

# Personal current accounts in the UK

Unarranged overdrafts

March 2010

OFT1216

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# 1 EXECUTIVE SUMMARY

## **Overview**

In July 2008 the OFT set out its concerns about the operation of the personal current account (PCA) market. In October 2009, it announced that PCA providers had agreed to make PCA costs more transparent and the switching process more trusted. Since then, and following the Supreme Court's ruling, the OFT has worked with the industry to address concerns around unarranged overdrafts.

The discussions the OFT has had with the major PCA providers have indicated there are likely to be significant developments over the next two years that will help customers exercise a real choice about whether to have an unarranged overdraft facility and keep better track of their balances. New entrants in the market, including well known brands, are also expected to stimulate further competition over products, services and charging structures.

The OFT has also worked with the industry to agree a range of commitments relating to unarranged overdraft charges (UOCs) including:

- the development of minimum standards to cover how consumers are offered the ability to opt out of unarranged overdraft facilities
- a new industry working group to explore ways to give consumers greater control and access to real-time information, and
- a new working group of industry and consumer representatives that will develop best practice for PCA providers in dealing with customers in (or at significant risk of being in) financial difficulty who incur UOCs.

The OFT believes that these cross-industry initiatives, anticipated changes by individual PCA providers and the improvements to transparency and switching announced in October 2009 should lead to a better equilibrium in the PCA market, where PCA providers' incentives are more closely aligned with those of customers and providers need to offer more competitive products and innovative services to attract customers.

These developments above build on significant changes seen in the market since the OFT started its study in 2007.

- The average level of unpaid item charges levied by the major PCA providers has fallen from approximately £34 in 2007 to £17 in 2010, and per transaction paid item charges for using an unarranged overdraft from approximately £30 to £22.
- New charging structures have emerged, contrasting sharply with a lack of innovation for many years prior to 2007.
- There is greater transparency in charging structures.
- The vast majority of standing order and one-off payments are routed through 'Faster Payments'. These were non-existent in 2007.

Given the significant developments under way, the OFT considers that a market-based approach with banks competing to find the best way of addressing the needs of their customers is likely to be preferable to a regulatory 'one size fits all' approach. The OFT is not recommending legislative change at the present time.

However, the OFT will continue to actively monitor the PCA market to ensure that there is movement towards an equilibrium that works well for consumers and it is prepared to take further action if required.

The OFT expects to conduct a review of the market in 2012 to analyse the impact of the initiatives introduced by PCA providers.

The OFT will also be undertaking a short piece of work looking at barriers to entry to consider whether there are any obstacles to entrants providing a competitive stimulus.

## Introduction

1.1 This report sets out the OFT's follow up work on charges for unarranged overdrafts since the publication of its market study, *Personal current accounts (PCAs) in the UK*, in July 2008.<sup>1</sup> It describes the work undertaken by the OFT to address its outstanding concerns around unarranged overdrafts in order to improve the operation of the market. It announces specific initiatives agreed with PCA providers to address concerns about control and responsibility, and outlines the significant changes in the market that will help lead to a better outcome for consumers.

## Background to this report

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. It identified three particular problems in the market:

- complexity and lack of control over UOCs
- low levels of transparency of charges and other costs, and
- problems with switching providers.

Collectively these features 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. In summary the OFT found that the market was stuck in an equilibrium that did not work well for consumers.

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<sup>1</sup> *Personal current accounts in the UK* (OFT1005)  
[www.of.gov.uk/shared\\_of/reports/financial\\_products/OFT1005.pdf](http://www.of.gov.uk/shared_of/reports/financial_products/OFT1005.pdf)

1.3 The work covered in this report builds on the transparency and switching initiatives that were announced in the follow up report published in October 2009:<sup>2</sup>

- To increase transparency, most PCA providers<sup>3</sup> agreed to provide better information on PCA costs (including an annual summary) and to provide illustrative scenarios showing unarranged overdraft costs.
- To address concerns about switching, the OFT worked with the industry group Bacs to provide measures to increase consumer awareness of the switching process and reduce the number, and impact, of problems that arise with the transferring of Direct Debits.

1.4 In its October 2009 follow up report, the OFT said that these initiatives were welcome steps towards improving the PCA market, but that the issue of bank charges (specifically UOCs) still needed to be resolved for the market to work well for consumers.

1.5 Alongside the market study, in March 2007 the OFT launched an investigation into the fairness of certain charging terms relating to unarranged overdrafts under the Unfair Terms in Consumer Contracts Regulations (1999). This case ultimately led to a judgment, dated 25 November 2009, which overturned previous High Court and Court of Appeal rulings. The Supreme Court found that unarranged overdraft charging terms cannot be assessed in full for fairness.

1.6 In December 2009, following the Supreme Court judgment in the test case,<sup>4</sup> the OFT indicated that a number of options were available to

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<sup>2</sup> *Personal current accounts in the UK: A follow up report* (OFT1123)  
[www.of.gov.uk/shared\\_of/personal-current-accounts/OFT1123.pdf](http://www.of.gov.uk/shared_of/personal-current-accounts/OFT1123.pdf)

<sup>3</sup> With the exception of certain aspects of the enhanced monthly information, PCA providers representing over 90 per cent of the PCA market agreed to implement these initiatives.

<sup>4</sup> Further details on the UTCCR investigation and associated materials can be found at:  
[www.of.gov.uk/advice\\_and\\_resources/resource\\_base/market-studies/completed/personal/personal-test-case/](http://www.of.gov.uk/advice_and_resources/resource_base/market-studies/completed/personal/personal-test-case/)

secure the changes that the OFT wants to see, ranging from voluntary action to legislative change.

1.7 The OFT indicated that it would, in particular, be seeking improvements around unarranged overdrafts in three critical areas:

- **control** - to give consumers greater ability to manage their finances, both for their own interests and to ensure that competition operates more effectively in the PCA market, in particular giving consumers a real choice about whether or not to have an unarranged overdraft facility
- **clarity and predictability** - to make charging structures more simple to understand and predict, and to make comparisons of the costs of using unarranged overdrafts between PCA providers and with other forms of short-term credit more effective, and
- **responsibility** - to ensure appropriate expectations regarding responsible lending through unarranged overdrafts, especially to customers for whom other lending arrangements might be more appropriate.

## **New developments and next steps on unarranged overdraft charges**

1.8 The discussions that the OFT has had with the major PCA providers<sup>5</sup> over recent weeks indicate that there are likely to be significant developments over the next two years, building on changes that have already occurred, that will address the OFT's concerns regarding **control**. The discussions the OFT has had with the major PCA providers have indicated that these new developments will give:

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<sup>5</sup> For the purposes of this report the term 'major PCA providers' refers to Barclays PLC, HSBC Bank plc, Lloyds Banking Group plc, National Australia Group Europe, Nationwide Building Society, Royal Bank of Scotland (NatWest and RBS brands) and Santander UK plc Group., who collectively represent over 90 per cent of the PCA market.

- customers a greater **choice about whether or not to have an unarranged overdraft facility**, and
- greater access to **tools that will help customers keep track of their balances**, such as text alerts and other improved mobile and internet banking services.

1.9 These developments will be supported by cross industry initiatives. As a result of the recent discussions it has been agreed that:

- the Lending Standards Board (LSB) will lead work to develop **minimum standards** to cover how consumers are offered the ability to opt out of an unarranged overdraft facility, and
- an industry Working Group will explore **ways to give consumers greater control** and access to real-time information.

1.10 On **clarity and predictability**, the OFT expects some PCA providers to introduce new products that provide consumers with greater clarity and predictability around unarranged overdraft charges, including in some cases a shift away from charges based on transactions towards other forms of charging. The major PCA providers have agreed that they will continue to work with the OFT to ensure that the **transparency initiatives** committed to in October 2009 remain relevant in order to ensure that consumers continue to be able to make meaningful comparisons between PCA providers.

1.11 To address the OFT's concerns regarding **responsibility**, in particular how banks deal with customers in financial difficulty as a result of unarranged overdraft charges, the major PCA providers have agreed:

- to **publish their existing policies** for dealing with consumers in financial difficulty who incur UOCs (or their equivalents).

1.12 This will be supported by a cross industry initiative that will:

- develop, in partnership with relevant stakeholders<sup>6</sup>, **best practice guidance** for how PCA providers deal with consumers in (or at significant risk of being in) financial difficulty who incur UOCs.
- 1.13 Following publication of this report, the OFT will be engaging with the smaller PCA providers and new entrants to ensure that concerns around unarranged overdrafts are addressed by all PCA providers in the UK.
- 1.14 In Northern Ireland, most PCA providers are subject to provisions of the Northern Ireland Personal Current Account Banking Market Investigation Order 2008 (NI Order). The OFT is currently reviewing the NI Order. The OFT will be engaging with PCA providers in Northern Ireland to discuss UOCs, taking account of any overlaps with the NI Order and the developing position with respect to the review of the NI Order.
- 1.15 New entrants to the banking market, including well-recognised brands such as Virgin Money and Tesco Bank, have the potential to stimulate competition by providing new products and innovative services, further benefiting consumers. The OFT will be undertaking a short piece of work during 2010 looking at barriers to entry to consider whether there are any obstacles to entrants providing this competitive stimulus.
- 1.16 Consumers also have a role to play in making the PCA market work better for them. They will not get the best from the market unless they manage their accounts actively and carefully. They will increasingly have access to better tools to assist them in this. In addition, consumers will have a much wider choice of types of account and charging structures. To drive competition the market needs active consumers, informed by greater transparency by PCA providers, prepared to shop around for the most appropriate PCAs for them and change product or provider if necessary.

