

# **Free-if-in-credit personal current accounts**

Annexe C of Personal current accounts in the UK - an  
OFT market study

July 2008

OFT1005c

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## FREE-IF-IN-CREDIT PERSONAL CURRENT ACCOUNTS<sup>1</sup>

C.1 This annexe presents an analysis of the pricing structure of free if in credit (FIIC) personal current accounts (PCAs) including:

- an overview of PCA revenue sources
- a discussion of the different aspects of the price structure of current accounts: credit balance interest, arranged overdraft interest, unarranged overdraft interest, insufficient funds charges, packaged fees and ancillary charges
- an analysis of how much current accounts cost different types of consumer.

### Free-if-in-credit price structure

C.2 In the UK, the price structure for a standard PCA is generally as follows:

- No charge for most day-to-day account management, such as transactions and monthly statements.

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<sup>1</sup> During our market study we collected data from 16 banks which we estimate accounted for 95 per cent of active current accounts in 2006. The sixteen banks are: Lloyds TSB, Royal Bank of Scotland Group, Barclays, HSBC Group, HBOS, Nationwide Building Society, Abbey National, Allied Irish Bank, Co-operative Bank, Coventry Building Society, National Australian Banking Group, Leeds Building Society, Handelsbanken, Alliance and Leicester, Northern Bank and Northern Rock. This data was supplied by banks in response to an OFT questionnaire. A large quantity of this data is considered commercially sensitive. When presenting this publicly we have aimed to provide an accurate and comprehensive picture of the PCA market without disclosing banks' confidential information. For this reason some data has been replaced with square brackets and bank names in figures have been replaced with numbers. So that individual banks can not be identified this numbering is not consistent across figures. In some cases not all of these banks were able to provide comparable data or, to minimise burdens on business, we did not expect a response for some items. Where possible we have provided the most complete data. The relevant data indicated by the letter in superscript is as follows. A: Data from 16 banks. B: Data from seven banks. C: Data from six banks. D: Data is from five banks. A '+' indicates that the figure has been prorated up to 16 to ease comparison of figures across the report. Results are based upon numbers of active PCAs for the 16 banks. Averages are means, weighted by market share. Data is for calendar year 2006 unless stated otherwise. Interest rates are EAR (equivalent annual rate).

- In most cases the customer receives low levels of interest on their balance when in credit.
- Interest rates are applied to arranged overdrafts, and a higher interest rate is often applied to unarranged overdrafts.
- Additional charges are levied for unarranged overdrafts when a consumer exceeds their arranged overdraft limit (or becomes overdrawn whilst they have no arranged limit).
- Charges are also levied when a consumer attempts to make a transaction that will take their balance into unarranged overdraft which is declined by their bank.
- There are often ancillary charges for additional (non-standard) services such as obtaining a bankers draft, using cards and cash machines overseas and stopping payments.
- Some accounts are provided as part of a bundle of retail banking products which involve a fee for the package, known as 'packaged accounts'. These typically require a monthly or quarterly fee.

C.3 Accounts that do not involve package fees are commonly referred to as free-if-in-credit. Banks earn revenue on credit balances as they derive a higher rate of return from these balances than they pay out to customers in interest. Revenue is also generated from interest charged on overdrafts, and charges relating to unarranged overdrafts and additional services.

C.4 The extent to which banks earn revenue from credit and overdraft balances will vary from customer to customer. Those who have large positive balances in their current account and relatively limited transactions, or customers regularly overdrawn particularly if they exceed their overdraft limits, will generate more revenue than those who, on average, have a small positive balance.

C.5 We consider each element of the price structure in more detail below. Tables 1, 2 and 3 summarise the key elements of the PCA

price structure and show the differences between the highest, lowest and average of the UK accounts that we looked at.<sup>2</sup> According to the data we collected, credit interest rates available range from zero to 7.72 per cent and arranged and unarranged overdraft interest rates vary even more; from 5.9 per cent to 30 per cent for the latter. For insufficient funds charges, some banks do not charge paid item fees, others do not levy overdraft excess fees.

