

Evaluating the impact of the 2008 OFT market study and UTCCR test case into personal current accounts

Prepared by the Office of Fair Trading

January 2013

OFT1005eval

© **Crown copyright 2013**

You may reuse this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit www.nationalarchives.gov.uk/doc/open-government-licence or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Any enquiries regarding this publication should be sent to us at: Marketing, Office of Fair Trading, Fleetbank House, 2-6 Salisbury Square, London EC4Y 8JX, or email: marketing@oft.gsi.gov.uk.

This publication is also available from our website at: www.oft.gov.uk.

CONTENTS

<i>Chapter/Annexe</i>	<i>Page</i>
1 Executive summary	4
2 Introduction	8
3 Evidence of impact	14
4 Benefits assessment	55

1 EXECUTIVE SUMMARY

- 1.1 The Office of Fair Trading (OFT) is committed¹ to commission an independent evaluation of the impact of at least one of its previous interventions each year. Evaluations support the OFT's external accountability by assessing whether the OFT has delivered its objectives cost-effectively. The OFT also relies on findings from such evaluations to learn lessons that can be applied to future comparable market interventions.
- 1.2 To fulfil this commitment for the financial year 2012-2013, the OFT has evaluated the impact of the OFT's 2008 market study and UTCCR test case work into Personal Current Accounts ('PCAs') in the UK. The evaluation has been carried out internally by OFT staff and independently reviewed by Professor Stephen Davies, academic advisor to the OFT.
- 1.3 The evaluation focuses on the impact of the OFT's recommendations on switching, transparency and unarranged overdraft charges ('UOCs') following the market study. It also considers the impact of the OFT's investigation into the fairness of PCA unarranged overdraft charging terms under the Unfair Terms in Consumer Contract Regulations 1999 (UTCCR) (the 'Test Case').
- 1.4 The evaluation relies primarily on PCA providers' data, desk-based research and on a consumer survey conducted by IFF in September 2012.
- 1.5 Where feasible it estimates the benefits to consumers that have arisen as a result of these interventions.
- 1.6 Overall, the success of the OFT's recommendations in the PCA market is mixed so far. The OFT's work appears to have had a very substantial

¹ The Business Plan 2011-15, adopted as part of the SR10 settlement, commits the OFT to commission an independent evaluation of the impact of at least one of its previous interventions each year.

impact in lowering unarranged overdraft charges, resulting in significant estimated consumer benefits. On the other hand, the recommendations on switching and transparency appear to have had less impact to date. They are unlikely to have significantly improved competition in the PCA market, though there are some positive signs.

- 1.7 The overall impact of the OFT's recommendations on switching appear to have been fairly modest so far. There has been an increase in the use of automatic switching services and a reduction in the Direct Debit error rate, suggesting there may be some positive impact. However, our consumer survey indicates that some problems with switching still arise. Importantly, PCA holders' perception of the switching process has not significantly improved. Consequently, the lack of confidence in the switching process is still likely to be a major impediment to effective competition.
- 1.8 Access and control for PCA holders has improved since 2008 with the roll-out of various online, mobile or text alert services. However, very few PCA providers offer consumers the ability to opt out of unarranged lending with non-fee carrying personal current accounts.
- 1.9 The implementation of the OFT's recommendations on transparency has been slow. Annual summaries have not yet been fully rolled out by PCA providers and enhanced monthly statements have only recently been rolled out. There are early indications from the consumer survey that this information may improve understanding and decision-making and enable consumers to save money but the slow progress in roll-out means the impact has been limited to date.
- 1.10 In light of this evidence, it appears unlikely that the OFT's switching and transparency recommendations have had significant impact so far on competition and hence on overall market prices and PCA core offerings, although as noted some of these recommendations have only recently been implemented.
- 1.11 There has been a substantial reduction in unarranged overdraft charges. Unpaid item charges ('UPICs'), incurred when a PCA provider rejects a

customer's attempt to exceed his arranged overdraft limit, have fallen in value by more than two-thirds. Charges for unarranged lending have also fallen by at least a quarter.

- 1.12 We estimate total annual consumer benefits of £652 million from the reduction in UPICs. We also estimate additional benefits from the reduction in charges when unarranged lending is provided to be at least £276 million. This suggests that consumer benefits from the decline in UOCs are at least £928 million (in 2011 prices), and could be significantly higher. However, at the same time as the decline in UPICs and unarranged lending charges, PCA providers' revenues from arranged lending charges have increased by £432 million and revenues from debit interest increased by £107 million. It is possible that some of this increase is because the reduction in UOCs has caused PCA providers to raise the costs of arranged lending. To the extent that this is the case it could be argued that the increased arranged lending charges should be netted off against the consumer benefits from the decline in UOCs to get an overall consumer benefits figure.
- 1.13 We therefore estimate that total annual consumer benefits are in the range between £388 million to £928 million (in 2011 prices). We think that annual consumer benefits are more likely towards the upper end of this range. This is both because we consider it unlikely that the entire increase in PCA providers' arranged lending revenues is due to the reduction in UOCs and because our approach in estimating this range makes a number of conservative assumptions.²
- 1.14 The work of the FSA and media pressure created by consumer groups are likely to have contributed to the decline in unarranged overdraft charges we observe. We therefore attribute only two-thirds of the estimated annual consumer benefits to the OFT. This results in benefits attributable to the OFT of between £259 million and £619 million.

² For example, PCA providers' revenues from unarranged lending have fallen by £395 million however, we conservatively attributed only £276 million to the OFT's intervention.

1.15 Evidence from the OFT indicates that the total direct cost of the OFT of undertaking its Market Study, Test Case and follow up work was in the order of £3.8 million between 2007 and 2011 (in 2011 prices).

2 INTRODUCTION

- 2.1 The Business Plan 2011-15, adopted as part of the SR10 settlement, commits the OFT to commission an independent evaluation of the impact of at least one of its previous interventions each year. Evaluations support the OFT's external accountability by assessing whether the OFT has delivered its objectives cost-effectively. The OFT also relies on findings from such evaluations to learn lessons that can be applied to future comparable market interventions.
- 2.2 To fulfil this commitment for the financial year 2012-2013, the OFT has evaluated the impact of the OFT's 2008 market study and Test Case work into Personal Current Accounts ('PCAs') in the UK. The evaluation has been carried out internally by OFT staff and independently reviewed by Professor Stephen Davies³, academic advisor to the OFT.

Scope of the evaluation

- 2.3 The evaluation focuses on the impact of the OFT's recommendations and follow-up work on unarranged overdraft charge ('UOCs'), switching and transparency following the market study and the investigation into the fairness of PCA unarranged overdraft charging terms under the Unfair Terms in Consumer Contract Regulations 1999 ('UTCCR') (the 'Test Case'). It attempts to estimate where feasible the benefits to consumers that have arisen as a result.

The OFT's recommendations

- 2.4 The OFT concluded that the PCA market as a whole was not working well for consumers⁴: a combination of complexity and a lack of

³ Stephen Davies is Professor of Economics at University of East Anglia (UEA) and a co-founder of the ESRC Centre for Competition Policy at UEA. His research focuses on Industrial Organisation and Competition Economics.

⁴*Personal Current Accounts in the UK*, July 2008, OFT1005, page 2.

transparency meant that consumers and competition were focused almost exclusively on more visible fees, and not on the less visible elements such as insufficient funds charges and forgone interest – despite the fact that these made up the vast bulk of PCA providers’ revenues. For UOCs, this effect was exacerbated by a lack of simple mechanisms for consumers to control, or opt out of, an unarranged overdraft. Furthermore, a significant proportion of consumers believed that it is complex and risky to switch accounts, with the result that switching rates were very low.

- 2.5 The OFT pursued a separate investigation into the fairness of PCA unarranged overdraft charging terms under the Unfair Terms in Consumer Contract Regulations 1999 ('UTCCR') (the 'Test Case'). The Test Case started in March 2007 and ended in November 2009 with a final Supreme Court judgement ruling that unarranged overdraft charging terms are not assessable in full under the UTCCRs.⁵
- 2.6 There were discussions between the OFT and the PCA providers regarding changes to UOC levels and structures in parallel with and after the Test Case. At the time of the Test Case there was also significant press coverage which led to increased consumer awareness of UOCs. The evaluation considers the effect of these follow-on actions and impacts in addition to the other recommendations that directly followed the market study.
- 2.7 Following the Test Case ruling the OFT worked with the industry to agree a range of commitments relating to **UOCs** including:⁶
- the development of minimum standards to cover how consumers are offered the ability to opt out of unarranged overdraft facilities

⁵ Prior to the Supreme Court judgement an initial High Court ruling in April 2008 and a Court of Appeal ruling in February 2009 ruled that overdraft charging terms for PCAs could be assessed for fairness. For a timeline and further information see www.offt.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-completed/UTCCRs

⁶ *Personal current accounts in the UK, Unarranged overdrafts*, March 2010, OFT1216.

- 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.

2.8 To improve the process and perception of **switching**, the OFT worked with Bacs' Switching Working Group and the following improvements have been introduced:⁷

- 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.

2.9 To increase **transparency** of charges and interest rates, most PCA providers agreed to:⁸

- provide enhanced monthly information

⁷ *Personal Current Accounts in the UK: A follow up report*, October 2009, OFT1123, page 9 and *Personal Current Accounts in the UK: Progress update*, September 2010, OFT1275, page 13.

⁸ *Personal Current Accounts in the UK, A follow up report*, October 2009, OFT1123: With the exception of certain aspects of the enhanced monthly information, PCA providers representing 90 per cent of the PCA market have agreed to implement these initiatives.

- provide consumers with an annual summary of the cost of their PCA
- provide information on average credit and average debit balances⁹
- provide illustrative scenarios showing unarranged overdraft costs.

2.10 The OFT also took steps to help consumers understand and compare the costs of PCAs through new advice and tools on the Consumer Direct website. Furthermore, the OFT encouraged the creation of a price comparison website which subsequently has been launched by the Money Advice Service.¹⁰

Analytical framework

2.11 For each set of OFT recommendations (UOCs, switching and transparency) the evaluation considers the following elements:

- The **original objectives** of the recommendations and the extent to which these can be defined in specific/measurable terms.
- The **implementation** of specific actions in response to the OFT's market study recommendations, including the timing of legislative and other changes and the agencies/organisations responsible for undertaking these activities.
- The **awareness** of PCA holders of some of these actions and subsequent effect on their attitudes and **behaviour**.
- The **outcomes** (both intermediate and final) that the OFT expected to result from the market study, including consumer impacts and any unintended consequences.

⁹ Average credit and debit balances could be included either in the annual summary or enhanced monthly statements.

¹⁰ For more details see *Review of the personal current accounts market*, January 2013.

2.12 Our overall methodology follows a ‘before-and-after’ comparison, looking at the changes that have occurred between 2007 and 2011. Where possible we have also considered the evolution of variables year by year because of the additional insights this analysis offers. We have considered in more detail whether this approach provides the appropriate counterfactual when estimating consumer benefits attributable to the OFT in Chapter 4.

Evidence

2.13 The evaluation involved a mix of primary and secondary research including:

- **Desk-based research** – The OFT undertook desk based economic research to seek evidence on the evolution of the market for Personal Current Accounts.
- **Consumer survey** – As part of the PCA review the OFT commissioned IFF to conduct a representative survey of 1,752 PCA holders in the UK. IFF gathered information on switching, transparency and unauthorised overdraft charges. The consumer survey was designed primarily to provide evidence on the current conditions of the PCA market. However, where possible we ensured there was comparability with the 2008 market study consumer survey.
- **Information from PCA providers and industry** – As part of the PCA review the OFT asked PCA providers and industry bodies like payment provider Bacs to provide information on the market situation and implementation of OFT’s recommendations.

Structure of this report

2.14 The remainder of this report presents the findings of the evaluation. It is structured as follows:

- Chapter 3 first assembles and presents the qualitative and quantitative evidence necessary to evaluate the effect of the OFT's interventions on the PCA market.
- Chapter 4 presents monetary estimates of impact.

3 EVIDENCE OF IMPACT

- 3.1 This chapter assembles and presents the qualitative and quantitative evidence necessary to evaluate the effect of the OFT's interventions on the PCA market.