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<sup>6</sup> This is likely to include, among others, the Financial Services Authority, the Lending Standards Board, the Financial Inclusion Task Force, the OFT and consumer groups

## Better outcomes for consumers

1.17 The developments set out above will build on the significant improvements seen in the market since the OFT started its study in 2007. These changes include:

- Unpaid Item Charges across the major PCA providers falling from an average of approximately £34 in 2007 to £17 in 2010<sup>7</sup>
- a diversity of charging structures for unarranged overdrafts, which creates the opportunity to meet the needs of different types of consumers in different ways
- per transaction paid item charges for using an unarranged overdrafts falling from an average of approximately £30 in 2007 to £22 now<sup>8</sup>, as well as a general trend away from transaction-based charges towards other forms of charging that are often more predictable
- some PCA providers introducing the ability to 'turn off' or 'opt out' of having an unarranged overdraft facility
- new tools being introduced to help consumers better manage their accounts, such as mobile text alerts, mobile applications to manage account balances and improved internet banking, and
- the majority of PCA providers using Faster Payments for standing orders and one-off payments.

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<sup>7</sup> Based on the major PCA providers' published UPIC data for their main PCA product - see chapter 3 for more detail on how this has been calculated.

<sup>8</sup> Based on published data from those PCA providers that used this model of charging for unarranged lending. The figure for each year includes all banks that used this type of charge. (For those PCA providers that used these charges in both years the average fell from £28 in 2007 to £22 in 2010.) This figure does not include monthly charges which are still levied in some cases.

- 1.18 They will also build on the improvements to transparency and switching announced in October 2009. The transparency initiatives will start to be implemented from June 2010 with the remaining information provided to consumers by late 2011. The switching improvements have now been implemented.
- 1.19 It is the OFT's view that together these developments should, if fully implemented, lead to a better equilibrium in the PCA market, where PCA providers' incentives are more closely aligned with those of customers and providers need to offer more competitive products and innovative services to attract customers.

### **Future OFT work**

- 1.20 The OFT has considered carefully whether it would be appropriate to recommend regulation of unarranged overdrafts. Given the significant developments underway, the OFT considers that a market-based approach with banks competing to find the best way of addressing the needs of their customers is likely to be preferable to a regulatory 'one size fits all' approach. As a result the OFT is not recommending legislative change at the present time.
- 1.21 However, the OFT will continue to monitor the PCA market actively to ensure that there is movement towards an equilibrium that works well for consumers. In this equilibrium, PCA providers will provide consumers with a choice of PCA products that meets their needs, relevant and timely information that enables them better to use their accounts, greater ability to compare different providers, and robust policies to deal with consumers in financial difficulty. To make the most of this equilibrium, consumers will need to select their PCA carefully and manage their account effectively. By taking active steps in managing their own money, consumers can, in turn, help drive the virtuous pro-competitive circle.
- 1.22 The OFT will continue to look at:

- the choice of charging structures (or models) of PCAs available to customers
- the level of UOCs, especially the Unpaid Item Charge
- the options available for customers that do not want access to unarranged overdraft facilities, and
- with the FSA and the FOS as appropriate, the treatment of customers who find themselves in financial difficulty related to UOCs.

1.23 If over the next two years the PCA does not move towards an equilibrium that works well for consumers, the OFT will reconsider whether further intervention, including legislation by the Government, is required. Unless further action appears appropriate sooner, the OFT expects to review the market, and the impact of the range of initiatives introduced following the 2008 market study, in around 2012.

## 2 INTRODUCTION

2.1 This chapter provides background on the OFT's recent work in the PCA market including the findings of the market study, the transparency and switching initiatives agreed in October 2009, and the specific concerns in relation to UOCs<sup>9</sup> that are discussed in this report.

### The OFT's market study on PCAs

2.2 The OFT's market study on PCAs was published in July 2008.<sup>10</sup> It established a picture of the UK's £8 billion PCA market, noting a number of positive features for customers. However, the OFT was concerned that there were features of the market that led to an equilibrium that did not work well for consumers:

- **unarranged overdraft charges** - complexity in the way that UOCs 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
- **transparency** - low levels of transparency about UOCs, forgone interest and other fees - these elements were the least visible<sup>11</sup> to consumers and were not effectively competed on by PCA providers, and

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<sup>9</sup> The term unarranged overdraft charges is taken to include all charges levied as a result of consumers requesting or instructing their bank to make payments for which there are insufficient funds available in their PCA.

<sup>10</sup> *Personal current accounts in the UK* (OFT1005)  
[www.of.gov.uk/shared\\_of/reports/financial\\_products/OFT1005.pdf](http://www.of.gov.uk/shared_of/reports/financial_products/OFT1005.pdf)

<sup>11</sup> The market study found that competition concentrated predominantly on the more 'visible' aspects of PCAs, such as monthly and core transaction fees. See, for example, page 2 of *Personal current accounts in the UK*.

- **switching** - a perception amongst consumers that switching was both complex and risky with some real risk of the switching process going wrong.

2.3 Taken together, these factors meant that the PCA market was trapped in an equilibrium that did not work well for consumers, where PCA providers were not incentivised to offer the services that consumers valued and adopted business models that meant a significant amount of revenue came from less visible charges that were not subject to effective competition.<sup>12</sup> This meant that the market was not delivering value for a significant proportion of consumers and reduced incentives for PCA providers to increase efficiency and offer innovative new products. One symptom of the problems in the market was increasingly high levels of certain UOCs, which became the focus of widespread public protest, campaigning and efforts to seek redress.

2.4 Following the publication of the market study, in addition to pursuing the test case referred to below through the courts, the OFT has worked with PCA providers, consumer groups and other organisations to develop initiatives to address these areas of concern.

## Transparency

2.5 The market study found that many consumers were not in a position to assess whether they were getting value for money from their PCA and whether they would benefit from switching PCA providers or from managing their money differently. The lack of familiarity with the key costs associated with running their PCA was at the root of this problem.

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<sup>12</sup> The market study found that around half of all revenue generated from PCAs derived from net credit interest income (that is, the difference between the interest earned on a PCA and the interest earned by banks using the balances for other business) and more than 30 per cent from UOCs – neither of which were readily visible to consumers. For more information, see paragraph 1.5 of *Personal current accounts in the UK*.

2.6 Following discussions with the industry and consumer groups, in October 2009 the OFT announced<sup>13</sup> that PCA providers had voluntarily agreed to implement a number of initiatives that will make the costs of PCAs more transparent. To enable customers to understand more easily the costs of their accounts and compare them with other accounts, PCA providers agreed that they will:

- introduce an annual summary of the cost of their account for each customer
- make charges prominent on monthly statements, so that customers are more aware of the charges that they pay
- provide average credit and debit balances, which will help customers to estimate the potential benefits of switching PCA provider, and
- produce illustrative scenarios showing UOCs, giving customers an idea of the costs for different patterns of use.

2.7 The illustrative scenarios will be available from PCA providers' websites from June 2010 and the remaining information will be provided to consumers by late 2011.

2.8 The OFT also announced steps to help customers understand and compare the costs of their accounts through new advice and tools, including an interest calculator, on its Consumer Direct website.<sup>14</sup> In addition, the Financial Services Authority (FSA) is conducting a feasibility study on the introduction of a PCA comparison section on its 'Moneymadeclear' website<sup>15</sup> to help consumers understand and compare PCAs.

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<sup>13</sup> *Personal current accounts in the UK: A follow up report* (OFT1123)  
[www.of.gov.uk/shared\\_of/personal-current-accounts/OFT1123.pdf](http://www.of.gov.uk/shared_of/personal-current-accounts/OFT1123.pdf)

<sup>14</sup> [www.consumerdirect.gov.uk/before\\_you\\_buy/money\\_and\\_credit/Currentaccounts/](http://www.consumerdirect.gov.uk/before_you_buy/money_and_credit/Currentaccounts/)

<sup>15</sup> [www.moneymadeclear.fsa.gov.uk](http://www.moneymadeclear.fsa.gov.uk)

2.9 The OFT expects that these initiatives will lead to an increase in the transparency of costs of PCAs to consumers, which in turn will lead to consumers both using their PCAs more efficiently (for example, by avoiding charges) and being more aware of the benefits of shopping around for a better PCA. Together these outcomes will help drive competition in the PCA market, which will lead to PCA providers needing to offer better value products to retain and attract consumers.

## Switching

2.10 The market study found that the UK has low levels of switching between PCAs. A contributory factor to these low levels was the actual and perceived problems that consumers faced when switching.

2.11 The OFT worked with Bacs, the payment processor, to improve the process of switching bank accounts and to increase consumers' confidence in the switching process. In October 2009, the OFT announced that the following initiatives had been agreed, all of which have now been implemented:<sup>16</sup>

- steps to reduce problems that arise from transferring Direct Debits
- measures to reduce the impact on customers of any problems with transferring Direct Debits, and
- a new consumer guide and website as part of efforts to increase consumer awareness of the automatic switching process.<sup>17</sup>

2.12 The OFT believes that the above steps will lead to improvements in the switching process by effectively reducing the problems that can arise

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<sup>16</sup> It is currently too early to assess the impact on switching of these initiatives.