**Table C.1- Credit interest rates**

CIR	
Highest	7.72%
Average	1.74%
Lowest	0.00%

*Source: OFT analysis of Moneyfacts data, January 2008*

**Table C.2 – Overdraft interest rates**

	AOD Interest	UOD Interest
Lowest	5.9%	5.9%
Average	15.4%	22.7%
Highest	20.0%	30.0%

*Source: OFT analysis of Moneyfacts data, January 2008<sup>3</sup>*

<sup>2</sup> For interest rates the average is a non-weighted mean of highest and lowest FIIC account rates available from the following banks: Lloyds TSB, RSBG, Barclays, HSBC Group, HBOS, Nationwide, Abbey National, Co-operative Bank, National Australian Banking Group, Leeds Building Society, Alliance and Leicester, Northern Bank and Northern Rock. For the unarranged overdraft charges, it is a non-weighted mean of the charges levels of the seven largest banks which apply each charge: Lloyds TSB, RSBG, Barclays HSBC Group, HBOS, Nationwide and Abbey National. Figures are for free-if-in-credit PCAs, different rates may be available for packaged or student accounts.

<sup>3</sup> Data on lowest arranged and unarranged overdraft interest rate is from October 2007.

**Table C.3 - Insufficient funds charges<sup>4</sup>**

	Paid item fee	Unpaid item fee	Overdraft excess fee
Charged by	6 banks	7 banks	4 banks
Lowest	£22	£25	£20
Average	£28	£33	£25
Highest	£30	£38	£28

*Source: response to OFT questionnaire by banks<sup>B</sup>, June 2007*

### **PCA revenue**

C.6 We estimate that total revenue derived directly from PCAs was £8.3<sup>A</sup> billion in 2006. This excludes any revenue generated from products cross-sold with PCAs such as insurance and mortgages. It includes revenues from packaged PCAs.

C.7 PCA revenue is largely generated through five sources:

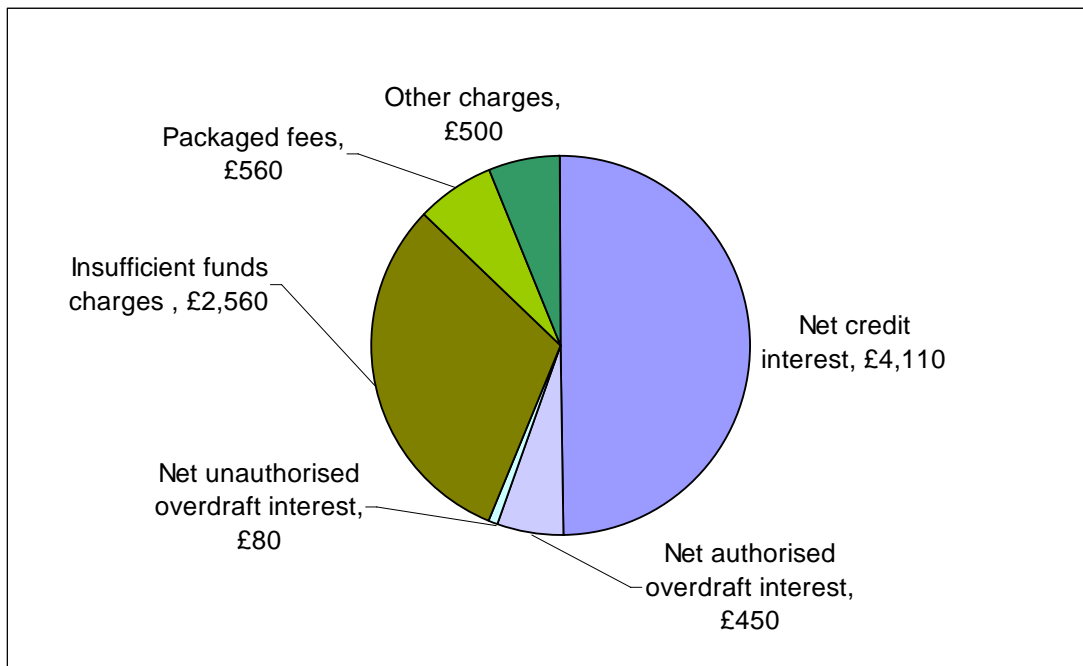
- net credit interest (the difference between the interest paid on credit balances to consumers and the income derived by the bank from these funds)
- net debit interest from arranged and unarranged overdrafts (the interest paid by consumers minus the cost to the bank of lending these funds)
- insufficient funds charges
- packaged fees, and
- ancillary charges.

C.8 Figure C.4 shows the size of each of these revenue sources in 2006.

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<sup>4</sup> See section on unarranged overdraft charges for description of paid item, unpaid item and overdraft excess fees.