Unauthorised overdraft charges

Background

- 3.2 Unauthorised Overdraft Charges ('UOCs') are charges levied by the PCA provider when a PCA holder makes a Relevant Instruction. A Relevant Instruction is defined as an instruction to a PCA provider to make a payment, where this payment is not covered by sufficient funds in the customer's account or arranged overdraft. A Relevant Instruction can result either in a decline of the payment or the customer going into an unarranged overdraft, depending on whether the PCA provider decides whether or not to honour the instruction.
- 3.3 Where a Relevant Instruction is declined, the PCA provider will charge an Unpaid Item Fee ('UPIC'). When a Relevant Instruction is honoured, the PCA provider will provide the customer with unarranged lending. The charging structures for unarranged lending are complex and can involve transaction fees known as Paid Item Charges ('PICs'), periodic fees known as Maintenance Charges and interest rates.
- 3.4 Relevant Instructions are often not the result of a genuine customer choice. For example, a customer might not have perfect knowledge or control over the funds in his or her account at any point in time. Therefore, the customer cannot always be said to choose consciously to pay UOCs.
- 3.5 The OFT's market study found that there was complexity in the way that UOCs were implemented, which made it hard for consumers to understand, predict and control when they would be charged. Coupled with a lack of mechanisms for consumers to exercise control or opt out

of situations which incurred these charges, this meant that many consumers were incurring a large number of charges.

- 3.6 At the time of the OFT's market study UOCs constituted a significant financial burden levied on customers. For example, in 2007 the average nominal UPIC was £34.¹¹
- 3.7 The OFT opened an investigation into the fairness of UOCs under the UTCCRs in March 2007 which complemented the market study into PCAs. A litigation agreement with eight PCA providers¹² was entered into in July 2007 and a test case ('the Test Case') commenced to assist in securing a clear and orderly resolution of the fairness of these charges. The Test Case started in March 2007 and ended in November 2009 with a final Supreme Court judgement ruling that unarranged overdraft charging terms are not assessable in full under the UTCCRs.¹³
- 3.8 Following the 'Test Case' the OFT worked with the industry to agree a range of commitments relating to UOCs to improve the market situation. These recommendations included:
- The development of **minimum standards to cover how consumers are offered the ability to opt out** of unarranged overdraft facilities.
 - The OFT wanted consumers to be given **greater control** as to whether they enter into unarranged overdraft.¹⁴ As part of this the

¹¹ Nominal charge based on PCA providers representing over 90 per cent of the market.

¹² 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.

¹³ Prior to the Supreme Court judgement an initial High Court ruling in April 2008 and a Court of Appeal ruling in February 2009 ruled that overdraft charging terms for PCAs could be assessed for fairness. For a timeline and further information see www.of.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-completed/UTCCRs/

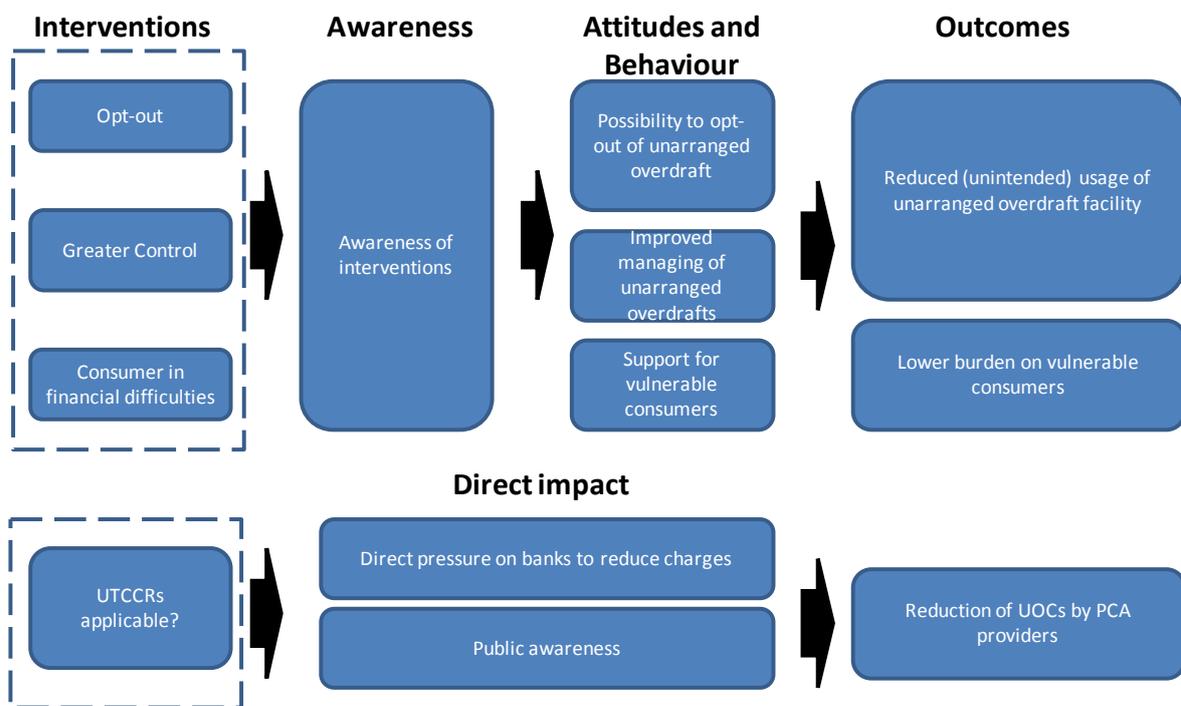
¹⁴ *Personal current accounts in the UK, A follow up report*, October 2009, OFT1123, page 21.

OFT recommended a new industry working group to explore ways to **give consumers greater control** and access to real-time information.¹⁵

- 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.

3.9 The following diagram illustrates the analytical framework for the evaluation of the OFT intervention into UOCs. It depicts the interventions, effects, and expected outcomes of the OFT market study and the Test Case in line with the methodology outlined in paragraph 2.10.

Figure 1- UOCs impact framework



Source: OFT diagram

¹⁵ Subsequent development in the market around text messaging and mobile applications meant that the industry Working Group wasn't required.

- 3.10 Through the Test Case and subsequent negotiations, the OFT put pressure on PCA providers to change their unarranged overdraft charging structures and look into the fairness of these charges. This pressure was created directly through the court proceedings but also through the publicity generated by the OFT's work, which raised public awareness of unarranged overdraft charges. UOCs have reduced significantly since the Test Case as a result and this has led to significant consumer benefit. Assessing the changes in the levels of overdraft charges is therefore one important element of the evaluation.
- 3.11 PCA holders who previously incurred a significant number of charges from unintentional usage of the unarranged overdraft facility can avoid these charges if they decide to opt out.¹⁶ Customers did not have the ability to opt out of unarranged lending prior to the intervention.¹⁷ If opt out has been successfully implemented, we would expect those customers that have chosen to opt out to be able to avoid PICs and maintenance fees they may have previously incurred unintentionally.
- 3.12 The provision of greater control and access to real-time information should also help to limit the unintentional usage of and costs of unarranged overdrafts. The OFT anticipated in its market study¹⁸ that tools that help customers to keep track of their balances, such as text alerts and other improved mobile and internet banking services, would lower consumer detriment from UOCs.
- 3.13 The PCA market study found in 2008 that UOCs disproportionately affected consumers in households with low incomes or savings. The OFT stipulated minimum standards which were intended to ensure a better, and more consistent treatment of consumers in, or at risk of

¹⁶ However, even customers who had opted out would still incur UPICs if they placed a Relevant Instruction, as the bank would be obliged to reject it.

¹⁷ Maintaining a fully functional bank account, that is, not switching to a basic bank account which does not offer a lending facility.

¹⁸ *Personal Current Accounts in the UK*, July 2008, OFT1005.

being in financial difficulty who incur UOCs and cover issues such as how providers can take a more pro-active approach to contacting and assisting customers and a number of potential solutions to assist customers in financial difficulties.

3.14 Therefore, we have considered the following questions in the evaluation:

- Have UOC levels changed?
- Are PCA providers offering consumers the option to opt out of unarranged overdrafts? Are consumers aware of this option? What is the consumer uptake of opt out?
- Are PCA providers offering consumers a greater level of control and access to real-time information? What is the uptake of these tools? Does this help consumers avoid incurring UOCs?
- Are policies in place for consumers in (or at significant risk of being in) financial difficulty?

Have UOC levels changed?

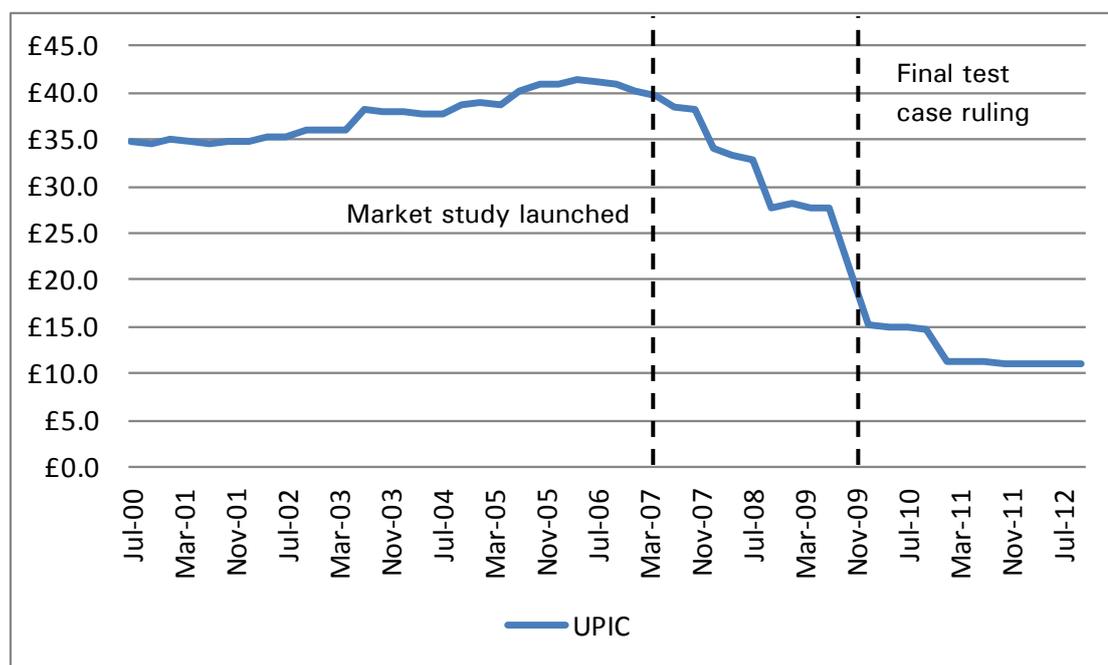
3.15 UOC revenues have declined substantially from £2,765 million by £1,047 million (in 2011 prices) since the OFT's 2008 Market Study to £1,718 million. This decline is due to a reduction in UPIC revenues by £652 million and a reduction in revenues from unarranged lending by £395 million. The following sections will analyse the respective changes in more detail. The analyses are based upon data submitted by PCA providers.

Unpaid Item Charges (UPICs)

3.16 UPICs have fallen substantially since the Market Study and Test Case from almost £40 to just over £10 (in 2011 prices).

3.17 Figure 2 shows the quarterly average UPIC from 2000 to 2012, weighted by each PCA providers' market share. The timings of the Test Case and Market Study work are illustrated in the figure.

Figure 2 - UPIC levels between 2000 and 2012



Source: OFT 2008 Market Study and PCA providers' response to OFT (2012), OFT analysis. Average UPICs across PCA providers representing over 90 per cent of the market in 2011 prices weighted by market share.

3.18 Prior to the Test Case between 2000 and 2007, UPIC levels were high with a slightly increasing trend. Since 2007, average UPIC charges have declined from over £39 to around £11 in 2011 prices. This decline occurred during the course of the OFT's Test Case and other PCA work.

3.19 The changes in average UPIC levels are largely driven by one off changes by the large PCA providers that occurred between 2008 and 2010. Barclays lowered its UPIC from £35 to £8 in August 2008. RBS lowered its UPIC from £38 to £5 in October 2009. Lloyds TSB lowered its UPIC from £20 to £10 in December 2010. HSBC has not changed its UPIC level, which is up to £25 (for unpaid items over £25).¹⁹

¹⁹ HSBC does not charge for any unpaid item up to £10, it charges £10 for UPICs between £10 and £25, and £25 for items over £25. We have accounted for the highest (£25) charge to

3.20 Revenues derived from UPICs are shown in Table 2 below. Real UPIC revenues, across all PCA providers, fell by 61 per cent between 2007 and 2011. Revenues started to decline in 2008 and 2009, but fell most significantly between 2009 and 2010. This is consistent with the changes in the UPIC levels described above.