<sup>17</sup> [www.bacs.co.uk/Bacs/Consumers/AccountSwitching/Pages/default.aspx](http://www.bacs.co.uk/Bacs/Consumers/AccountSwitching/Pages/default.aspx)

when switching between PCAs.<sup>18</sup> Consumers should have greater confidence in the switching process as they will be provided with clearer information about it and the steps that they can take to make it run more smoothly.

- 2.13 A reduction in switching problems and an increase in customers' confidence in the process, should lead to an increase in the number of consumers willing to switch PCAs. Greater willingness to switch should help increase the competitiveness of the PCA market, providing incentives for banks to improve their services and reduce their charges.

### **Unarranged overdraft charges**

- 2.14 Despite these improvements around switching and transparency, the OFT stressed in October 2009 that a number of problems relating to unarranged overdrafts remained and needed to be resolved for the market to work in the best interests of PCA customers.<sup>19</sup>
- 2.15 In March 2007 the OFT launched an investigation into the fairness of certain charging terms relating to unarranged overdrafts under the Unfair Terms in Consumer Contracts Regulations (1999) (the UTCCRs). In July 2007 the OFT entered into a litigation agreement with eight PCA providers<sup>20</sup> and commenced a test case to assist in securing a clear and orderly resolution of the fairness of these charges. This case ultimately led to a Supreme Court judgment, dated 25 November 2009.<sup>21</sup> This

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<sup>18</sup> Further, as set out on page 53 of *Personal current accounts in the UK – A follow-up report*, OFT, October 2009, Bacs will gauge the effectiveness of the improvements to the switching process.

<sup>19</sup> *Personal current accounts in the UK – a follow-up report*, OFT, October 2009, paragraph 1.23.

<sup>20</sup> The eight PCA providers who were party to the litigation agreement were the Abbey National plc, Barclays Bank plc, Clydesdale Bank plc, HBOS plc, HSBC Bank plc, Lloyds TSB Bank plc, Nationwide Building Society, and the Royal Bank of Scotland Group plc.

<sup>21</sup> *Office of Fair Trading v Abbey National plc and others*  
[www.supremecourt.gov.uk/docs/uksc\\_2009\\_0070\\_judgmentV3.pdf](http://www.supremecourt.gov.uk/docs/uksc_2009_0070_judgmentV3.pdf)

judgment overturned previous High Court and Court of Appeal rulings. The Supreme Court found that unarranged overdraft charging terms cannot be assessed in full for fairness. The Supreme Court judgment established, not that the charging terms were fair and appropriate, but that the law did not in the particular circumstances of the case, allow the OFT to argue that they were unenforceable on the basis that they were too high.

2.16 Following the Supreme Court judgment, in December 2009 the OFT set out the next steps for its PCA work.<sup>22</sup> After detailed consideration of the judgment and of the various options available to it, the OFT concluded that any investigation it were to continue into the fairness of current unarranged overdraft charging terms under the UTCCRs would have a very limited scope and low prospects of success. Given this, it decided against taking forward such an investigation. The OFT nevertheless continued to have significant concerns about the operation of the market for PCAs and indicated that it would discuss these concerns and the options available to address them with banks, consumer groups and other organisations.

2.17 These discussions have taken place since January 2010.<sup>23</sup> They have focused on seeking improvements in three critical areas of concern around unarranged overdrafts:

- **control** - to give consumers greater ability to manage their finances, both for their own interests and to ensure that competition operates more effectively in the PCA market, in particular giving consumers a real choice about whether or not to have an unarranged overdraft facility

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<sup>22</sup> *Personal current accounts – unarranged overdraft charges: decision on an investigation under the UTCCRs and next steps*, December 2009 [www.offt.gov.uk/shared\\_offt/personal-current-accounts/oft1154](http://www.offt.gov.uk/shared_offt/personal-current-accounts/oft1154)

<sup>23</sup> A complete list of parties the OFT discussed these issues with is provided in Annexe A.

- **clarity and predictability** - to make charging structures more simple to understand and predict, and to make comparisons of the costs of using unarranged overdrafts between PCA providers and with other forms of short-term credit more effective, and
- **responsibility** - to ensure appropriate expectations regarding responsible lending through unarranged overdrafts, especially to customers for whom other lending arrangements might be more appropriate.

2.18 The OFT has concentrated its discussions on the major PCA providers with the largest market shares.<sup>24</sup> In total they represent over 90 per cent of the market. It has also held discussions with some smaller providers of PCA and potential new entrants to the market.<sup>25</sup> Following publication of this report, the OFT will engage with the smaller PCA providers to ensure that its concerns around unarranged overdrafts are addressed by all PCA providers.

2.19 In Northern Ireland, most PCA providers are subject to the provisions of the NI Order. The OFT is currently reviewing the NI Order. While the review is a separate and distinct project from the work that the OFT has carried out into UOCs, there is a link between the two because the NI Order contains provisions relating to UOCs. The NI Order means PCA providers in Northern Ireland start in a different position with regard to some of the identified concerns around the clarity and predictability of charges. The OFT will be engaging with PCA providers in Northern Ireland to discuss UOCs, taking account of any overlaps with the NI

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<sup>24</sup> For the purposes of this report the term 'major PCA providers' refers to Barclays PLC, HSBC Bank plc, Lloyds Banking Group plc, National Australia Group Europe, Nationwide Building Society, Royal Bank of Scotland (NatWest and RBS brands) and Santander UK plc Group.

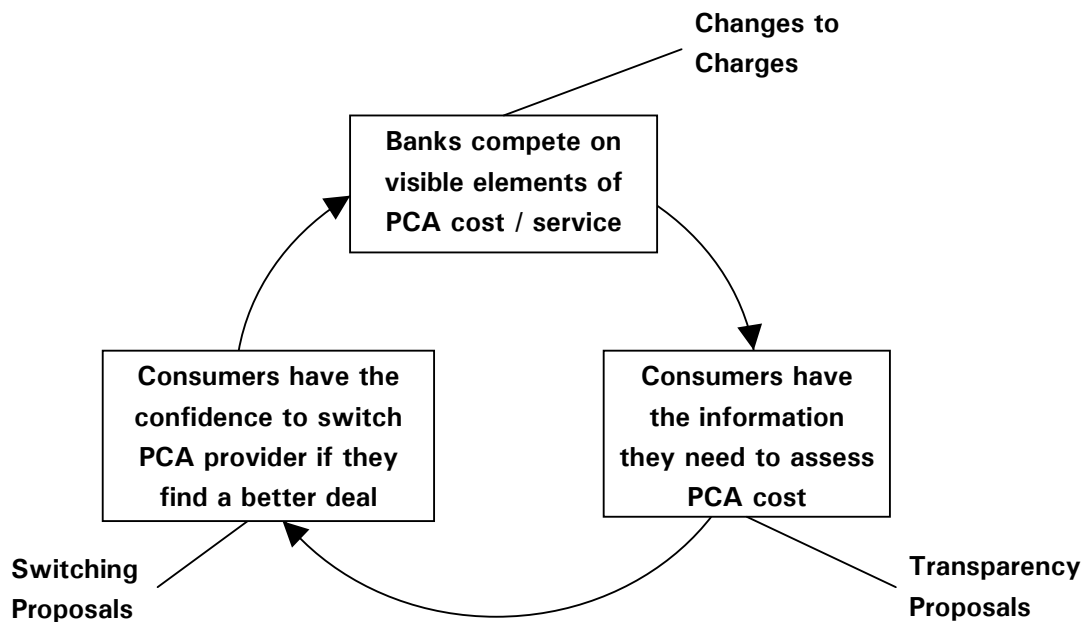
<sup>25</sup> The OFT has met with the Co-operative Bank, Norwich and Peterborough Building Society, banks operating in Northern Ireland (First Trust Bank, Bank of Ireland (Northern Ireland), Northern Bank Ltd and Ulster Bank Ltd) and two companies that have indicated that they may enter this market, Tesco Bank and Virgin Money.

Order and the developing position with respect to the review of the NI Order.

### **An effective market outcome**

2.20 By giving consumers effective control over when charges are incurred; by making them more aware of the costs of their current account; and by improving confidence in switching as a means to get better value for money, PCA providers will need to offer more competitive products and innovative services to attract custom. This is illustrated in diagram 1.<sup>26</sup>

**Diagram 1: the pro-competitive 'virtuous circle'**



2.21 In a market displaying these characteristics, more efficient firms gain market share at the expense of less efficient firms which is good for

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<sup>26</sup> This diagram is reproduced from *Personal current accounts in the UK – a follow-up report*, OFT, October 2009, page 6.

consumer welfare and, by providing pressure to reduce costs, is good for UK productivity.