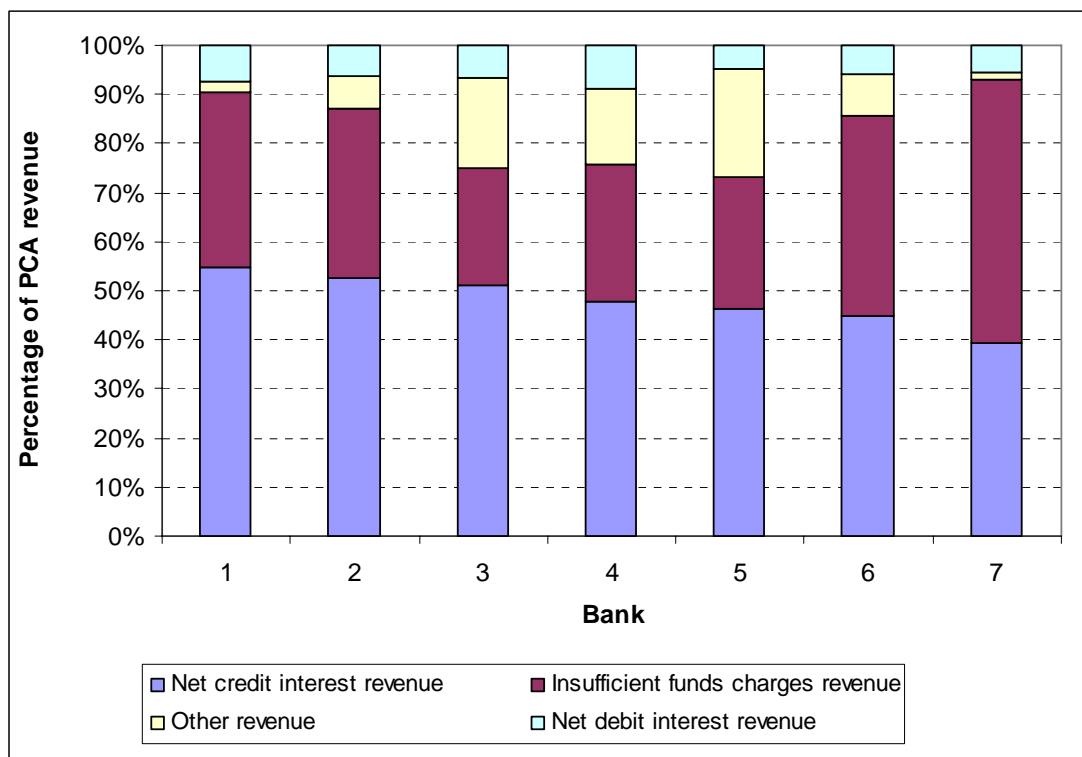
**Figure C.4 – Composition of industry PCA revenue in millions total £8.3 billion, 2006**



*Source: response to OFT questionnaire by banks <sup>A</sup>*

C.9 The average revenue per account of the seven largest banks ranged from £97<sup>B</sup> to £177<sup>B</sup> with an average of £152<sup>B</sup>. Figure C.5 shows the relative importance of four constituent parts of this revenue.

**Figure C.5 – Per centage of PCA revenue from different revenue sources, 2006**



Source: response to OFT questionnaire by banks<sup>B</sup>

C.10 The proportion of PCA revenue the seven largest banks generated from insufficient funds charges ranged from 24<sup>B</sup> to 54<sup>B</sup> per cent. For the same banks net credit interest income ranged from 39<sup>B</sup> to 55<sup>B</sup> per cent of total PCA revenue.

C.11 Figure C.5 shows the average breakdown of revenue per active account for each bank: not every account will generate revenue from all the sources listed above. For the seven largest banks:

- 12.6m<sup>B+</sup> or 23<sup>B</sup> per cent of accounts incurred insufficient funds charges in 2006. Insufficient funds charges revenue is derived entirely from these accounts, averaging £205<sup>B</sup> per account
- There were 7.7m<sup>B</sup> packaged accounts. The average annual packaged fee revenue for these accounts was £73<sup>B</sup> per packaged account.

C.12 The revenue generated from PCAs is used by banks to cover a range of costs. As discussed in Chapter 2, a range of retail banking products often share common costs. The revenue from PCAs typically contributes to covering these common costs as well as the direct costs of providing PCAs.

### **Level of credit and overdraft balances**

C.13 There are two main ways of calculating the average credit (or overdraft) balance of a current account:

- 'Average daily credit balance over the year': the average daily credit (overdraft) balance is calculated over the whole year by summing the end of day credit (overdraft) balances for the year and dividing by 365. This is the average from which it is easiest to calculate interest payments as interest rates are usually quoted as equivalent annual rates.
- 'Average daily credit balance when in credit (overdraft)': the average credit (overdraft) balance for only the days in credit (overdraft) is calculated by summing the end of day credit (overdraft) balances for the year and dividing by the number of days in credit (overdrawn). This gives a better indicator of what a consumer's average balance is likely to be when they are in credit (or overdrawn).