Table 1 – Total UPIC revenues, PCA providers, 2007-2011

	2007	2008	2009	2010	2011
Revenues (£ million in 2011 prices)	1,064	929	835	509	413
% of 2007 revenues	100%	87%	78%	48%	39%

Source: PCA providers' response to OFT (2012), OFT analysis. Covers PCA providers representing roughly 95 per cent of market, 2011 prices.

3.21 UPIC volumes reported by individual PCA providers (not shown here) are roughly constant over time for most providers with a small increase in 2009.²⁰

create the weighted average in Table 1, as the data was not available to calculate a weighted average charge.

²⁰ However, UPIC volumes significantly increased for one large PCA provider that implemented substantially changes to its charging structure.

Unarranged lending charges

- 3.22 Unarranged lending charges have also fallen substantially. However, it is more difficult to compare average prices for unarranged lending than for UPICs.²¹
- 3.23 Charging structures for unarranged lending are complex. The cost to customers for unarranged lending consists of both charges, including transaction fees (PICs) and periodic fees (maintenance fees that can be either daily, monthly or weekly), and interest payments. In addition, some PCA providers have charging policies that include buffers (for example where the first £10 of unarranged lending is free), waivers (for example for first charge incurred by a customer) and caps on the total number of charges a customer can incur in a given period. Further some PCA providers have altered their charging structure over time, for example by replacing PICs with maintenance charges. This makes it more difficult to analyse the evolution of average prices for unarranged lending over time.
- 3.24 To analyse the evolution of unarranged lending charges in a way that accounts for this issue we have looked at the charges levied on a variety of possible unarranged lending scenarios. Each 'charging scenario' describes a different situation in which unarranged lending has been provided to a PCA holder. These scenarios were agreed with the industry following the market study to help customers to better understand the costs of different ways in which unarranged overdrafts might be used²². They were intended to be reflective of a range of different ways in which PCA holders might use unarranged overdrafts.

²¹ Note for the purposes of this analysis we have considered the Barclays Personal Reserve facility as a form of unarranged lending as it operates in addition to the arranged overdraft facility offered and shares similar characteristics to unarranged lending in terms of charging structures.

²² See *Personal current accounts in the UK, A follow up report*, October 2009, OFT 1123, for a discussion of implementation and *Personal current accounts in the UK, Progress update*, March 2011, OFT 1319, for details on the agreed scenarios.

- 3.25 The scenarios only consider the unarranged charges and not interest charges, as for the scenarios and time periods we are looking at the interest payments are negligible relative to the other charges.²³ We consider the increase in net interest revenues in Chapter 4.
- 3.26 For each scenario, we have calculated the total amount that would be payable by the customer for each PCA provider, taking into account the complexities of the charging structure. In order to take account of buffers, waivers and caps applied by the PCA providers, we also introduced certain assumptions,²⁴ where these were not specified in the original scenario and considered the sensitivity of these assumptions.
- 3.27 We have compared across time the weighted average total charge under each charging scenario. Table 3 shows the weighted²⁵ average change in the level of these payments under each scenario between 2007 and 2012 for unarranged overdraft requests of £20 per transaction. In each scenario considered unarranged lending charges have fallen substantially.
- 3.28 The scenarios we use are in principle similar to those published by PCA providers on their websites.²⁶ However, the published scenarios reflect the PCA providers' current charging structure and so do not allow us to

²³ *Review of the personal current account market*, January 2013.

²⁴ The assumptions used for the charging scenarios are shown in Table 3. They specify the amount of unarranged lending per payment, the timing and sequence of payments and whether it was the first time the customer had entered unarranged lending.

²⁵ Charges for each scenario are a (market share) weighted average across PCA providers covering over 90 per cent of the market. If PCA providers have changed their charging structure during the year charges have been weighted accordingly. Charges are for the respective PCA providers' main accounts.

²⁶ See section on transparency.

analyse changes since 2007.²⁷ Furthermore, in order to calculate total costs for consumers, PCA providers need to make certain assumptions. In order to ensure that these assumptions are consistent across providers we have calculated the scenarios ourselves. We therefore calculated total payments using the scenarios and a consistent set of assumptions between 2007 and 2012.

- 3.29 We conducted sensitivity analysis on these results by considering different assumptions for the value of the payment made in each relevant transaction (between £10 and £50). We have also considered the impact of waiver policies.²⁸ The decrease in charges between 2007 and 2012 follows a similar pattern for each of these specifications.

²⁷ Charging scenarios have been published in *Personal current accounts in the UK, Progress update*, March 2011, OFT1319 and *Personal current accounts in the UK, Progress update*, September 2010, OFT1275. However, these have not been published for earlier years and we therefore calculated total charges using a consistent set of assumptions for 2007-2012.

²⁸ Some PCA providers waive the charges if the customer is incurring them for the first time in six months or in one year. These PCA providers however have not changed their waiving policy over time. Therefore relaxing the assumption on customer past charges does not have an impact on the decreasing trend of scenarios since 2007.

Table 2 - Changes in total charges for unarranged lending between 2007 and 2012 under different charging scenarios (2011 prices).

Charging scenario	2007	2012	change
Scenario 2: ²⁹ A payment from your account takes you into an unarranged overdraft by less than £10. You are overdrawn for one day during the month.	£32	£9	(-73%)
Scenario 3: A payment from your account takes you into an unarranged overdraft and you make another payment from the account while you are overdrawn. You are overdrawn for two days in a row during the month.	£61	£27	(-56%)
Scenario 4: A payment from your account takes you into an unarranged overdraft, and you make nine more payments from the account while you are overdrawn. You are overdrawn for 10 days in a row during the month.	£185	£81	(-56%)
Scenario 5: A payment from your account takes you into an unarranged overdraft. You are overdrawn for one day. However, on three more ³⁰ occasions during the month, a payment takes you into an unarranged overdraft. On each of these occasions you are overdrawn for three days in a row.	£104	£78	(-25%)
Scenario 6: A payment from your account takes you into an unarranged overdraft. You are overdrawn for 21 days in a row during the month and you make 12 more payments from the account while you are overdrawn.	£217	£104	(-52%)

Assumptions applied to all scenarios: the amount of unarranged lending per payment where not specified in the scenario is £20;³¹ the customer incurred other charges in the past six months; where more than one payment is made these are incurred on separate days. The scenarios are based on formal charges and do not take into account (discretionary) waiver policies to the extent these might have been in place.

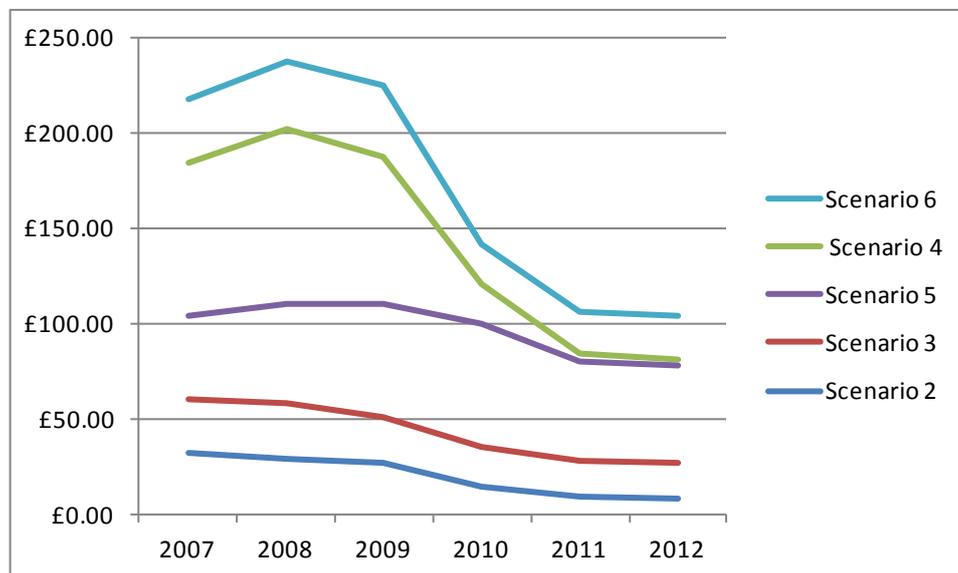
²⁹ Scenario 1 excluded as it refers to UPICs only.

³⁰ Scenario 5 uses an extra assumption: each unauthorised overdraft is at least 5 days after the last request.

³¹ With the exception of Scenario 2 for which less than £10 is explicitly specified.

3.30 Figure 3 below shows that average unarranged lending charges have declined gradually since 2008.

Figure 3: Evolution of charging scenarios for unarranged lending across time



Source: PCA providers' response to OFT (2012), OFT analysis. Weighted average charges across PCA providers covering over 90 per cent of the market, data for main accounts, 2011 prices. See table for additional details.

3.31 Unarranged lending charges have fallen by approximately 50 per cent on average across scenarios 2 to 6. It is not possible for us to estimate a weighted average for the fall in prices arising from the different charging scenarios as we do not have this information on the true relative incidence of these scenarios.³²

3.32 Our scenario analysis indicates that for a payment amount of £10 the reduction in unarranged lending charges is more pronounced with a minimum decline of 49 per cent and an average decline of 55 per cent. For a £50 amount per payment the minimum fall in total unarranged charges is 34 per cent and the average fall is 52 per cent.

³² We therefore treated Scenario 2 to 6 as equally likely when calculating the average fall in charges.

3.33 In addition to the scenarios we also analysed aggregate revenues. Revenues from paid item and maintenance charges have fallen by 23 per cent from their 2007 level (in 2011 prices), as can be seen in Table 4 below. Revenues increased somewhat in 2008, before substantially decreasing in the following years, in line with the changes in charging structures by the large PCA providers described above.

Table 3: Revenues from unarranged lending charges

	2007	2008	2009	2010	2011
Revenues (£ million in 2011 prices)	1,701	2,034	1,836	1,540	1,306
% of 2007	100%	120%	108%	91%	77%

Source: PCA providers' submission to OFT (2012), OFT analysis, 2011 prices.

3.34 There is significant variation across PCA providers in both the changes in unarranged charges and corresponding revenues. Whilst most PCA providers, including the larger providers have substantially reduced charges, a minority have raised charges or introduced new charges.

3.35 It is unclear whether the total number of unarranged lending charges incurred per year has risen or fallen. Differences in charging structure between PCA providers and especially changes in charging structures over time mean that it not possible for us to accurately compare the aggregate number of charges or relevant transactions over time on a like for like basis. Further, we did not receive complete data from all of the PCA providers on the volume of unarranged lending charges. The data we did receive indicated that volumes of charges had fallen for some PCA providers and risen for others.

Are PCA providers offering customers the option to opt out of unarranged overdrafts? Are customers aware of this option? What is the consumer uptake of opt out?

- 3.36 In July 2010 the OFT published the terms of reference for a working group that would develop minimum standards for how consumers are offered the ability to opt out of unarranged overdraft facilities, either on existing or via new accounts, for inclusion in the revised Lending Code.
- 3.37 The working group, led by the Lending Standards Board (LSB), comprised the major PCA providers, the British Bankers' Association (BBA), the Building Societies Association (BSA), consumer groups, the Financial Services Authority (FSA) and other government departments. The minimum standards have been agreed and finalised in March 2011. They give PCA providers clarity over how they should offer consumers the ability to opt out of unarranged overdrafts and create minimum standards that consumers can expect PCA providers to follow when providing such an option.
- 3.38 The recommended minimum standards cover what information should be provided before the sale of an account with opt out facility is concluded (pre-sale information) and how providers communicate and offer the ability to opt out for PCAs that have such a facility (post-sale information). However, the standards do not require providers to actively offer an opt out of unarranged overdraft facilities on all or any of their PCA products and do not cover pricing issues.³³
- 3.39 After the finalisation of the minimum standards the OFT expected individual PCA providers to begin to offer customers the ability to opt out of unarranged overdraft.³⁴ Regarding pricing of opt out the OFT noted in its March 2011 update that '...for some PCA providers, an opt

³³ *Personal current accounts in the UK, Update on unarranged overdraft charges*, July 2010, OFT 1249, page 6.