## Report structure

2.22 The rest of the report is structured as follows:

- **chapter 3** sets out the OFT's concerns about the level of **control** that consumers have over their unarranged overdrafts and how these concerns will be addressed
- **chapter 4** examines the problems associated with the **clarity and predictability** of charging for unarranged overdrafts and how these concerns will be addressed
- **chapter 5** explores concerns associated with the **responsibility** of PCA providers around unarranged overdrafts and how these concerns will be addressed
- **chapter 6** sets out ways in which consumers can take **active steps** to take responsibility over their unarranged overdrafts to ensure that they can get the best value from their PCA and drive competition in the market, and
- **chapter 7** sets out the OFT's **conclusions and next steps**.

### 3 CONTROL

- 3.1 This chapter summarises the OFT's concerns regarding consumers' ability to control whether they use an unarranged overdraft or not. It sets out how the market has developed in this respect since the OFT began the market study in April 2007 and how the remaining concerns will be addressed.
- 3.2 The OFT is not a price regulator and has no power to impose price caps on bank charges or elsewhere. The OFT aims to ensure that consumers get value for money by making markets work well. Providing consumers with greater control over whether and when they use an unarranged overdraft can help consumers to get value for money from their PCAs.

#### Concerns identified in the market study

- 3.3 The market study found that consumers were not able to control easily whether, or when, they use an unarranged overdraft. This is because:
- consumers were not generally able to 'turn off' or 'opt out' of the unarranged overdraft facility, and
  - consumers were not able to easily keep a track of their account balances.
- 3.4 In a survey conducted for the market study, only seven per cent of consumers that exceeded their arranged overdraft limit said that they had chosen to do so.<sup>27</sup> The survey further found that more than half of consumers said that they would opt out of having the ability to go into unarranged overdraft through debit card transactions if they could, and over half said that they did not want a debit card transaction processed that would take their current account into unarranged overdraft.<sup>28</sup>

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<sup>27</sup> *Personal current accounts in the UK*, paragraph 4.65.

<sup>28</sup> *Personal current accounts in the UK*, paragraphs 4.96 and 4.97

Similarly, in a recent Which? survey, 46 per cent of people said that they would prefer to have a payment blocked rather than pay unarranged overdraft fees.<sup>29</sup>

3.5 The market study also found that it was difficult for consumers to keep track of their account position.<sup>30</sup> At any given time, to work out whether they have funds available, consumers need to take account of:

- their current balance
- what commitments that they have already made (for example, cheques that they have written but have not yet been cashed by the recipient and debit card transactions that have not yet been processed)
- what upcoming commitments they may have (such as Direct Debits and standing orders), and
- what payments are coming in, such as salary or benefit payments.

3.6 They also need to understand how the timing of transactions will affect their balance. This can be difficult, especially when PCA providers are not able to provide effective advice to customers. For example, research showed that 19 out of 22 PCA providers gave out wrong cheque clearance times or were unable to offer practical advice on this to consumers.<sup>31</sup> The large number of Direct Debit commitments that

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<sup>29</sup> Press release from Which? of 30 November 2009 titled 'Block payments to halt unauthorised overdrafts, say almost half of current account holders', [www.which.co.uk/about-which/press/campaign-press-releases/personal-finance/2009/11/block-payments-to-halt-unauthorised-overdrafts-say-almost-half-of-current-account-holders.jsp](http://www.which.co.uk/about-which/press/campaign-press-releases/personal-finance/2009/11/block-payments-to-halt-unauthorised-overdrafts-say-almost-half-of-current-account-holders.jsp)

<sup>30</sup> *Personal current accounts in the UK*, paragraphs 4.81 - 4.94.

<sup>31</sup> *Themed review of Cheque Clearing Cycles*, Banking Code Standards Body, May 2006 (see *Personal current accounts in the UK*, paragraphs 4.66).

consumers have further complicates the assessment of the likelihood of becoming overdrawn or exceeding their arranged overdraft limit.<sup>32</sup>

- 3.7 In a market that works well for consumers, it would be expected that consumers can choose how much of a product or service to buy and when to buy it. Consumers' lack of ability to opt out of an unarranged overdraft facility and the difficulty in controlling when they use it has two effects. Firstly, it reduces the ability of consumers to manage their finances. Secondly, consumers are unable to act as an effective competitive constraint by rejecting a service that they perceive is poor value or inappropriate, thereby reducing incentives for providers to improve their service or reduce prices.

### **Developments since the market study**

- 3.8 Since the OFT began its PCA market study in April 2007, there have been a number of developments in the PCA market that have begun to address the lack of control around unarranged overdrafts. Table 1 below summarises the changes in the level of control since the start of the OFT's market study.

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<sup>32</sup> In the UK, 14.6 million households had five or more regular direct debits commitments on their main PCA *Personal current accounts in the UK*, paragraphs 4.84.

**Table 1: Summary of developments around control since the OFT began its market study in April 2007**

	<b>April 2007</b>	<b>March 2010</b>
<b>Ability to turn off unarranged overdrafts</b>	No consumers could turn off unarranged overdrafts	Some PCA providers allow customers to effectively turn off unarranged lending. We expect other to follow suit with similar services
<b>Tracking account balances</b>	Little innovation to provide consumers with greater control	Some innovations such as text alerts, mobile phone applications and improved internet banking facilities
<b>Level of Unpaid Item Charge</b>	Average of approximately £34	Average of approximately £17
<b>Faster Payments</b>	Faster Payments not used	Vast majority of standing orders and one-off payments use the Faster Payments system

Source: Terms and Conditions of the major PCA providers, CHAPs and information supplied by the major PCA providers.

- 3.9 Consumers have had, for some time, the ability to opt out of unarranged overdrafts by choosing to have a basic bank account. However, the basic bank account may not be a suitable alternative for many consumers who value other features of a PCA that are not available with a basic bank account.<sup>33</sup>
- 3.10 At the time of writing, the OFT is aware that some PCA providers now offer consumers the ability to opt out of unarranged overdraft lending (and its equivalents) on their main PCA. This is either through switching the facility off on their existing account or choosing another account with similar features but with no unarranged overdraft.

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<sup>33</sup> As set out in the Moneymadeclear guide to basic bank accounts ([www.moneymadeclear.fsa.gov.uk/pdfs/bank\\_accounts.pdf](http://www.moneymadeclear.fsa.gov.uk/pdfs/bank_accounts.pdf)), these accounts have limited functionality such as not offering a full debit card, not being able to make standing orders and having conditions around branch, Post Office and ATM access.

- 3.11 If a customer turns their unarranged overdraft facility off and does not change their behaviour, it is more likely that items will be unpaid or returned, in which case the customer may be liable for an Unpaid Item Charge (UPIC).<sup>34</sup> Consumers will not have a real choice as to whether to switch an unarranged overdraft off if they are deterred from switching it off through higher fees for unpaid items.
- 3.12 The UPIC levels for the major PCA providers' main PCA product in April 2007 and March 2010 are shown in Table 2 below.<sup>35</sup> While the UPIC is only one of a number of PCA charges and not the only basis for choosing a provider, the OFT notes that since it began its PCA market study, there have been significant reductions in the level of UPICs for a number of the major PCA providers. Between April 2007 and March 2010, the weighted average<sup>36</sup> UPIC across the major PCA providers declined by approximately 50 per cent from about £34 to about £17.<sup>37</sup>

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<sup>34</sup> The UPIC or Returned Item Fee is an unarranged overdraft charge that is levied on any unpaid payment that, if it had been paid, would have created or extended an unarranged overdraft.

<sup>35</sup> Many PCA providers offer a range of accounts. The UPIC for other accounts (such as packaged accounts or accounts linked to other products such as mortgages or investments) may be different from the ones provided in this table. The table does not provide accurate comparisons between PCA providers as it does not take account of details of banks individual policies, such as waiving of charges.

<sup>36</sup> The average was weighted by the market share in the relevant year. It relates to the major PCA providers, who collectively accounted for over 90 per cent of all PCAs in 2007 and 2010. Where providers have a sliding scale for UPIC levels, the charge was assumed to be the highest one. PCA providers that do not charge a UPIC were included, with the charge set at £0.

<sup>37</sup> It should be noted that this fall refers to the average level of UPIC, not the total revenue earned from these charges or number of UPICs levied.

**Table 2: Unpaid item charges for the main account of major PCA providers in April 2007 and now**

	<b>UPIC in April 2007</b>	<b>UPIC in March 2010</b>
Barclays Bank plc	£35 per item	£8 per item
Halifax Bank of Scotland	£39 per item	£0 per item
HSBC Bank plc	£0 for items less than £10 £10 for items between £10 and £25 £25 for items over £25	£0 for items less than £10 £10 for items between £10 and £25 £25 for items over £25
Lloyds TSB	£35 per item	£20 per item
National Australia Group Europe (Clydesdale Bank and Yorkshire Bank)	£35 per item	£35 per item
Nationwide Building Society	£30 per item	£30 per item
Royal Bank of Scotland (RBS and NatWest brands)	£38 per item	£5 per item
Santander UK plc Group	Santander (then known as Abbey): £35 per item Alliance and Leicester £34 per item	Santander £5 for items less than £10 £15 for items between £10 and £19.99 £25 for items between £20 and £29.99 £35 for items over £30 Alliance and Leicester £0 for items less than £10 £25 for items over £10

Source: Terms and Conditions of the major PCA providers in addition to information supplied by the major PCA providers.

