.20 Qualitative research carried out by the OFT found that the reasons for the low switching rate include concerns over the difficulty in switching and fears, in some cases justified, that the process would go wrong.
- 1.21 We have therefore worked with the industry group Bacs and the following improvements have either been introduced or are being introduced:
- measures to increase consumer awareness of the automatic switching process including a new consumer guide and website
 - measures to reduce the number of problems that arise with the transferring of Direct Debits including through a best practice campaign aimed at Direct Debit originators and standardised industry redirection letters, and
 - measures to reduce the impact on consumers of any problems that arise with Direct Debits, including an update to the Bacs rules stipulating that consumers should not be adversely affected by any problems caused by the switching process.
- 1.22 The improvements to the switching process, and the increased confidence this should give consumers about switching PCA provider, are discussed in more detail in chapter 5.

Next steps

- 1.23 The OFT believes that the initiatives agreed with the PCA providers in two out of the three problem areas identified are welcome steps towards improving the current account market. However, the third element in this 'package' of improvements – bank charges – still needs to be resolved for the market to truly work well for consumers.

- 1.24 The OFT will monitor PCA providers' progress in implementing the transparency initiatives, as well as their impact, and will make these findings public.
- 1.25 Recommendations to make switching between PCAs easier have already been implemented, or are being implemented. The success of the recommendations will be measured by Bacs (which provides the Direct Debit product), and Bacs will report to the OFT on their success.
- 1.26 We expect to make more substantive comments on our thinking on unarranged overdraft charges in due course after the judgment from the Supreme Court.
- 1.27 Further details on how all the initiatives will be monitored and measured for success are outlined in chapter 6.