³⁴ *Personal current accounts in the UK, Progress update*, March 2011, OFT1319, page 14.

out facility is only available on accounts that carry a monthly fee. As opt out facilities become more common across a broad range of PCAs, it is likely that such facilities will increasingly become an area across which PCA providers compete, and may be offered without a fee.³⁵

- 3.40 Since 2010, only a few PCA providers offer consumers the option to opt out. For example, Barclays offers customers the ability to opt out of unarranged lending not linked to a monthly fee. However, customers with insufficient funds on account will usually incur a UPIC (or guaranteed transaction fee) even if they have opted out. In addition, some smaller PCA providers such as Nationwide, also offer opt out without a monthly fee (UPIC remains payable), or alternatively do not provide unarranged lending facilities to begin with (for example Leeds Building Society).
- 3.41 A number of other PCA providers require customers to pay a monthly account fee in order to access opt out but might not charge an unpaid item fee (for example HSBC offers a Bank Account Pay Monthly and Lloyds a Classic Account with Control).³⁶
- 3.42 Paying a monthly fee is likely to limit the appeal of opt out for a large group of customers and is likely to contribute to the limited uptake observed so far. Opt out therefore does not appear to have become an area in which PCA providers actively compete and which ultimately would be offered free of charge to consumers.
- 3.43 Information provided by PCA providers in the information request shows that the overall uptake of opt out by consumers is very low, with the exception of Barclays, which introduced the personal reserve to replace

³⁵ *Personal current accounts in the UK, Progress update*, OFT 1319, page 14.

³⁶ For a more detailed overview of individual PCA providers' implementation of opt out see *Review of the personal current account market*, January 2013.

unarranged overdrafts.³⁷ This is unsurprising since the majority of PCA providers have only offered opt out conditional on paying an upfront account fee.

- 3.44 In line with this, evidence from the consumer survey shows that awareness of the ability to opt out among PCA holders³⁸ is generally low: 20 per cent of PCA holders say that their account offers the ability to opt out, 22 per cent say it does not and 58 per cent do not know. Interestingly, the PCA holders who decided not to opt out although their account allows them to do so, most often say that it makes no difference to them as they are rarely, if ever, in unarranged overdraft (45 per cent), that they did not opt out because unarranged overdraft provides them with additional funds (12 per cent) or that they might need it in an emergency (16 per cent).

Are PCA providers offering consumers a greater level of control and access to real-time information? What is the uptake of these tools? Does this help consumers to avoid incurring UOCs?

- 3.45 Following the OFT's work in 2010,³⁹ the Government's Consumer Credit and Personal Insolvency Review more recently announced further commitments to improve consumers' control of bank charges in November 2011.⁴⁰ These commitments applied to all full-facility

³⁷ For PCA providers – other than Barclays- that introduced opt out uptake is typically below one per cent of total accounts. Opt out for Barclays actually means not signing up to the Personal Reserve Service.

³⁸ Based on PCA providers that offered opt out at the time of the survey. We have excluded basic account holders, where the opt out is not applicable.

³⁹ *Personal current accounts in the UK, Unarranged overdrafts*, March 2010, OFT1216.

⁴⁰ Consumer Credit and Personal Insolvency Review, Formal Response on Consumer Credit, HM Treasury and Department for Business Innovation and Skills, November 2011, paragraphs 6-7. For additional details see *Review of the personal current accounts market*, January 2013.

accounts offered by the major current account providers and made customers aware of a 'grace period', benefit from a small 'buffer zone' and have the option to receive a text or email alert.⁴¹

- 3.46 Access and control for PCA holders has improved overall since the market study with the roll-out of various online, mobile or text alert services. Most PCA providers are now offering at least a basic text alert service to their customers. As well as text alerts when customers are close to their account limit, customers can often also access account information, such as balances and statements of recent transactions.
- 3.47 However, while a large number of PCA providers are now offering such text alerts,⁴² only a relatively small percentage of PCA holders report having access to or using alert services for unarranged overdrafts (around 13 per cent). Sixteen per cent of the interviewed full-facility PCA holders⁴³ have chosen not to receive such a service, 37 per cent say they have a current account which does not offer such alerts and 34 per cent said they do not know whether their account offers this service.
- 3.48 Generally, take up of the text alert service is higher for those who say there are permanently, usually or sometimes overdrawn, which suggest it is being used most by customers who are most in need of it; we also observe a variation by age bands with take-up being generally higher for younger customers.⁴⁴

⁴¹ PCA providers committed to offer text alerts to all full-facility current account holders by March 2012 and to deliver the two other commitments by March 2013 at the very latest.

⁴² For details see *Review of the personal current accounts market*, January 2013.

⁴³ Excludes Basic Accounts.

⁴⁴ *Review of the personal current account market*, January 2013.

Table 4 - Availability and uptake of warning and alert service

Does your main current account offer any warning or alert service...?	
Yes – and I use this service	13%
Yes – but I have chosen not to receive this service	16%
No	37%
Don't know	34%

Source: OFT 2012 consumer survey

Base: Excludes Basic Accounts

- 3.49 Most of the alert services are provided by text message.⁴⁵ Many PCA holders that reported having received an alert stated that it helped to avoid incurring a charge (60 per cent). Other PCA holders reported that the alert was ignored as they already knew they would not go overdrawn (22 per cent).⁴⁶ One PCA provider estimated that customers signing up to their text alert program saved roughly £11 per year on average compared with non-registered customers.
- 3.50 Major PCA providers have also introduced small buffer zones within which UOCs are not levied. Furthermore, major PCA providers have committed to make customers aware of 'grace' periods within which they can credit funds to put their account back within their limit and so avoid a charge being applied by March 2013.⁴⁷

⁴⁵ Sixty-three per cent of respondents, on the last occasion they received a warning or alert, reported receiving a text message.

⁴⁶ For a more detailed discussion of the usage of text messages see *Review of the personal current account market*, January 2013.

⁴⁷ For more details see *Review of the personal current account market*, January 2013.

3.51 While the introduction of these services helps to address the existing market failures to some extent, we note that there is significant variation between PCA providers regarding the services offered and that there is currently a lack of awareness of this service amongst consumers.

Are policies in place for consumers in (or at significant risk of being in) financial difficulty?

3.52 The PCA market study 2008 found that consumers in households with low incomes or low or no savings incurred a disproportionately large numbers of UOCs and that there seemed to be a cross-subsidisation from those customers to other customer groups.⁴⁸

3.53 In July 2010, the OFT published the terms of reference for a working group that developed best practice guidance for how PCA providers deal with customers in (or at significant risk of being in) financial difficulty who incur UOCs. The working group was led by the LSB, and comprised the major PCA providers, the BBA, the BSA, consumer groups, the FSA and other government departments.

3.54 The best practice guidance has been agreed and finalised and was included in the revised Lending Code that was published on 31 March 2011. The guidance complemented existing initiatives in the area of responsibility and complaints handling. These standards ensure a better, and more consistent, treatment of consumers in, or at risk of being in financial difficulty who incur UOCs.

3.55 In response to our information request nearly all PCA providers informed us that responsibility policies have been published on websites (and/or leaflets). Several PCA providers also have specialised units to liaise with customers in (or at significant risk of being in) financial difficulties. Staff are trained to assess and discuss the financial situation of customers and

⁴⁸ '...there seems to be a significant cross subsidisation from those consumers who incur insufficient funds charges to those who do not; and to a considerable extent this is from socially vulnerable, low income and low saving consumers to higher income, higher saving ones.' *Personal current accounts in the UK*, July 2008, OFT1005, page 110.

then propose solutions to improve the financial situation (including for example switching bank accounts or turning off an overdraft facility).

- 3.56 The PCA market study found that in 2006 27 per cent of account holder who incurred UOCs paid no more than £50 and 51 per cent paid more than £100. It appears that in 2011 a far higher proportion of those who incurred overdraft charges (61 per cent) paid less than £50 and just 19 per cent paid at least £100.⁴⁹ However, it is likely that this is due to a fall in UOCs generally, rather than to PCA providers' responsibility policies.

Switching

- 3.57 The PCA market study found that relatively few consumers actively monitored the competitiveness of their current account, that consumers had valid concerns about the switching process going wrong resulting in a poor perception of the ease of the process. As a result, the PCA market study found low levels of switching between PCAs.⁵⁰ The actual and perceived problems that consumers face when switching their PCA were thought to be contributory factors to these low levels. The OFT considered that a reduction in these problems would lead to an increase in the willingness to switch and that in turn would help to increase the competitiveness of the PCA market.
- 3.58 Following the publication of the 2008 market study, the OFT worked with the existing Bacs Switching Working Group and identified outcomes to address the concerns that had been found.⁵¹ In order to pursue these

⁴⁹ *Review of the personal current accounts market*, January 2013.

⁵⁰ *Personal Current Accounts in the UK*, July 2008, OFT1005, Section 5.

⁵¹The objectives agreed were set out in a follow up report published in October 2009 together with the initiatives established to fulfil them. The outcomes were: increase the level of consumer awareness of the switching process, reduce problems encountered by consumers when switching and reduce the fear of the switching process. For more information see *Personal current accounts in the UK: A follow up report*, October 2009, OFT1123, pages 48ff.

objectives, the following initiatives were implemented at the time of the follow up report published in October 2009:⁵²

- Measures to **increase consumer awareness of the automatic switching process including a new consumer guide and website**. The website provides helpful advice and tools for switching, including a timeline for the switching process, template letters for consumers to use and send to their old PCA provider, and a guide to switching between PCAs which could be downloaded. The guide tells consumers clearly what they and their PCA provider need to do in the switching process and can be downloaded from the Bacs website.⁵³
- Measures to **reduce the problems that arise with the transferring of Direct Debits**. This included an originator education strategy which involved disseminating best practice, writing to Direct Debit originators who do not update their records explaining the need for prompt action and producing new forms to standardise interbank communication.
- 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.

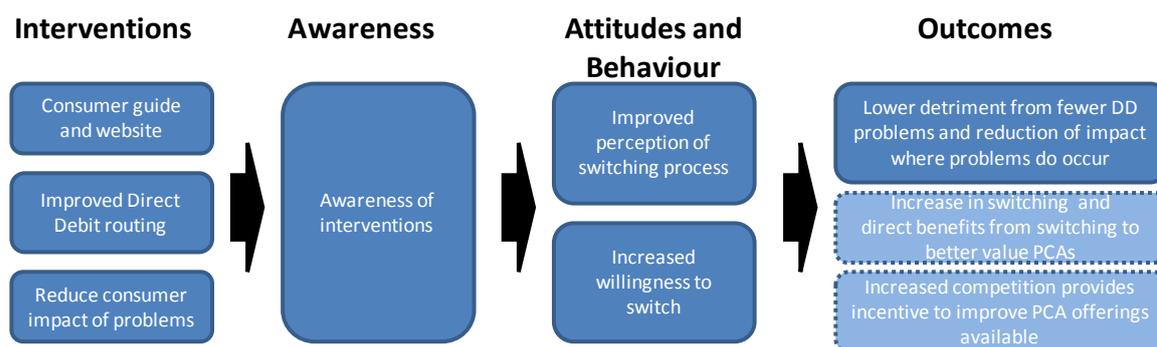
3.59 These initiatives were intended to increase the level of consumer awareness of the switching process and to improve the perception of the switching process by reducing problems encountered and the impact of these problems.

⁵² *Personal Current Accounts in the UK: A follow up report*, October 2009, OFT1123, page 9 and *Personal Current Accounts in the UK: Progress update*, September 2010, OFT1275, page 13.

⁵³ See www.BACS.co.uk/BACS/consumers/accountswitching/pages/accountswitching.aspx.

3.60 The following diagram illustrates the analytical framework for the evaluation of OFT interventions into switching. The diagram follows the analytical framework and approach we laid out in paragraph 2.10: We first look at the interventions and status of implementation, consumer awareness and impact on attitudes and behaviour and finally the outcomes. We distinguish between short term and long term outcomes (shaded) which are likely to need additional time to materialise.

Figure 4 - Switching Analytical Framework



Source: OFT diagram

3.61 As the diagram shows, a first step to evaluate the OFT interventions is to measure consumer awareness of the initiatives mentioned in paragraph 2.11. Consumers have to be aware that switching PCAs has become easier and that there is support available (for example consumer guide) for the interventions to have an impact on attitudes and behaviour.