- 3.13 There have also been a number of developments in the PCA market which provide consumers with more accurate information to help control their use of unarranged overdrafts. A number of PCA providers have taken steps such as offering increasingly more sophisticated mobile text alerts when consumers are approaching agreed limits and other mobile applications to help consumers track their account balance. These innovations create greater awareness of the likelihood of entering into an unarranged overdraft thereby increasing the ability of customers to control whether or not they use unarranged overdrafts.
- 3.14 The OFT also notes that there has been increased use of Faster Payments across the industry so payments between bank accounts should be made within hours rather than days as had been the case previously.<sup>38</sup> The increased use of Faster Payments means that consumers can more quickly rectify a mistake by transferring money quickly to their PCA. If consumers rectify mistakes more quickly they are likely to incur less UOCs. Where consumers want to be able to rectify mistakes using their savings accounts, they should check that their savings account can send Faster Payments, in addition to their PCA being able to receive them.
- 3.15 The increased use of Faster Payments also enables consumers to better predict and track money flows into and out of their accounts, which in turn allows them to be aware of whether they are likely to incur UOCs.
- 3.16 However, Faster Payments have been introduced at varying speeds across banks meaning many consumers are still not benefiting from this new service. The availability of Faster Payments at the major PCA providers is shown in Table 3 below.<sup>39</sup> Consumers can check the UK

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<sup>38</sup> Faster Payments does not apply to Direct Debits.

<sup>39</sup> The latest information on which PCA providers provide Faster Payments can be found on the CHAPS website: [www.chapsco.co.uk/faster\\_payments/-/page/762](http://www.chapsco.co.uk/faster_payments/-/page/762)

Payments' on-line sort-code checker to see whether Faster Payments is available on their own PCA.<sup>40</sup>

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<sup>40</sup> [www.ukpayments.org.uk/sort\\_code\\_checker/](http://www.ukpayments.org.uk/sort_code_checker/)

**Table 3: Availability of Retail Faster Payments from the major PCA providers, March 2010**

Bank	One off payments		Standing orders	
	Availability	Value limit	Availability	Value limit
Alliance and Leicester (part of Santander UK plc Group)	No	-	Yes	£250
Barclays Bank plc	Yes, phone and internet	£10,000	Yes	£100,000
HSBC Bank plc	Yes, phone and internet	£10,000	No, Sept 2010	N/A
Lloyds TSB	Yes, internet	£5,000	Yes	£1,000
	Yes, phone	£500		
Halifax, Bank of Scotland	Yes, phone, branch	£1,000	Yes	£1,000
	Yes, internet	£2,500		
National Australia Group Europe (Clydesdale Bank and Yorkshire Bank)	Yes, phone and internet	£500	Yes	£25
Nationwide Building Society <sup>41</sup>	Yes, although limited phone and Internet service	£250	Yes, although limited service	£250
Royal Bank of Scotland (RBS and NatWest brands)	Yes, phone and internet	£10,000	Yes	£2,500
Santander UK plc Group	No	-	Yes	£250

Source: Information taken from [www.ukpayments.org.uk/faster\\_payments\\_service/value\\_limits/](http://www.ukpayments.org.uk/faster_payments_service/value_limits/) in addition to information supplied by the major PCA providers.

3.17 The OFT welcomes the introduction of the services described above. Taken together these developments represent a significant improvement in the level of control since the publication of the market study.

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<sup>41</sup> The limits for Nationwide Building Society are expected to be increased to £1,000 shortly.

## New developments and next steps on control

- 3.18 Since January 2010, the OFT has been discussing the concerns set out above with PCA providers. The OFT wants to achieve an outcome whereby consumers can readily control what services are used and the overall cost of using a PCA and, as a result, exercise a competitive constraint on providers.
- 3.19 Following these discussions, the major PCA providers have indicated further developments that are likely to be implemented over the next two years that will increase the ability of customers to control their use of unarranged overdrafts. In particular, the OFT considers that future developments by the major PCA providers will mean that:
- customers will have a greater **choice about whether or not to have an unarranged overdraft facility**, and
  - there will be greater access to **tools that will help customers keep track of their balances**, such as text alerts and other improved mobile and internet banking services.
- 3.20 As discussed in chapter 7, the OFT will be monitoring whether these developments take place, and will consider appropriate action if the outcomes it envisages do not happen.
- 3.21 The Lending Standards Board (LSB) has agreed to lead work to develop minimum standards to cover the operation of those PCAs that offer customers the ability to opt out<sup>42</sup> of an unarranged lending facility (or its equivalent) as well as how customers are offered a choice where a provider offers PCAs that provide unarranged lending facilities and PCAs that do not. Such standards will consider issues such as the information

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<sup>42</sup> The OFT acknowledges that this opt-out facility may not apply to certain forms of transactions such as guaranteed cheques or non-authorized (below-floor limit) debit card transactions. The important issue is that individual customers have the information required to understand what is or is not covered by any individual account.

that is provided to customers to inform them about this facility (including the operation of any default setting), how and when such information is to be provided, and any notice periods or application processes required to use the facility.

- 3.22 The LSB will develop these standards in consultation with PCA providers, industry associations, consumer representatives and the OFT. The standards will be agreed by December 2010 and will cover both those accounts which already have such a facility available at the time, and those introduced thereafter. A transitional implementation period may be agreed if, for example, the agreed standards require changes to those existing accounts that already offer the facility.<sup>43</sup> All major PCA providers and the four main PCA providers in Northern Ireland<sup>44</sup> have agreed to support this process and participation in this group will be open to all industry participants.
- 3.23 The OFT will work with the British Bankers' Association (BBA) and Building Societies Association (BSA) to ensure that other PCA providers have the opportunity to take part in the development of these standards.
- 3.24 The PCA market is constantly developing new technologies that could have an impact on the ability of consumers to exercise control over their unarranged overdraft. The OFT would like to ensure that future developments in the PCA market do not reduce this control and where possible increase it.
- 3.25 A Working Group will be established including, but not limited to, PCA providers, the Payments Council, the BBA, the BSA, the UK Cards Association, the payment card schemes, the British Retail Consortium, the OFT and consumer groups, that will explore and assess new

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<sup>43</sup> It should be noted that having these minimum standards agreed by December 2010, does not imply that all the major PCA providers will have implemented this functionality by December 2010.

<sup>44</sup> That is Bank of Ireland (Northern Ireland), First Trust Bank, Northern Bank Ltd and Ulster Bank Ltd.

systems, processes and technologies (or improvements in the use of existing systems, processes and technologies) which give consumers greater ability to access real-time information on their personal current account. This will, among other things, review approaches to floor limits and to the timing of payments. This Working Group will be ongoing and its scope will be limited to network-wide issues. Individual PCA providers will continue to be able to develop and implement their own systems. All major PCA providers and the four main PCA providers in Northern Ireland have agreed to support this process.

- 3.26 The OFT will work with the BBA and BSA to ensure that other PCA providers have an opportunity to take part in this Working Group.
- 3.27 All major PCA providers have agreed that they will, individually and collectively, respect the principle that PCA customers will have the ability to choose whether or not to use new facilities that are a result of future technological developments if those facilities further limit the customers' ability to control their use of unarranged overdrafts. PCA providers will provide information to customers about such facilities in order to allow customers to make informed decisions about whether or not to use them.
- 3.28 With respect to Faster Payments, the OFT notes that many PCA providers have already rolled this out fully across all accounts. It expects the remaining providers to fully roll out Faster Payments to higher value limits shortly in time to meet the 1 January 2012 deadline set out in the Payment Services Directive.<sup>45</sup>

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<sup>45</sup> See Countdown to Payment Services Directive, March 2009 by the Payments Council, [www.paymentscouncil.org.uk/media\\_centre/press\\_releases\\_new/-/page/579/](http://www.paymentscouncil.org.uk/media_centre/press_releases_new/-/page/579/)

## 4 CLARITY AND PREDICTABILITY

- 4.1 This chapter summarises the OFT's concerns around the clarity and predictability of charging for unarranged overdrafts. It notes the initiatives regarding transparency that PCA providers have already agreed, as well as other developments. It then sets out next steps in this area.
- 4.2 The market study found that in 2006 PCA providers' total revenue from PCAs was £8.3 billion, equating to £152 per active PCA. Of this around 30 per cent (£2.6 billion) came from UOCs.<sup>46</sup> Making charges clearer and more predictable will enable customers to make informed choices as to whether or not to incur UOCs, and assist them to make comparisons between PCA providers, improving competition on charges.

### Concerns identified in the market study

- 4.3 The market study found that consumers were not familiar with key charges associated with their account, and that consumers have difficulty making comparisons across PCA providers and with other lending products.
- 4.4 Evidence of a lack of awareness of charges was obtained from a consumer survey conducted by the OFT. This found that:
- of all consumers, 67 per cent said that they did not know what their bank charged for entering an unarranged overdraft
  - over a fifth of consumers who had been charged in the last twelve months did not know about UOCs before they incurred one, and
  - of those consumers that had been charged in the past twelve months, 25 per cent did not know what their bank charges were.<sup>47</sup>

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<sup>46</sup> *Personal current accounts in the UK*, chart 2.3

<sup>47</sup> *Personal current accounts in the UK*, paragraphs 4.74 and 4.75

- 4.5 For those customers who pay UOCs (around 23 per cent of all account holders each year), this lack of focus on costs resulted in them being poorly placed to assess their PCA's value for money and the potential gains from switching. The lack of ability to make effective comparisons across providers and products, also made it hard for them to assess value for money and act as a competitive constraint on the level of unarranged overdraft charges.