3.62 In general, a high level of switching is not necessary for effective competition in a market, provided that the barriers to switching are low. Therefore, the main objective of OFT recommendations was to reduce these barriers by improving consumer perception of switching and improving the switching process overall, rather than to increase the level of switching. The evaluation therefore focuses on barriers to switching and perceptions of switching. In particular, the evaluation focuses on

whether the perception of the switching process has improved and whether this has caused an increased willingness to switch.⁵⁴

- 3.63 It is unclear whether switching levels would increase as a result of a reduction of barriers to switching or whether the threat of switching would be sufficient on its own to ensure PCA products became more competitive. Nevertheless, we consider whether switching levels in the PCA market have changed.⁵⁵
- 3.64 If successful these changes in consumer attitudes and behaviour should lead in the long run to improved competition and improved PCA offerings. However, having considered the evidence on the perceptions and switching, we consider it is too early to evaluate this last outcome.
- 3.65 The OFT has therefore considered the following questions in its evaluation
- Has PCA holders' awareness of the switching process increased?
 - Have the problems PCA holders incur with transferring Direct Debits during switching been reduced? Has the impact of these problems on consumers been reduced?
 - Have PCA holders' perceptions of the difficulty of switching and willingness to switch improved?
 - Have these interventions led to an increase in the level of switching by PCA holders?
- 3.66 These questions are considered in turn below.

⁵⁴ Consumer attitude and behaviour will provide an indication of whether the objective concerning reducing fear of the switching process is being achieved.

⁵⁵ However, increasing switching levels was not an objective of the OFT's original intervention.

Has PCA holders' awareness of the switching process increased?

- 3.67 Subsequent to the market study and 2009 follow-up report, the OFT continued to monitor developments with the switching process and published progress reports in 2010⁵⁶ and 2011.⁵⁷ These reports found that, within 12 months of being set-up,⁵⁸ over 7,000 visitors had clicked through to the relevant pages of the Bacs website, and over 10,000 account switching documents had been downloaded from its website.⁵⁹ These materials continue to be promoted, and the most recent Bacs review in 2012 of the website shows that more than 1,000 consumers a month are visiting the Account Switching webpage.⁶⁰
- 3.68 Many PCA providers also offer a switching guide on their own websites and in branches. For PCA providers that were able to provide this information, there were just over one million unique views of this information.⁶¹

⁵⁶ *Personal Current Accounts in the UK: progress update*, September 2010, OFT1275 see Section 2.

⁵⁷ *Personal Current Accounts in the UK: progress update*, March 2011, OFT1319.

⁵⁸ September 2009 – September 2010.

⁵⁹ *Personal Current Accounts in the UK: progress update*, OFT1275, pages 15-16. The number of downloads exceeds the number of visitors as there are multiple documents available for download. The most popular document has been the Account Switching Guide, followed by the timeline and credit re-direction letter respectively.

⁶⁰ Bacs response submitted to the OFT (2012). Average monthly visits between April and July 2012 of Account Switching Website:
www.thesmartwaytopay.co.uk/DirectDebitExplained/Pages/AccountSwitching.aspx

⁶¹ PCA providers' submission to the OFT (2012). Based on PCA providers representing around 57m accounts in 2011 (roughly 75 per cent of market). Note that data for some banks does only cover part of 2011 so total number of views in 2011 is likely to be higher.

- 3.69 In addition to the measures the OFT agreed with payment provider Bacs and the industry, PCA providers' recent efforts to attract switchers may have also improved knowledge of switching. Several PCA providers have engaged in campaigns to advertise their pricing promotions in order to encourage switching. These promotions have included offering monetary incentives for example a cash payment or favourable credit or debit interest rate for customers willing to switch to that PCA provider.⁶²
- 3.70 Despite evidence that some consumers are accessing information about switching, our survey suggests that it has not been on a sufficient scale to greatly improve consumers' knowledge of the switching process. Forty-five per cent of all consumers knew at least a little about switching in 2012⁶³ compared to 41 per cent in 2008.⁶⁴
- 3.71 On the other hand, the survey shows that awareness and usage of the automated switching service⁶⁵ has increased amongst switchers: 66 per cent of consumers who switched account at least once said they had some knowledge⁶⁶ of the switching service compared to 54 per cent in 2008. In 2012, 62 per cent of those who switched their current account in the last 12 months used the switching service of their new PCA provider compared to 51 per cent in 2008.⁶⁷ In line with our 2012

⁶² PCA providers' submission to the OFT (2012).

⁶³In contrast, 35 per cent of respondents have heard of switching services but don't know about them, 18 per cent have never heard about them and two per cent don't know.

⁶⁴ Difference is significant at the five per cent level. This increase is for all consumers (that is, both consumers who have and those who have never switched). The increase is larger for switchers. For more information see *Review of the personal current accounts market*, January 2013.

⁶⁵ The free of charge account switching service facilitates account switching and the transfer of regular and recurring payments such as Direct Debit and Standing Orders.

⁶⁶ Either a little or a lot of knowledge.

⁶⁷ Difference is significant at the five per cent level.

survey, research by the Payment Council finds that 59 per cent of consumers completed the switch using PCA providers' switching service.⁶⁸

Have the problems PCA holders incur with transferring Direct Debits during switching been reduced? Has the impact of these problems on consumers been reduced?

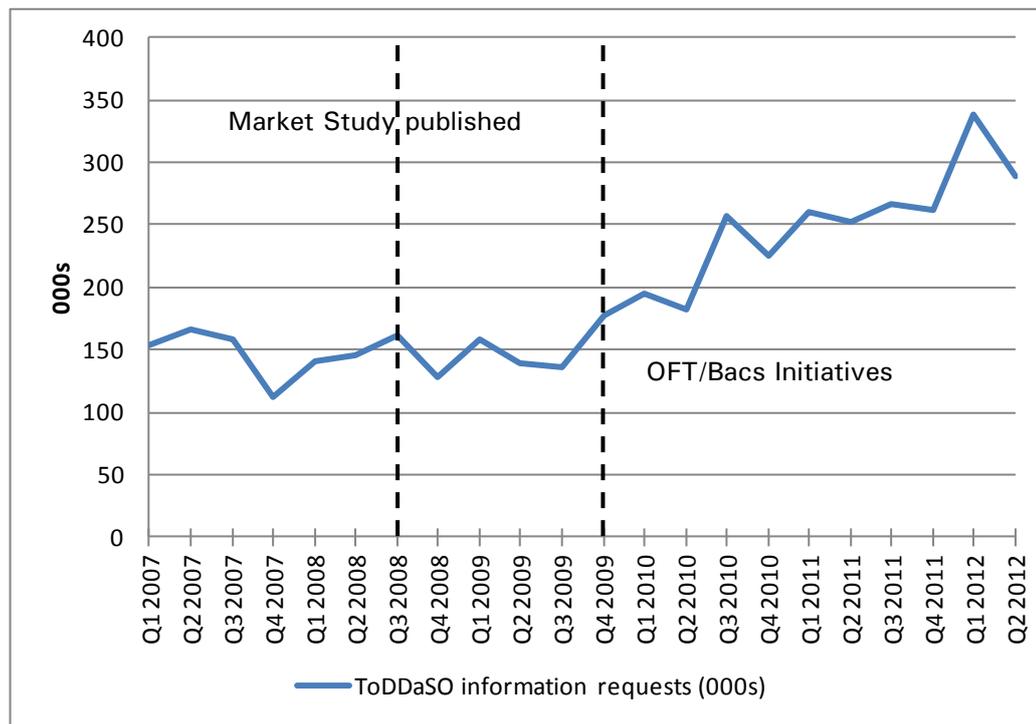
- 3.72 When changing PCA providers, consumers can either handle the process themselves or they can use the switching service of their new PCA provider, which includes an automated process for transferring direct debits and standing orders known as ToDDaSO (Transfer of Direct Debits and Standing Orders). According to Bacs the routing of Direct Debits was the most frequent problem switchers faced, amounting in 2007 to 39 per cent of all problems.⁶⁹ Usage and error rates of the ToDDaSO service therefore provide a metric for assessing the OFT's impact in this area.⁷⁰
- 3.73 As can be seen in Figure 5, information requests to the PCA providers' automated switching service have nearly doubled since 2008, indicating the increased use and acceptance of automated switching amongst consumers. The timing of this increase is consistent with the timing of the OFT interventions and discussions with Bacs. The number of information requests was fairly stable between 2007 and most of 2009 but rose steeply around October 2009, when the OFT initiatives were implemented.

⁶⁸ 27 per cent transferred their own Direct Debits and Standing Orders, 11 per cent had no Direct Debits or Standing Orders to transfer, remainder did not know. *Account Switching, Quantitative Market Research Results*, September 2012.

⁶⁹ *Personal current accounts in the UK, A follow up report*, October 2009, OFT1123, page 46.

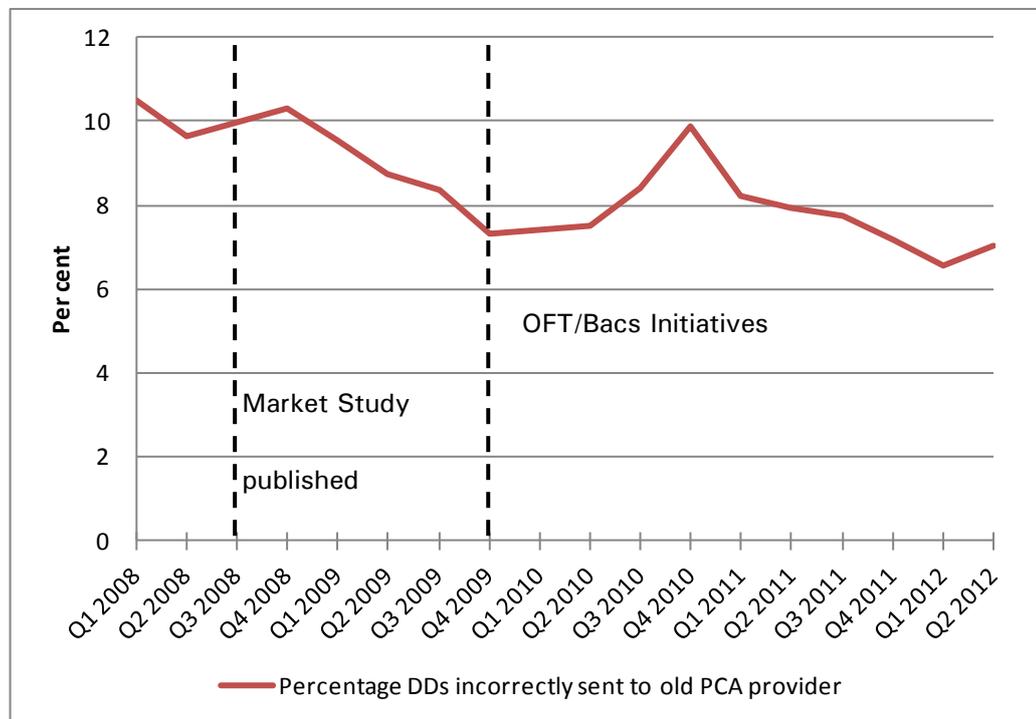
⁷⁰ Bacs uses the number of ToDDaSO information requests received at the new bank to measure the number of initiated switches (Bacs submission, 2012).

Figure 5 - Quarterly number of ToDDaSO Information Requests



Source: Bacs data, OFT analysis.

Figure 6 – Per cent of Direct Debits incorrectly sent to old PCA provider



Source: Bacs data, OFT analysis.

- 3.74 The increase in ToDDaSo requests does not directly imply an increase in switching rates.⁷¹ However, it does suggest that more people are using the automatic switching service due to the activities agreed between Bacs and the OFT⁷² and that fewer are switching manually. As the automated service is likely to reduce consumer time and efforts involved in switching this is also an encouraging sign.
- 3.75 As can be seen in Figure 6 the increase in the volumes of transfer requests has been coupled with a reduction in the percentage of Direct Debits incorrectly sent to the old PCA provider, from an annualised average of 10.1 per cent in 2008 to 7.8 per cent in 2011, a 23 per cent reduction. However, as the data is quite volatile and we do not have pre-2008 data, we treat this evidence with caution.⁷³ Further, despite the positive improvements reported by Bacs, the OFT's 2012 consumer survey shows that the number of consumer reporting problems with Direct Debits remained broadly unchanged when compared to 2008.⁷⁴
- 3.76 Research by the Payments Council, which looks at overall satisfaction with the switching process, finds that on average satisfaction seems to be higher for switchers who used ToDDaSO than for those who

⁷¹ It is likely that the increase in usage of the automated service has led to a decline in the number of people switching manually.

⁷² According to Bacs' submission (2012) there is strong evidence to suggest that the activities agreed with the OFT together with the work undertaken by the members have increased consumer awareness of the automated transfer service and those opting for this service over the manual switch have increased.

⁷³ According to Bacs, the increase reflected between August 2010 and August 2011 was caused by two high volume Service Users who experienced system issues. This was an exceptional event and, although it took some time to normalise, the series continued to decrease.

⁷⁴ The number of consumers experiencing problems with Direct Debits was broadly unchanged from 27 per cent in 2008 to 25 per cent in 2012; an explanation could be that consumers can have multiple Direct Debits and might still incur some problems (although fewer). Consumers experiencing problems with Standing Orders decreased from 15 per cent to six per cent. We did not split according to usage of automated service because of the low sample sizes involved.

switched without help or had no Direct Debits and Standing Orders to switch.⁷⁵

- 3.77 Finally, although problems are still occurring they were often resolved, at least partially, by their PCA provider. According to the 2012 consumer survey, 66 per cent of respondents, who said they had raised the problem(s) with their PCA provider, reported that they were all resolved to their satisfaction. A further 10 per cent reported some of the problems were resolved.

Have PCA holders' perceptions of the difficulty of switching and willingness to switch improved?

- 3.78 Perceptions of switching among consumers who have never switched PCAs have not changed significantly since 2008. Similarly, switchers in 2012 report comparable levels of satisfaction to 2008.
- 3.79 The following table shows that there has been no significant change in the willingness to switch between 2008 and 2012 amongst consumers who have never switched.

⁷⁵ Average satisfaction score for those who used ToDDaSO is 77, for those who switched without help it is 66, for those who had no Direct Debits or Standing Orders to switch it is 61 (out of 100). *Account Switching, Quantitative Market Research Results*, September 2012.

Table 5 - Willingness to switch for those who have never switched⁷⁶

Have you considered switching current account?	2008	2012
Yes	26%	25%
No	74%	75%

Source: OFT 2008 and 2012 consumer surveys

Base: those that have never switched

3.80 There has also been no real change in the level of confidence in the switching process running smoothly since 2008 for those who have never switched. This evidence could be consistent with changes in perceptions needing time to occur, particularly if they are not based on own experience.

Table 6- Confidence that the switching process would go smoothly

How confident would you be that it would smoothly? Would you say you would be...	2008	2012
Very or fairly confident	52%	50%
Not very or not at all confident	45%	41%
Don't know	3%	9%

Source: OFT 2008 and 2012 consumer surveys

Base: those that have never switched

3.81 Table 8 shows that the perception of the switching process hasn't changed significantly⁷⁷ for switchers. Some 75 per cent of respondents found the switching process easy or fairly easy in 2008, compared to 81 per cent in 2012.

⁷⁶ Q49 2008 questionnaire (Base: all who did not switched current account 1328); F2 2012 questionnaire (Base: all who have never switched current account 1315).

⁷⁷ The difference was not statistically significant at the 5 per cent level.

Table 7 - Perception of the switching process for those who switched⁷⁸

Overall, how easy or difficult would you say it was to switching your current account?	2008	2012
Very of fairly easy	75%	81%
Very or fairly difficult	21%	15%
Don't know/no opinion	3%	3%

Source: OFT 2008 and 2012 consumer surveys

Base: those who switched their main PCA in the last 12 months

3.82 There has been no real change in the likelihood of switchers recommending changing accounts. In 2008, 63 per cent of those who had switched account in the last 12 months said they were either very or fairly likely to recommend changing current account provider, compared to 73 per cent in 2012⁷⁹ (see Table 5).

⁷⁸ Q43 of 2008 consumer survey (Base: all those who switched in the last year 117); H10 of 2012 consumer survey (Base: all those who switched in the last year 101).

⁷⁹ The difference was not statistically significant at the five per cent level.

Table 5– Recommending switching⁸⁰

Overall, how likely or unlikely would you say you would be to recommend switching current account providers to others?	2008	2012
Very or fairly likely	63%	73%
Very or fairly unlikely	32%	16%
Don't know/no opinion	5%	11%

Source: OFT 2008 and 2012 consumer surveys

Base: those who switched their main PCA in the last 12 months

Have these interventions led to an increase in the level of switching by PCA holders?

- 3.83 We have considered evidence on the level of switching from various sources. Not all of these are fully comparable over time because of the slightly different definitions of switching adopted. Still, the overall message arising from these sources is that switching levels remain low and are either constant or displaying a very gradual increase over time.
- 3.84 According to data from GfK's Financial Research Survey,⁸¹ the proportion of current account holders who reported switching their main account from another PCA provider within the last 12 months has gradually increased although it remains low. In the third quarter of 2012, 3.1 per cent of PCA holders reported switching their main account in the last 12 months, compared to 2.3 per cent in the first quarter of 2008.

⁸⁰ Q44 of 2008 consumer survey (Base: all those who switched in the last year 117); H14 of 2012 consumer survey (Base: all those who switched in the last year 101);

⁸¹ The GfK Financial Research Survey is a monitor of consumers' financial behaviour based on 60,000 interviews a year with a representative sample of British adults.

3.85 Evidence from the OFT 2012 consumer survey also report switching rates to be rather low (around 3.6 per cent for consumers who switched in the last 12 months). Relatively low switching levels are also confirmed by Payments Council research (2.5 per cent switchers in the past 12 months).⁸²

Conclusion

3.86 Some aspects related to switching have improved, though the overall impact of the OFT's interventions on switching appears to have been fairly modest so far. There has been an increase in the use of the automatic switching service and a reduction in the Direct Debit error rate, suggesting there may be some positive impact. However, the consumer survey shows that consumers' perception and views of switching have not significantly changed.

Transparency

3.87 The OFT's 2008 PCA market study found that many consumers were unaware of the key costs associated with their PCA. This was driven by low levels of transparency of significant PCA costs - including UOCs which made up a substantial share of PCA revenues in 2006.⁸³ Further, the market study concluded that a lack of transparency was a key hurdle consumers had to overcome to compare different PCA products and understand the way UOCs are levied.

3.88 To increase transparency of charges and interest rates, seven PCA providers⁸⁴ representing over 90 per cent of the PCA market in October

⁸² *Account Switching, Quantitative Market Research Results*, September 2012.

⁸³ Insufficient funds charges amounted to £2,560 million in 2006. *Personal current accounts in the UK*, July 2008, OFT1005.

⁸⁴ 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: Barclays, HSBC, Lloyds Banking Group, National Australia Banking Group, Nationwide, Royal

2009 voluntarily agreed to a number of initiatives to increase the transparency of costs associated with PCAs. These were intended to help consumers to better understand the costs of their PCA and those of competing PCAs. The initiatives included:⁸⁵

- Making **charges and other key information** more prominent on **monthly statements**, so that customers are more aware of the charges that they pay. Enhanced monthly statements summarise and/or highlight key information on PCA costs to make this information more easily distinguishable for and accessible to consumers⁸⁶. The respective changes were intended to prompt consumers to manage their accounts better and change their behaviour.
- Introducing an **annual summary** of the cost of their account for each customer. Annual summaries were designed to provide an easy to understand analysis of the charges and interest rates that have been applied to a consumer's PCA in the previous 12 months. The OFT recognised in addition, that annual summaries would provide something akin to a natural break point for a PCA contract, which is currently not available for a PCA.⁸⁷
- Provide information on average **credit and average debit balances**.⁸⁸

Bank of Scotland (RBS) and Santander. See *Personal Current Accounts in the UK, A follow up report*, October 2009, OFT1123, page 8.

⁸⁵ *Personal current accounts in the UK, A follow up report*, October 2009, OFT1123.

⁸⁶ This information would include unarranged overdraft charges, monthly/periodic management fees, value of debit interest, value of credit interest, information on debit and credit interest rates. See *Personal Current Accounts in the UK, A follow up report*, October 2009, OFT 1123, p. 31

⁸⁷ *Personal current accounts in the UK, A follow up report*, October 2009, OFT1123, page 34.

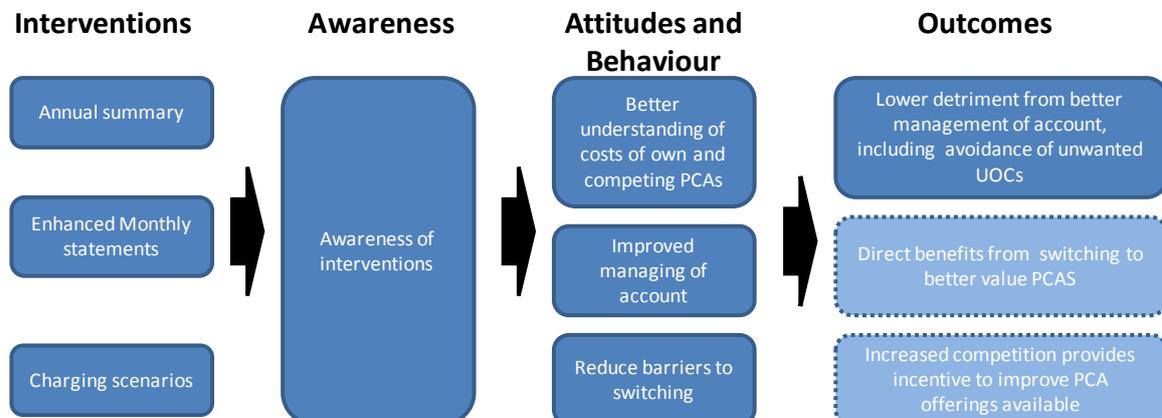
⁸⁸ Average credit and debit balances could be included either in the annual summary or enhanced monthly statements.

- Producing **illustrative scenarios** showing unarranged overdraft charges (UOCs), giving customers an idea of the costs for different patterns of use. Charging scenarios were intended to provide consumers with information on the costs of using unarranged overdrafts and to enable comparison of PCAs regarding these costs. PCA providers agreed to provide information on how much their PCAs would cost in a series of scenarios involving transactions that result in unarranged overdraft; these scenarios were made available on major PCA provider's websites from June 2010.⁸⁹

3.89 The OFT also took steps to help consumers understand and compare the costs of PCAs through new advice and tools on the Consumer Direct website. Furthermore, the OFT encouraged the creation of a price comparison website which subsequently has been launched by the Money Advice Service.⁹⁰

3.90 The following diagram illustrates the framework for the evaluation of the OFT interventions in the area of transparency.

Figure 7 - Transparency - Framework



Source: OFT diagram

⁸⁹ *Personal current accounts in the UK, Progress update*, September 2010, OFT1275, page 18 and Annex A for a list of scenarios.

⁹⁰ For more details see *Review of the personal current accounts market*, January 2013.

- 3.91 As Figure 7 shows, a first step to evaluate the OFT's recommendations is to measure consumer awareness of annual summaries, enhanced monthly statements and charging scenarios.
- 3.92 The objective of the OFT's transparency related recommendations was primarily to allow PCA customers to better understand the costs of running their account and to compare the value for money offered by different PCA products. The main measurable objectives are therefore changes in consumer attitudes and behaviour. In particular, the evaluation focuses on whether there are indications that consumers have gained a better understanding of the costs of their PCA and of competing PCA products and whether account management has become easier.
- 3.93 Long term outcomes of the transparency initiatives – if successful – are likely to be increased switching levels and competition between PCA providers resulting in new PCA offerings for customers. However, it is too early to assess whether these outcomes have been achieved as important OFT recommendations are not yet fully implemented.
- 3.94 The OFT has therefore limited the scope of the evaluation of the transparency recommendations to addressing the following two questions:
- Have the recommendations been implemented?
 - Are PCA holders aware of the recommendations? Have there been changes in consumer attitudes and behaviour?

Have the recommendations been implemented?