### **Developments since the market study**

- 4.6 In 2007, seven of the eight major PCA providers used charging models in which a charge was levied per transaction for using an unarranged overdraft. The average per transaction paid item charge was approximately £30, plus in some cases there was an additional monthly fee of around £25 when the unarranged overdraft was used.
- 4.7 Since 2007, many of the PCA providers have developed new charging structures for some or all of their PCA products and others have changed the level of their charges. Currently, four of the major PCA providers retain a per transaction paid item charge with a weighted average of approximately £22 (compared with an average of £30 in 2007)<sup>48</sup>. The other providers now use a mixture of daily, weekly and monthly charges. These are often easier to predict than per transaction charges, and are more likely to be proportional to the duration of the unarranged overdraft.
- 4.8 The development of new charging structures will give consumers a choice over the structure that is most appropriate for their needs. However, as charging structures become more diverse, it is important that it is still possible for consumers to be able to compare UOCs across PCA providers.
- 4.9 The OFT has worked with PCA providers and others to develop initiatives to improve the ability of all consumers to assess the costs and

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<sup>48</sup> See chapter 1 for more detail on how these figures have been calculated.

benefits of their PCA.<sup>49</sup> To improve transparency, so that customers can more easily understand the costs of their accounts and compare them with others, PCA providers agreed that they will:

- introduce an annual summary of the cost of their account for each customer
- make charges prominent on monthly statements, so that customers are more aware of the charges that they pay
- provide average credit and debit balances, which will help customers to estimate the potential benefits of switching bank, and
- produce illustrative scenarios showing charges giving customers an idea of the costs for different patterns of use.

4.10 The PCA providers have agreed that the illustrative scenarios will be available from June 2010 and the remaining information will be provided to consumers by late 2011.

4.11 A further comparative tool to assist consumers is information on how many complaints PCA providers receive, and how many of those are upheld in the complainant's favour.

4.12 By the end of August 2010, consumers will be able to see data on the level of complaints received and how they are dealt with across five broad categories by each PCA provider on their website.<sup>50</sup> The FSA will also publish consolidated data on complaints by the end of September

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<sup>49</sup> *Personal current accounts in the UK: A follow up report*, chapter 4.

<sup>50</sup> For more information on complaints handling in the financial services industry, see the joint discussion paper published by the FSA, FOS and the OFT on 11 March 2010. It outlines the roles of firms, the regulators and the ombudsman service. It covers fair complaint handling by firms, how new and emerging risks can be identified and how 'mass claims' should be handled, [www.fsa.gov.uk/pages/Library/Policy/DP/2010/10\\_01.shtml](http://www.fsa.gov.uk/pages/Library/Policy/DP/2010/10_01.shtml).

2010.<sup>51</sup> This data will build on existing complaints data already available on the FOS website<sup>52</sup> to help improve how PCA providers treat their customers and provide incentives for them to deal more effectively with complaints when they are received.

## **New developments and next steps on clarity and predictability**

- 4.13 The OFT wants to achieve an outcome in the PCA market where charges are clear and predictable, and consumers are able to make effective comparisons between PCA providers to get the best deal for themselves.
- 4.14 Following recent discussions with the major PCA providers, the OFT understands that some are developing new product propositions that will provide consumers with greater clarity and predictability around UOCs.
- 4.15 The OFT's transparency initiatives outlined above will help ensure that consumers will be able to make effective comparisons between providers through standardised scenarios, even if the underlying charging structures differ. All major PCA providers have agreed that they will continue to work with the OFT to ensure that these transparency initiatives committed to in October 2009 remain relevant as market conditions develop in order to ensure that consumers remain able to make meaningful comparisons between providers and manage their PCA. The OFT expects other PCA providers to similarly contribute to this process and participate in its outcomes.

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<sup>51</sup> FSA confirms plan for publishing information on firms' complaints handling, [www.fsa.gov.uk/pages/Library/Communication/PR/2010/018.shtml](http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/018.shtml).

<sup>52</sup> The FOS website has aggregated data on the most complained about financial products, including PCAs, and information on the number of complaints upheld. See [www.financial-ombudsman.org.uk/publications/ar09/about.html#3](http://www.financial-ombudsman.org.uk/publications/ar09/about.html#3) and [www.financial-ombudsman.org.uk/publications/ar09/dealt.html#ar4](http://www.financial-ombudsman.org.uk/publications/ar09/dealt.html#ar4). The website also has data on complaints received about individual financial institutions across broad categories of financial products, [www.ombudsman-complaints-data.org.uk/](http://www.ombudsman-complaints-data.org.uk/).

- 4.16 The OFT also announced steps to help customers understand and compare the costs of their accounts through new advice and tools, including an interest calculator, on its Consumer Direct website. In addition, the FSA is conducting a feasibility study on the introduction of a PCA comparison section on its 'Moneymadeclear' website<sup>53</sup> to help consumers understand and compare PCAs.
- 4.17 As discussed in chapter 7, the OFT will be monitoring whether PCA providers continue to develop and offer clear and predictable charging structures, and that consumers are able to make effective comparisons between PCA providers.

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<sup>53</sup> [www.moneymadeclear.fsa.gov.uk](http://www.moneymadeclear.fsa.gov.uk)

## 5 RESPONSIBILITY

- 5.1 This chapter summarises the OFT's concerns over how UOCs affect those in financial difficulty. It then sets out initiatives that the major PCA providers have voluntarily agreed to implement that will address these concerns.
- 5.2 The market study found that, while over 12.6 million accounts incurred at least one charge in 2006 and over 6.6 million paid at least £100, there were 1.4 million account customers that paid at least £500. The OFT is concerned to ensure customers who are in financial difficulty and incurring unarranged overdraft charges are treated appropriately by PCA providers.

### Concerns identified in the market study

- 5.3 The market study found that UOCs disproportionately affected consumers in households with low incomes or savings. It found that consumers with less than £1,000 in household savings were significantly more likely to have been charged for going into their unarranged overdraft in the last 12 months (48 per cent compared to 18 per cent of those with at least £1,000 in household saving).<sup>54</sup> These consumers were also more likely to have been charged for an item being refused in the last 12 months (31 per cent of those with less than £1,000 of household saving compared to 8 per cent of those with at least £1,000 household saving).<sup>55</sup> The impact of these charges can disproportionately affect these types of consumers, who are financially constrained and already facing a tight budget.
- 5.4 The publicity or previous experience of high charges may act to dissuade consumers who are currently 'unbanked' from acquiring a PCA if they believe that they will be liable for large charges. This has wider social

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<sup>54</sup> *Personal current accounts in the UK*, paragraph 4.111

<sup>55</sup> *Personal current accounts in the UK*, paragraph 4.111

implications, especially as benefits and other transfers are now largely made through the banking system.

5.5 It is important that PCA providers have effective policies in place to work with such consumers to ensure that they are using the most appropriate borrowing product according to their financial situation and that appropriate steps are taken to assist consumers in, or approaching, financial difficulty that are incurring UOCs. It is equally important that consumers are aware of these policies and can challenge PCA providers if these policies are not followed.

5.6 The OFT is aware that PCA providers have in place a range of procedures to deal with consumers in financial difficulty. Section 9 of the Lending Code sets out minimum standards of good practice for dealing with consumers with financial difficulties.<sup>56</sup> Many PCA providers have dedicated departments dealing with consumers in financial difficulty and have policies to waive or cap charges in certain circumstances. Most of the PCA providers have good elements to their policies. However, there is a great deal of variation in them, and a number of consumer groups have voiced concerns over their effectiveness.

5.7 The OFT has also heard concerns around the operation of basic bank accounts. These include:

- obtaining a basic bank account is not straightforward and in some instances providers have sought to steer consumers towards full PCAs that the customer may not want or may not be appropriate
- some basic bank accounts only allow limited ATM withdrawals,<sup>57</sup> and

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<sup>56</sup> [www.lendingstandardsboard.org.uk/docs/lendingcode.pdf](http://www.lendingstandardsboard.org.uk/docs/lendingcode.pdf)

<sup>57</sup> Details of the different features and limitations can be seen on the Moneymadeclear guide to basic bank accounts, [www.moneymadeclear.fsa.gov.uk/pdfs/bank\\_accounts.pdf](http://www.moneymadeclear.fsa.gov.uk/pdfs/bank_accounts.pdf)

- customers face UIPCs on some basic bank accounts that are no different from full PCAs.

5.8 These concerns suggest that the basic bank account is not operating as effectively as it might.

### **Next steps on responsibility**

5.9 Since January 2010, the OFT has been discussing the above concerns with PCA providers. The OFT is aware that this is an area where there are broader concerns around how consumers in financial difficulty are dealt with (not just those incurring UOCs) and how lending is conducted.<sup>58</sup> It has also discussed these issues with a number of other stakeholders, including:

- the FSA, which is responsible for, amongst other things, Banking Conduct of Business sourcebook (BCOBS), Treating Customers Fairly (TCF), the MoneyMadedclear website, and publishing complaints data<sup>59</sup>
- the LSB, which oversees the Lending Code covering good practice in relation to loans, credit cards and current account overdrafts<sup>60</sup>
- the Financial Ombudsman Service (FOS), which settles individual complaints between consumers and businesses providing financial services,<sup>61</sup> and

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<sup>58</sup> The OFT aims to publish guidance on irresponsible lending, in relation to its supervision of the consumer credit market and monitoring of fitness to hold a consumer credit licence, in March 2010. [www.oft.gov.uk/advice\\_and\\_resources/resource\\_base/legal/cca/irresponsible](http://www.oft.gov.uk/advice_and_resources/resource_base/legal/cca/irresponsible).