- 3.95 In October 2009 most PCA providers in Great Britain agreed to implement the OFT's transparency initiatives and provide enhanced

monthly statements, annual summaries and illustrative overdraft charging scenarios.⁹¹

- 3.96 The major PCA providers with the exception of Barclays now provide enhanced monthly statements to their PCA customers.⁹² Several PCA providers that were not part of the original OFT initiative have voluntarily been providing their customers with similar information.
- 3.97 As of January 2013 almost all major PCA providers completed the rollout of annual statements to their entire customer base. A substantial number of smaller PCA providers not subject to the original OFT initiative have also introduced annual statements. However, roll out for most large PCA providers was completed in the second half of 2012 or in January 2013. This roll-out is behind timeline as PCA providers had originally agreed to provide this information by late 2011.⁹³
- 3.98 Illustrative charging scenarios are provided by all PCA providers on their websites. Originally, these were not always easy to locate on PCA providers' websites⁹⁴ and the OFT encouraged providers to make scenarios easier to find and noted subsequent improvements.
- 3.99 Whereas charging scenarios have been provided by major PCA providers as well as a number of other providers by the end of June 2010, roll-out

⁹¹ 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: Barclays, HSBC, Lloyds Banking Group, National Australia Banking Group, Nationwide, Royal Bank of Scotland (RBS) and Santander. See *Personal Current Accounts in the UK, A follow up report*, October 2009, OFT1123, page 8.

⁹² The exception is Barclays, who provide total value and number of Personal Reserve fees and value of debit interest but is not proposing to offer a summary of monthly fees and highlighting charges and fees.

⁹³ *Personal current accounts in the UK, Unarranged Overdrafts*, March 2010, OFT1216, page 37.

⁹⁴ *Personal current accounts in the UK, Progress Update*, September 2010, OFT1275, page 19.

of enhanced monthly statements and especially the annual summary had been slow. Three years after they were agreed, not all customers have received an annual summary; the majority of customers have received their first annual summary very recently.

Are PCA holders aware of the recommendations? Have there been changes in consumer attitudes and behaviour?

Enhanced monthly statements

- 3.100 According to the OFT's consumer survey only 61 per cent of respondents reported that their most recent statement contained, or had with it, at least some additional information that enhanced statements should include.⁹⁵ However, 21 per cent of respondents reported that they don't generally check the details of their bank statements on a regular basis; these respondents might not immediately notice the additional information provided.⁹⁶
- 3.101 There is some evidence that monthly statements might be improving consumer knowledge: Of those consumers that reported receiving an enhanced monthly statement, 33 per cent knew how much they are charged for their arranged overdraft (compared to 21 per cent for those who did not report receiving an enhanced monthly statement). The same applies to unarranged overdrafts (25 per cent versus 16 per cent who did not receive an enhanced monthly statement). Although this evidence

⁹⁵ Respondents were asked whether their most recent statement contained, or had with it, any of the following information: value of unarranged charges; value of fee associated (only packaged accounts); total amount of interest added; total amount of interest deducted; debit/credit rates.

⁹⁶ Seventeen per cent only read or check them occasionally and four per cent never read or check them.

is encouraging, we cannot draw conclusions that these are causal relationships.⁹⁷

3.102 Following-up with consumers who have received an enhanced monthly statement, 24 per cent said that it is likely that they would do something different as a result of seeing the information. This included 59 per cent saying they may consider managing their finances differently to avoid charges, 17 per cent considering comparing interest rates to see where they could gain more, and 13 per cent saying that they may consider switching to another provider.⁹⁸

Annual summaries

3.103 Only 26 per cent of survey respondents stated that they have received an annual summary of their PCA. Based on information from PCA providers, the OFT estimates that over 64 million annual summaries have been provided to customers, which represents around 83 per cent of the PCA market.⁹⁹ Of those who received an annual summary, 63 per cent felt that the summary increased the understanding of their PCA costs and benefits.

⁹⁷ If for example, consumers who realise that their statement has changed are more likely to engage with the information provided, these consumers will in general have better knowledge of PCA products.

⁹⁸ See *Review of the personal current accounts market*, January 2013, for additional details.

⁹⁹ The difference might be due to some consumers not engaging in detail with the information.

Table 8 - Annual Summary – Understanding PCA costs of those who received annual summary

	A great deal	Somewhat	Not at all	Don't know
Annual summary helped in understanding PCA costs and benefits	15%	48%	35%	2%

Source: OFT 2012 consumer survey

3.104 However, we consider this evidence preliminary as PCA providers are currently rolling out statements and most consumers are likely to have received these statements only very recently. We therefore decided not to analyse behavioural impacts as the measured effects will be at best indicative. A full evaluation of the impact of annual statements on consumers is likely to be possible at the earliest in a few years' time.

Charging scenarios

3.105 Data from PCA providers shows that there were 1.4 million unique views¹⁰⁰ of the charging scenarios in 2011. The consumer survey suggests that a quarter of respondents had seen their provider's charging scenarios,¹⁰¹ which is substantially more than the number suggested from the PCA providers' data. The difference might arise if some consumers are referring to their provider's fees and charges website as opposed to the specific charging scenarios.

3.106 Of those respondents reporting having seen the charging scenarios, 46 per cent felt the scenarios were relevant to their circumstances. Twenty-three per cent of those who felt the scenarios were relevant said they

¹⁰⁰ The number of first time views of the page containing the scenarios. Where these pages contain additional information, it is possible that the charging scenarios were not read in detail.

¹⁰¹ Based on the number of active accounts this would imply about 15 million views.

changed the way they used their account.¹⁰² Thirty-two per cent of these consumers say they saved over £50.

Conclusion

3.107 The implementation of the OFT's recommendations on transparency has been slow. Annual summaries have not yet been fully rolled out by PCA providers and enhanced monthly statements have only recently been rolled out.

3.108 There are early indications from the consumer survey that this information may improve understanding and decision-making and enable customers to save money but the slow progress in roll-out means the impact has been limited. However, we have not found strong evidence supporting a causal effect so far.

¹⁰² Asked how much they thought they saved in unarranged overdraft charges from using the scenarios, 46 per cent of respondents said they didn't know. Nine per cent said they saved nothing and the remainder reported saving between £5 and £30.

4 BENEFITS ASSESSMENT

- 4.1 We have assembled the qualitative and quantitative evidence necessary to evaluate the effect of the OFT's interventions on the PCA market in Chapter 3.
- 4.2 The following quantification of consumer benefits focuses principally on the reduction in UOCs resulting from the Test Case and negotiations with the PCA providers parallel to the Test Case.
- 4.3 We find total annual consumer benefits of £652 million from the reduction in UPICs. We conservatively estimate in the following section additional benefits from the reduction in unarranged lending charges at £276 million. This suggests that annual consumer benefits may total £928 million (in 2011 prices), or more.
- 4.4 However, at the same time as the decline in UPICs and unarranged lending charges, revenues from arranged lending have increased by £432 million and revenues from debit interest increased by £107 million per annum (in 2011 prices). It is possible that some of this increase is because the reduction in UOCs has caused PCA providers to raise the costs of arranged lending.
- 4.5 We therefore estimate total annual consumer benefits in the range between £388 million to £928 million. Because we consider it unlikely that the entire increase in PCA providers' arranged lending revenues are due to the reduction in UOCs and because of our conservative approach in estimating this range, we think that annual consumer benefits are more likely towards the upper end of this range.
- 4.6 The work of the FSA and also media pressure created by consumer groups are likely to have been other significant contributory factors to the decline in unarranged overdraft charges we observe. We therefore attribute only two-thirds of the estimated annual consumer benefits to the OFT which is between £259 million and £619 million.

- 4.7 We have considered possible consumer benefits from the switching and transparency recommendations but do not claim any consumer benefits from these interventions for the reasons expressed below.

Unarranged Overdraft Charges

Approach

- 4.8 As discussed in paragraph 2.11, our overall methodology for estimating consumer benefits follows a 'before and after' comparison. We consider that our best estimate of annual consumer benefits resulting from the OFT's work is the difference in consumer detriment between years 2007 and 2011.

- We have used the year 2007 as the 'before' reference point to reflect the pre-intervention market situation. This is the earliest year included in our data request and should adequately reflect the situation prior to the OFT's PCA work. To be more confident that the effects we observe are due to the OFT's work and do not reflect underlying trends, where available we have also used data before 2007 for sensitivity analyses.
- We have chosen 2011 as the 'after' post-intervention reference point. This is the most recent data and so captures the impact of the OFT's work to the greatest extent. Different PCA providers have changed unarranged overdraft charging levels and structure at different times over the last three years. We note that some PCA providers have only recently reduced their charging levels and may still do so further. We therefore consider that this approach is cautious and may understate the eventual extent of the impact of the OFT's work.

- 4.9 The drawback of a 'before and after' comparison is that it does not take into account the effects of other events that may have influenced the PCA market in the last five years. We consider that the OFT's direct work and the accompanying publicity is likely to have been the

predominant driver of changes in unarranged charging structures and levels.

- 4.10 Unarranged overdraft charges had shown a long and sustained increasing trend for a number of years before falling substantially during and after the OFT market study and Test Case.¹⁰³ The 2008 Market Study found that few consumers knew about the insufficient funds charges that applied to their account.¹⁰⁴ The OFT's work created significant public awareness of unarranged overdraft charges which is likely to have led to additional pressure on PCA providers.¹⁰⁵ The lowering of unarranged charges by some PCA providers may have led to pressure on other PCA providers to also change. PCA providers responded to the information request that changes in UOCs were motivated by a desire to simplify the unarranged overdraft charging structure and because of competitive pressure following the OFT investigation.¹⁰⁶
- 4.11 However, we note that the OFT's work was supported and promoted by other Government bodies, such as the FSA, and consumer associations. We therefore attribute only two-thirds of the estimated annual consumer benefits to the OFT.
- 4.12 Given the timing of the OFT's intervention, it is also important to consider the likely impact of the financial crisis. We consider that the financial crisis is unlikely to have had a substantial impact on UOC structures and

¹⁰³ *Personal Current Account in the UK*, July 2008, OFT 1005, page 44.

¹⁰⁴ *Personal Current Account in the UK*, July 2008, OFT 1005, page 82.

¹⁰⁵ A simple article count of 'Office of Fair Trading' and 'overdraft' and 'charges' reveals that between 2005 and 2012 there were over 1000 articles including all of these keywords, mostly concentrated between 2007 and 2009. For other evidence see also *Current, Packaged and Premium Accounts, Finance Intelligence*, June 2009, Mintel, page 16-17.

¹⁰⁶ For example, some PCA providers submitted that they wanted to simplify charging structures to make it more transparent, make comparison easier for consumers and in response to the OFT's review. Others report competitive pressure as rational for changes.

levels. It is possible that the financial crisis had a significant impact on the volumes of unarranged lending. According to PCA providers there has been a decline in overdraft lending due to consumers acting more cautiously.¹⁰⁷ We have considered this in more detail in our analysis below and have accounted for it by using conservative assumptions for the counterfactual when estimating consumer benefits.

- 4.13 We have included all PCA providers in the estimation for which we have complete revenue time series between 2007 and 2011. The respective PCA providers cover roughly 94 per cent of the PCA market in 2011. In keeping with our conservative approach to estimating benefits, we have not scaled the results up to account for other PCA providers which may have also changed their UOCs following the OFT's work.
- 4.14 We have considered consumer benefits from unpaid item charges and from unarranged lending separately below.

Benefits from reductions in Unpaid Item Charges

- 4.15 As shown in Table 2, UPIC revenues have fallen from £1,064 million to £413 million in 2011 prices. This implies that the reduction in UPICs has resulted in annual consumer benefits of £652 million.
- 4.16 We consider that the fall in UPIC revenues from 2007 to 2011 can properly be interpreted as an estimate of the annual consumer benefit that has arisen from reduced UPIC charges. Customers place relevant instructions and incur UPICs without receiving beneficial lending services, because of the control and information issues mentioned in paragraph 3.5 above. We consider it reasonable to assume that a customer would not chose to incur UPICs if these issues did not exist. In other words, the customer would not have placed the Relevant

¹⁰⁷ See for example BBA High Street Banking, October 2012. www.bba.org.uk/statistics/high-street-banking. Amounts outstanding at end-period have somewhat declined between 2007 and 2011.

Instruction if he or she knew that it would be declined.¹⁰⁸ Therefore any revenue derived from UPICs above the costs of their provision is likely to represent detriment to consumers.

Benefits from the reduction in Unarranged Lending Charges

- 4.17 As customers receive a lending service, assessing the consumer benefits from unarranged lending are not as straightforward to assess as UPICs. Some consumers might value the service provided (for example where the request is placed deliberately), whereas others may have preferred the payment to be declined (for example if the Relevant Instruction was placed unknowingly and the payment was of low importance).
- 4.18 We consider that a conservative estimate of the consumer benefits arising from the fall in unarranged lending prices is the volume of unarranged lending under the counterfactual multiplied by the fall in unarranged lending prices. Customers that would previously have incurred charges under the counterfactual are now paying less for the same service.
- 4.19 We have estimated the counterfactual to be a 35 per cent fall in unarranged lending volumes.¹⁰⁹ Under this counterfactual, revenues from unarranged lending charges would have been £1,105m in 2011, had UOCs not been reduced.
- 4.20 It is difficult to measure accurately the extent to which the effective price of unarranged lending has fallen. The scenario analysis provides evidence that the effective price per transaction has fallen substantially. However, the data available does not allow us to weight the different scenarios to get an accurate estimate of consumer benefit. The simple

¹⁰⁸ A customer would not place a relevant instruction if she knew that payment will be declined and charges levied with certainty. Not placing the relevant instruction would lead to a higher benefit because it avoids charges.

¹⁰⁹ Our counterfactual is based on the available evidence on changes in unarranged overdrafts balances and volumes.

average fall in charges from the baseline scenario between 2007 and 2012 is approximately 50 per cent. The smallest fall in charges is 25 per cent. On a conservative basis, we have used 25 per cent as an estimate for the average change in unarranged lending charges.

- 4.21 To estimate consumer benefits we have therefore multiplied the counterfactual revenues of £1,105 million by the 25 per cent estimated decrease in prices since 2007. This results in annual consumer benefits from reduced unarranged lending charges of £276 million.
- 4.22 We believe that this estimate is conservative for the following reasons:
- We have taken a conservative estimate for the change in unarranged lending prices. The charging scenario analysis suggests that prices have fallen by at least this amount and could have fallen by twice as much.
 - Our estimate does not account for any reduction in deadweight loss. As charges for unarranged lending have fallen, we might expect there to be some increase in the demand for unarranged lending. In a market where consumers were in full control of the decision to purchase the product, we would expect this increase in demand to bring benefits to those customers who were now able to purchase the product.¹¹⁰
- 4.23 By way of illustration, we have also calculated a less conservative estimate of consumer benefits of £553 million, by assuming the fall in charges is equivalent to the simple average from our scenario analysis (50 per cent).

¹¹⁰ However, in the case of unarranged lending, it is less clear that this would result in a significant increase in benefit, as some of the increase in volume may be from customers that would not have chosen to take out unarranged lending had they been given the active choice. We therefore consider it appropriate to exclude any possible benefits from a reduction in deadweight loss in unarranged lending.

Other effects

- 4.24 Arranged and unarranged lending exhibit complementarities, to the extent that PCA customers are tied into purchasing a bundle of arranged and unarranged lending from the same provider. For example, a customer may base its decision to choose a PCA provider on arranged lending charges and interest but then later also use the unarranged lending facility.
- 4.25 PCA providers' incentives when pricing arranged lending may therefore also be affected by the additional profits that they expect to make from unarranged lending. High profits from unarranged lending may provide an incentive for PCA providers to charge lower prices for arranged lending in order to win more customers. Lowering UOCs may therefore create an incentive for PCA providers to raise arranged lending prices.
- 4.26 The extent of such an effect will be related to the strength of the economic linkage between the two markets. In the case of arranged and unarranged lending, this linkage relies on there being a significant incentive for PCA providers to lower arranged lending charges in order to win additional customers and profits for unarranged lending. Lowering UOCs would therefore create an incentive for PCA providers to raise arranged lending prices. We consider the PCA market to display a number of features that would limit these incentives:
- Competition in the PCA market is limited. Switching rates are very low and market shares have remained relatively static for a number of years. This implies that PCA providers would be unlikely to gain significant new customers and corresponding revenues from UOCs by lowering arranged overdraft interest rates and fees
 - Arranged lending and unarranged lending are both, to a large extent, characteristics of a PCA. Customer choice of PCA depends on a variety of other factors such as branch location, quality of service, upfront financial incentives, credit interest rates and other add-on products, rather than solely overdraft borrowing rates and fees. Evidence from the consumer survey suggests that overdraft charges

and fees are unlikely to be a major driver of switching PCAs compared to other factors.¹¹¹ This further suggests that PCA providers would be unlikely to gain significant new customers and corresponding revenues from UOCs by lowering arranged overdraft interest rates and fees

- Just seven per cent of respondents to the consumer survey reported incurring an UOC in the last 12 months, which is substantially lower than the proportion that claim to have an arranged overdraft facility on their account (65 per cent). Moreover, most (44 per cent) of those with an overdraft facility say they are never overdrawn and 21 per cent say they are rarely overdrawn.¹¹² This further reduces the linkage between arranged and unarranged overdrafts as it limits the profit from UOCs that PCA providers might gain from lowering arranged lending fees, even if customers were to switch
- Finally, UOC demand is likely to be relatively insensitive to price changes compared to arranged overdraft demand, as consumers generally have better knowledge about their arranged overdraft charges and limits. According to the consumer survey, 29 per cent of respondents said they knew what the fixed charge was for using going into arranged overdraft, which is significantly¹¹³ higher than the proportion who said they knew what the UOC were (22 per cent). Therefore, increasing charges and fees for arranged overdraft would most probably lead to a larger reduction in quantity demanded compared to increasing unarranged charges and fees.

¹¹¹ Taking the first answer given by respondents to the consumer survey on what prompted them to switch, only 12 per cent said it was because overdraft charges and fees on their current account were too high. This compares to 20 per cent who switched because of cash incentives to join the new account and 14 per cent who had switched because of errors with the operation of their current account.

¹¹² Twenty-one per cent said they were sometimes overdrawn, eight per cent usually over drawn and six per cent permanently overdrawn.

¹¹³ Significant at the five per cent level.

- 4.27 The extent to which there is a fall in UOCs and corresponding increase in arranged lending and interest revenues varies significantly across PCA providers. For some we observe an increase in both arranged and unarranged lending revenues. This further suggests that the extent to which the rise in arranged lending charges is linked to the fall in UOCs is limited.
- 4.28 Another argument in relation to this effect is that PCA providers would simply seek to recover profits lost in UOCs by taking advantage of unused profitable opportunities they had elsewhere. In the absence of an economic linkage, we consider that if the PCA providers would find it profitable to introduce additional charges for arranged lending then this would be the case irrespective of whether unarranged lending charges were reduced. We note that the effect of the financial crisis is likely to also have provided motivation for PCA providers to exploit unused profitable opportunities if these opportunities existed.
- 4.29 However, the response of one large PCA provider indicates that shifting the burden of charges from unarranged and towards arranged overdrafts was a deliberate policy.¹¹⁴ For the reasons above we do not think that recoupment is likely to be complete. However, we have taken a cautious approach and offset our estimate of consumer benefit by these changes in the cost of arranged lending as discussed below.

Maintenance charges

- 4.30 Revenues from arranged maintenance charges have increased substantially overall by £432 million (2011 prices), from £16 million in 2007 to £448 million in 2011.
- 4.31 The increase in revenue is likely to be due to some PCA providers introducing maintenance fees for arranged lending and to changes in arranged overdraft volume. However, we do not have robust evidence

¹¹⁴ See *Review of the personal current accounts market*, January 2013.

on volume changes: whereas arranged volumes increased for some PCA providers, they remained constant or declined for others.

- 4.32 The £432 million change in revenue from arranged maintenance charges is therefore considered as a maximum indirect impact figure.

Interest charges

- 4.33 Debit interest rates for arranged lending have increased from 17.7 per cent to 19.3 per cent on average.¹¹⁵ Average rates for unarranged lending have generally showed a declining trend with a number of PCA providers stopping to charge interest on unarranged lending and introducing maintenance charges.
- 4.34 Reported net debit interest revenues¹¹⁶ for both arranged and unarranged lending have increased by approximately £107 million in total. This increase may partly reflects the increase in debit interest rates and partly the change in accounting costs of capital. Net debit interest margins have increased as the base rate has declined substantially from 5.7 per cent in July 2007 to 0.5 per cent in July 2011, while the debit interest rate charged to consumers has increased. We consider that this increase in net interest revenues is likely to overstate economic revenues for PCA providers as we were told by some PCA providers that the cost of capital used in the calculation of net interest revenues is not an accurate reflection of the actual opportunity cost of these funds and increased costs of lending after the financial crises.

¹¹⁵ Bank of England, Monthly interest rate of UK monetary financial institutions (excl. Central Bank) sterling overdraft households (in per cent) not seasonally adjusted; annual average calculated.

¹¹⁶ Net debit interest revenues take into account the margin the bank makes on the lending. The margin is accounted for by the interest rate charged to the customer minus the banks' internal transfer price for the cost of internal funding, which is typically based on a bank specific metric of costs of funds. See Inflation Report, August 2011, Bank of England, p.16 for a general discussion of credit spreads.

4.35 On a conservative basis the £107 million change in revenue from net debit interest is therefore considered a maximum indirect impact figure.

Opt out and control

4.36 We do not attempt to quantify benefits from opt out, control measures and policies to support consumers with financial difficulties. Given the limited implementation of opt out and low consumer uptake, calculated benefit would be minimal. However, to the extent that opt out and control allow customers to avoid UOCs this will be reflected in the reduction in PCA providers' revenues below.

Switching and transparency

4.37 While it is likely that there have been some benefits arising from the OFT's switching recommendations, we have not sought to claim consumer benefits from these recommendations for the following reasons:

- There is uncertainty about the extent to which the switching recommendations have already had an impact. While there is an indication that some aspects relating to switching have improved, such as increased use of the switching service and reduced direct debit problems, there is not very strong evidence supporting a substantial and quantifiable impact.
- The consumer benefits that would arise from any impact of the switching recommendations would be hard to quantify. As noted above, it is too early to assess whether there has been an impact on market outcomes such as prices.¹¹⁷ In addition, there may be intermediate benefits, for example from reduced direct debit problems.

¹¹⁷ Bacs put the respective recommendations in place end of 2009. However, any substantial impact on switching rates and PCA pricing would materialise through an improved switching experience and awareness which is likely to take more time to materialise.

4.38 Similarly, we have not estimated benefits from the OFT’s transparency recommendations. In the case of the monthly and annual summaries, we think that these are too early to evaluate, as these have only been implemented recently and partially.

Total impact

4.39 The OFT’s intervention had a direct effect on UOCs. We estimate that the benefits of the OFT’s interventions were in total £928 million:

- £652 million per annum consumer benefit due to the reduction in UPICs
- £276 million per annum consumer benefit due to the reduction in unarranged lending charges.

4.40 As discussed above it is unlikely but possible that PCA providers attempted to recoup some of this reduction in revenue through changes to interest and maintenance charges for arranged lending (£432 million increase in arranged maintenance charges and £107 million increase in total interest revenues). The respective calculations are shown in Table 11 below.

Table 9 – Total Benefits range

£ million		
Benefits from fall in UPICs	652	652
Benefits from fall in unarranged lending charges	276	276
Increase in arranged lending revenues		(432)
Increase in interest revenues		(107)
Total Benefits	928	388

Source: PCA providers' response to OFT (2012), OFT analysis.

- 4.41 We therefore estimate total annual consumer benefits in the range between £388 million to £928 million. Because we consider it unlikely that the entire increase in PCA providers' arranged lending revenues are due to the reduction in UOCs and because of our conservative approach in estimating this range, we think that annual consumer benefits are more likely towards the upper end of this range.¹¹⁸
- 4.42 The work of the FSA and media pressure created by consumer groups are likely to have contributed to the decline in unarranged overdraft charges we observe. We therefore attribute only two-thirds of the estimated annual consumer benefits to the OFT which is between £259 million and £619 million.

Financial costs associated with the OFT's market study

- 4.43 A final aspect of this evaluation study is to quantify the costs associated with the OFT's intervention, including the direct costs to the OFT of undertaking the study, the costs to Government, regulators and local authorities of implementing changes in regulations arising from the OFT's study and any costs to businesses as a result of increased regulatory burden. This section documents the cost information that it has been possible to gather and evidence.
- 4.44 As we consider it to be too early to assess benefits from switching and transparency recommendations and have not accounted for these benefits, we do not consider the implementation costs to the PCA providers of these recommendations.
- 4.45 We do not consider there to be significant implementation costs to the PCA providers of lowering UOC levels.
- 4.46 Evidence from the OFT indicates that the total direct cost of the OFT of undertaking its Market Study, Test Case and follow up work was in the

¹¹⁸ For example, PCA providers' revenues from unarranged lending have fallen by £395 million however, we conservatively attributed only £276 million to the OFT's intervention.

order of £3.8 million between 2007 and 2011 (in 2011 prices). To be conservative we included all internal and external costs the OFT incurred.