<sup>59</sup> [www.fsa.gov.uk/](http://www.fsa.gov.uk/)

<sup>60</sup> The Lending Standards Board is the successor organisation to the Banking Code Standards Board and began its work on 2 November 2009. [www.lendingstandardsboard.org.uk/](http://www.lendingstandardsboard.org.uk/)

<sup>61</sup> Information on how to complain to the financial ombudsman is available at [www.financial-ombudsman.org.uk/consumer/complaints.htm](http://www.financial-ombudsman.org.uk/consumer/complaints.htm).

- Consumer Focus which has undertaken advocacy on behalf of consumers in this area, especially on issues around financial inclusion.<sup>62</sup>
- 5.10 These discussions have explored a range of issues (not just unarranged overdrafts) to take into account wider initiatives in this area. However, for the purposes of next steps, the OFT's focus has been on responsibility in relation to UOCs.
- 5.11 The OFT wants to achieve an outcome in the PCA market where banks have in place adequate safeguards to deal with consumers who are repeatedly incurring UOCs to ensure that they do not get into further financial difficulty as a result of incurring them and are able to access lending products most appropriate to their financial situation.
- 5.12 All major PCA providers and the four main providers in Northern Ireland have agreed to develop (in partnership with other relevant stakeholders) best practice guidance for PCA providers dealing with PCA customers in (or at significant risk of being in) financial difficulty who incur UOCs (or their equivalents). A Working Group will be set up to develop this guidance, initially facilitated by the OFT, and will take into account relevant existing rules, initiatives and guidance in this area. The OFT expects this Working Group to include, among others, the PCA providers, representatives from relevant trade associations, the FSA, the LSB, the Financial Inclusion Task Force, the OFT and consumer groups. As a first step in the process, the OFT expects the Working Group to report within three months, in broad terms, what the best practice guidance will cover, how it will be developed, who will develop it and by when it will be produced.
- 5.13 All major PCA providers have agreed to publish on their own websites within six months a description of their existing policies for dealing with

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<sup>62</sup> An example of the work of Consumer Focus is its report on providing alternative banking solutions for low-income consumers at the Post Office which is available at [www.consumerfocus.org.uk/assets/1/files/2009/06/Opportunity-knocks-web1.pdf](http://www.consumerfocus.org.uk/assets/1/files/2009/06/Opportunity-knocks-web1.pdf)

consumers in financial difficulty who incur UOCs or unpaid item charges (or their equivalents). The Working Group may, if this were to be considered useful, provide guidance on the types and scope of documents to be published.

- 5.14 Having these policies easily available to consumers, should mean that expectations over how they will be treated will be better aligned to actual practice. It will also allow consumers to challenge banks to ensure that they comply with their own policies.
- 5.15 The OFT will continue to work with stakeholders to assess concerns about basic bank accounts to the extent that they are relevant to its mission of making markets work well for consumers.

## **6 ACTIVE CONSUMERS**

6.1 This chapter explains how consumers can help themselves by shopping around for the most suitable PCA and by managing their PCA better. By doing so those consumers will, in turn, also drive competition by creating an incentive for PCA providers to improve their products and reduce prices.

### **Context**

6.2 The market study noted that consumers faced a number of inherent difficulties in managing their unarranged overdraft and PCA more generally.<sup>63</sup> The previous chapters have outlined some developments around unarranged overdrafts that have already happened and further developments that are expected in future.

6.3 As the choice of charging structures for PCAs increases, it is all the more important for consumers to assess their options and choose the most suitable PCA. There may be significant financial benefits in shifting to an alternative product from the same provider or moving to another provider altogether. Consumers will also need to keep their decisions under review.

6.4 Just as with other goods and services, it is also important that consumers use their PCAs effectively to get the best value from them. Much of this is about basic financial budgeting, but it also requires understanding of the facilities offered by a PCA and how to make best use of them, and considering whether other financial products may be better in some circumstances.

### **Shopping around for a PCA**

6.5 Consumers can provide a strong competitive constraint on PCA providers by switching their account if they are dissatisfied with the service they

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<sup>63</sup> *Personal current accounts in the UK*, chapter 4.

receive or the charges levied. By doing so, this creates incentives for providers to improve their offering, whilst at the same time rewarding those providers that offer innovative services that meet consumers' needs.

6.6 The transparency initiatives announced in October 2009 should help consumers to 'shop around' for PCAs. In particular:

- the **illustrative scenarios showing unarranged overdraft charges** will give consumers an idea of the costs of unarranged overdrafts for different patterns of use. While they will not enable consumers directly to identify the PCA that is the best for them (given the sensitivity of charges to specific patterns of usage), they will enable some initial comparisons between providers that are likely to be of help to consumers, and
- the **annual summary of the cost of their account** for each customer will help them to focus on the value they are getting (in a similar way to annual car or house insurance renewal quotes) and will provide customer specific information that can help them assess the suitability of different PCAs for them.

6.7 The OFT also introduced a number of tools designed to inform consumers about PCAs and help them make better decisions about which products to use. These tools, which can be found on the Consumer Direct website,<sup>64</sup> are:

- a page of advice on PCAs covering what they are, what they do, and what to look out for
- a list of key questions that consumers should ask of PCA providers before taking out a PCA including questions on the benefits that a PCA offers and the key costs of the PCA

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<sup>64</sup> [www.consumerdirect.gov.uk/before\\_you\\_buy/money\\_and\\_credit/Currentaccounts/](http://www.consumerdirect.gov.uk/before_you_buy/money_and_credit/Currentaccounts/)

- a comparison sheet of key PCA features which allows consumers to make a note of the key features of as many PCAs as they want to compare, so that they can choose the right PCA for their needs, and
- an on-line calculator of credit interest which allows consumers to compare the amount of interest they are currently earning to the amount of interest that they could be earning with a different account.

6.8 There is also an important role for other sources of information and comparisons. As with other goods and services, there are comparison websites (provided by consumer bodies and businesses) offering consumers help in choosing PCAs. The national press also carries regular comparison tables.

6.9 In addition, the FSA is conducting a feasibility study on the introduction of a PCA comparison section on its 'Moneymadeclear' website to help consumers understand and compare PCAs.

## **Managing PCAs**

6.10 Consumers will benefit if they manage their PCAs actively and carefully. One important element for many consumers is sensible budgeting. There are many useful websites that can help consumers get started, for example:

- the FSA's Moneymadeclear pages<sup>65</sup>
- debt counselling services such as Citizens Advice<sup>66</sup> or the National Debtline<sup>67</sup>

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<sup>65</sup> [www.moneymadeclear.fsa.gov.uk/guides/everyday/managing\\_your\\_money.html](http://www.moneymadeclear.fsa.gov.uk/guides/everyday/managing_your_money.html)

<sup>66</sup> [www.citizensadvice.org.uk/](http://www.citizensadvice.org.uk/)

<sup>67</sup> [www.nationaldebtline.co.uk/](http://www.nationaldebtline.co.uk/)

- the BBA's consumer information webpages<sup>68</sup>, and
- other third party comparison websites.

Some agencies also provide services in person and over the telephone.

- 6.11 Keeping a check on their balance is also important for consumers. It is important for consumers to remember that transactions (including debit card transactions) do not generally appear on their accounts immediately. Consumers do not yet have complete real-time information over their account balances, but there is an increasing number of channels through which account balances can be checked, and (as discussed in chapter 3) PCA providers are moving towards providing greater access to tools (such as text alerts and other improved mobile and internet banking services) that will help customers keep track of their account balances.
- 6.12 If consumers are having trouble managing their money, or think that on a short term basis they are likely to be in a position where they have insufficient funds, it is generally best for them to contact their PCA provider. Speaking to the PCA provider is particularly important for consumers in financial difficulty, or in danger of being in this position. Seeking early advice can also be particularly helpful and there are a number of organisations that provide free independent help and advice.<sup>69</sup> As the previous chapter has detailed, PCA providers will be working to develop minimum standards around how to address consumers in or approaching financial difficulty who incur unarranged overdrafts. The PCA provider may be able to offer options for borrowing money or be able to provide practical assistance or sources of information about how to manage money. In some cases simple things

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<sup>68</sup> [www.bba.org.uk/bba/jsp/polopoly.jsp?d=260](http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=260)

<sup>69</sup> A list of relevant organisations can be found on the OFT Information Sheets on arrears and defaults: [www.of.gov.uk/shared\\_of/consumer\\_leaflets/credit/OFT965b.pdf](http://www.of.gov.uk/shared_of/consumer_leaflets/credit/OFT965b.pdf)

like rearranging the timing of Direct Debits to be paid shortly after (rather than before) monthly salary payments can be helpful.

### **Using an unarranged overdraft**

- 6.13 An unarranged overdraft facility can be a convenient mechanism for accessing credit at short notice. However, it may not always be the most appropriate method of borrowing available. Other options that may be available include arranging an overdraft (or an extension to an existing arranged overdraft facility), using a credit card or taking out a loan. These will not be appropriate for everyone or in all circumstances, but it is helpful for consumers to consider their options.
- 6.14 Increasingly, it will be possible to opt out of unarranged overdrafts.<sup>70</sup> By opting out of the unarranged overdraft facility, consumers make an active decision for the bank not to pay certain transactions, even if a request is made. Clearly, this may greatly help consumers who do not wish to use an unarranged overdraft. However, consumers need to consider the possibility that they may face subsequent charges from firms that they had agreed to pay as a result of the bank not paying certain transactions, for example Direct Debits to utility companies.

### **Next steps**

- 6.15 The market study highlighted a number of reasons why consumers found it inherently difficult to manage their unarranged overdraft effectively. Consumers only had limited ability to opt out of unarranged overdrafts, were not able to make effective comparisons between providers, and found it difficult to track their balance.
- 6.16 As previous chapters have set out, there have been a number of developments in the PCA market that have improved the ability of consumers to manage their unarranged overdrafts and PCA finances

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<sup>70</sup> There may initially be some transactions for which this may not be possible.

generally to exert competitive pressure on PCA providers. The OFT expects the market to continue to develop such tools.

- 6.17 However, to get the best out of their personal finances, consumers need to select their PCA carefully and then manage their account effectively. Many of these new tools will help them do so. By taking active steps in managing their own money, consumers can, in turn, help drive the virtuous pro-competitive circle.

## **7 CONCLUSIONS AND NEXT STEPS**

7.1 Following its discussions with PCA providers and others the OFT has been considering whether market-driven changes will deliver improvements in competition and efficiency, or whether other intervention will be required. This chapter sets out its assessment of the:

- developments that have happened and are anticipated
- the arguments for and against recommending regulation
- future monitoring and review, and
- the timetable for further steps.

### **Developments and future changes**

7.2 Since 2007 the PCA market has seen a number of significant changes which have benefited consumers. These changes include:

- a diversity of charging structures for unarranged overdrafts has emerged, which creates the opportunity to meet the needs of different types of consumers in different ways
- there has been a general trend away from transaction-based charges towards other forms of charging that are often more predictable
- UPICs across the major PCA providers have fallen from an average of around £34 in 2007 to around £17 in 2010
- per transaction paid item charges have fallen from an average of around £30 in 2007 to around £22 (for those that still use this form of charging) in 2010
- some PCA providers have introduced the ability to 'turn off' or 'opt out of' unarranged lending so that some or all of their customers can exercise control over whether or not they use the facility

- new tools have been introduced to help consumers better manage their accounts, such as mobile text alerts, mobile applications to manage account balances, and improved internet banking, and
- the majority of PCA providers now use Faster Payments for standing orders and one-off payments.

7.3 New entrants to the banking market, including Virgin Money and Tesco Bank, have the potential to stimulate competition by providing new products and innovative services, further benefiting consumers.

7.4 In addition to these developments, the OFT agreed a number of initiatives in October 2009 that will make costs for PCAs more transparent and the switching process more reliable and trusted:

- to increase transparency, PCA providers agreed to provide **enhanced information on PCA costs** and to provide **illustrative scenarios** showing unarranged overdraft costs, and
- to address concerns about switching, the OFT worked with the industry group Bacs to provide measures to **increase consumer awareness of the switching process** and **reduce the number and impact of problems that arise with the transferring of Direct Debits**.

7.5 The transparency initiatives will start to be implemented from June 2010 with the remaining information provided to consumers by late 2011. The switching improvements have been implemented. As a result of these initiatives, the OFT expects consumers will be better able to estimate the benefits of switching PCA provider and be more willing to switch, thereby increasing competition between PCA providers.

7.6 Following the October 2009 update report and the Supreme Court decision, the OFT has discussed its concerns regarding UOCs with PCA providers. The OFT has been able to agree a number of initiatives with PCA providers and others in addition to observing how the banks plan to continue the significant changes listed above.

7.7 The discussions that the OFT has had with the major PCA providers indicate that there are likely to be significant developments over the next two years that will address the OFT's concerns regarding **control**. In particular, the OFT has been told that major PCA providers are planning to implement changes that will give:

- customers a greater **choice about whether or not to have an unarranged overdraft facility**, and
- greater access to **tools that will help customers keep track of their balances**, such as text alerts and other improved mobile and internet banking services.

7.8 These developments will be supported by cross industry initiatives. As a result of the recent discussions it has been agreed that:

- the LSB will lead work to develop **minimum standards** to cover how consumers are offered the ability to opt out of an unarranged overdraft facility, and
- an industry Working Group will explore **ways to give consumers greater control** and access to real-time information.

7.9 On **clarity and predictability**, the OFT expects some PCA providers to introduce further new products that provide consumers with greater clarity and predictability around unarranged overdraft charges, including in some cases a shift away from charges based on transactions towards other forms of charging. The major PCA providers have also agreed that they will continue to work with the OFT to ensure that the **transparency initiatives** committed to in October 2009 remain relevant in order to ensure that consumers continue to be able to make meaningful comparisons between PCA providers.

7.10 To address the OFT's concerns regarding **responsibility**, in particular how banks deal with customers in financial difficulty as a result of unarranged overdraft charges, the major PCA providers have agreed:

- to **publish their existing policies** for dealing with consumers in financial difficulty who incur UOCs (or their equivalents), and
- develop, in partnership with relevant stakeholders,<sup>71</sup> **best practice guidance** for how PCA providers deal with consumers in (or at significant risk of being in) financial difficulty who incur UOCs.

## Regulation

- 7.11 The changes in the PCA market since 2007 and the changes that the OFT expects banks to implement in the coming two years, along with the measures agreed with PCA providers in October 2009 and March 2010, will together lead to a substantial improvement in the way that the PCA market works.
- 7.12 Given the significant developments underway, the OFT considers that a market-based approach with banks competing to find the best way of addressing the needs of their customers is likely to be preferable to a regulatory 'one size fits all' approach. As a result, the OFT is not recommending legislative change at the present time.

## Future monitoring and review

- 7.13 The OFT will actively monitor the PCA market to ensure that there is movement towards an equilibrium that works well for consumers. In particular, the OFT will look at:
- the choice of charging structures (or models) of PCAs available to customers
  - the level of unarranged overdraft charges, especially the UPIC
  - the options available for customers that do not want access to unarranged overdraft facilities, and

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<sup>71</sup> This is likely to include, among others, the Financial Services Authority, the Lending Standards Board, the Financial Inclusion Task Force, the OFT and consumer groups

- with the FSA and the FOS as appropriate, the treatment of customers who find themselves in financial difficulty related to UOCs.

7.14 If, over the next two years, the types of initiatives that PCA providers have indicated that they plan to introduce do not materialise then the OFT will reconsider whether further intervention, including legislation, is required. Unless further action appears appropriate sooner, the OFT expects to review the market, and the impact of the range of initiatives introduced following the 2008 market study, in around 2012.

7.15 The OFT will also be undertaking a short piece of work looking at barriers to entry to consider whether there are any obstacles to entrants providing a competitive stimulus.

**Table 4: Summary of the next steps for the OFT's work on the PCA market**

	June 2010	End 2010	End 2011	2012
<b>Control</b>	Working group established to explore ways to give consumers greater control and access to real-time information	Minimum standards agreed to cover how consumers are offered the ability to opt out of unarranged overdraft facilities		The OFT undertakes review of the PCA market
<b>Transparency</b>	Illustrative scenarios will be available from PCA providers websites		Annual summaries and improved monthly statements provided	
<b>Switching</b>	Bacs continue to work towards fewer errors in switching process	Bacs undertake survey to assess effectiveness of switching work		
<b>Responsibility</b>	Working group established to develop best practice for PCA providers in dealing with customers in (or at significant risk of being in) financial difficulty who incur unarranged overdraft	Major PCA providers publish on their own websites a description of their existing policies for dealing with consumers in financial difficulty who incur unarranged overdraft		

	<b>June 2010</b>	<b>End 2010</b>	<b>End 2011</b>	<b>2012</b>
	charges sets out framework for the guidance.	charges or unpaid item charges (or their equivalents) – to be complete by September 2010.		

## **A PARTIES CONSULTED**

Bank of Ireland (Northern Ireland)

Barclays PLC

Bob Egerton

British Bankers' Association

British Retail Consortium

Building Societies Association

Citizens Advice

Consumer Action Group

Consumer Council for Northern Ireland

Consumer Focus

The Co-operative Bank

Financial Ombudsman Service

Financial Services Authority

First Trust Bank

Financial Services Consumer Panel

HSBC Bank plc

Legal Beagles

Lending Standards Board

Lloyds Banking Group plc

MasterCard Europe S.p.r.l

Money Saving Expert.com

National Australia Group Europe

Nationwide Building Society

Northern Bank Ltd

Norwich and Peterborough Building Society

Payments Council

Royal Bank of Scotland (NatWest and RBS brands)

Santander UK plc Group

Tesco Bank

Ulster Bank Ltd

Virgin Money

Visa Europe

Which?