C.14 See Box C.1 for an example for how these different average balances are calculated.

### Box C.1: Example calculations of average balances

This is a simplified example of how 'over the year' and 'when in credit/overdraft' average balances are calculated.

Period	Days in period	Balance each day
Jan-Mar	90	£200
Apr-Jun	91	£100
Jul-Sep	92	-£100
Oct-Dec	92	-£200

The average balances are then calculated as follows:

Credit balance	Average over the year	$= (90 \times 200 + 91 \times 100) / 365$ $= £74$
	Average when in credit	$= (90 \times 200 + 91 \times 100) / (90 + 91)$ $= £150$
Overdraft balance	Average over the year	$= (92 \times -100 + 92 \times -200) / 365$ $= -£76$
	Average when in overdraft	$= (92 \times -100 + 92 \times -200) / (92 + 92)$ $= -£150$

C.15 The average credit, arranged overdraft and unarranged overdraft balances per current account over the year are shown in table C.6. However these aggregate values mask the distribution of average balances.

**Table C.6 Average balances per PCA**

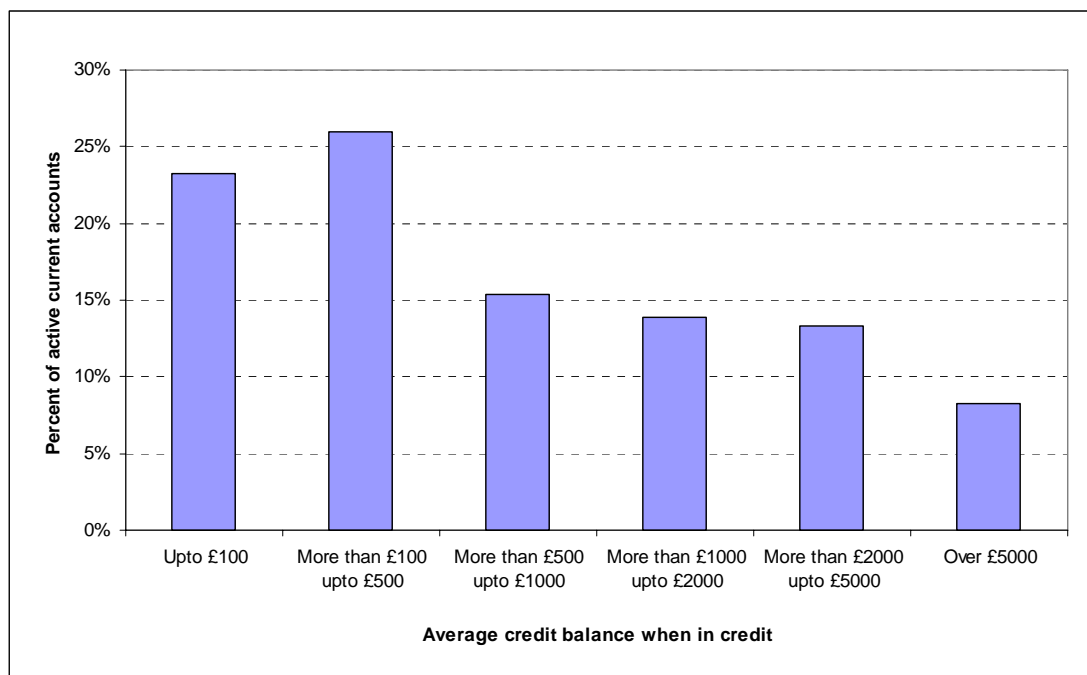
	Average balance per account over the year
Credit balance	£1740
Arranged overdraft balance	-£500
Unarranged overdraft balance.	-£50

*Source: response to OFT questionnaire by seven largest banks<sup>B</sup>*

C.16 Figures C.7 and C.8 show the distribution of average credit and overdraft balances by number of accounts. These are average balances *when in credit or overdraft*. We can see that:

- 49<sup>D</sup> per cent of accounts in credit had an average credit balance of less than £500 whilst 35<sup>D</sup> per cent had an average credit balance of more than £1,000
- 39<sup>D</sup> per cent of accounts overdrawn had an average overdraft balance of less than £100 whilst 15<sup>D</sup> per cent of accounts overdrawn had an average overdraft balance of more than £1,000.

**Figure C.7 – Distribution of average credit balances when in credit, 2006**



Source: response to OFT questionnaire by five banks<sup>c</sup>

**Figure C.8 – Distribution of average overdraft balances when overdrawn, 2006**

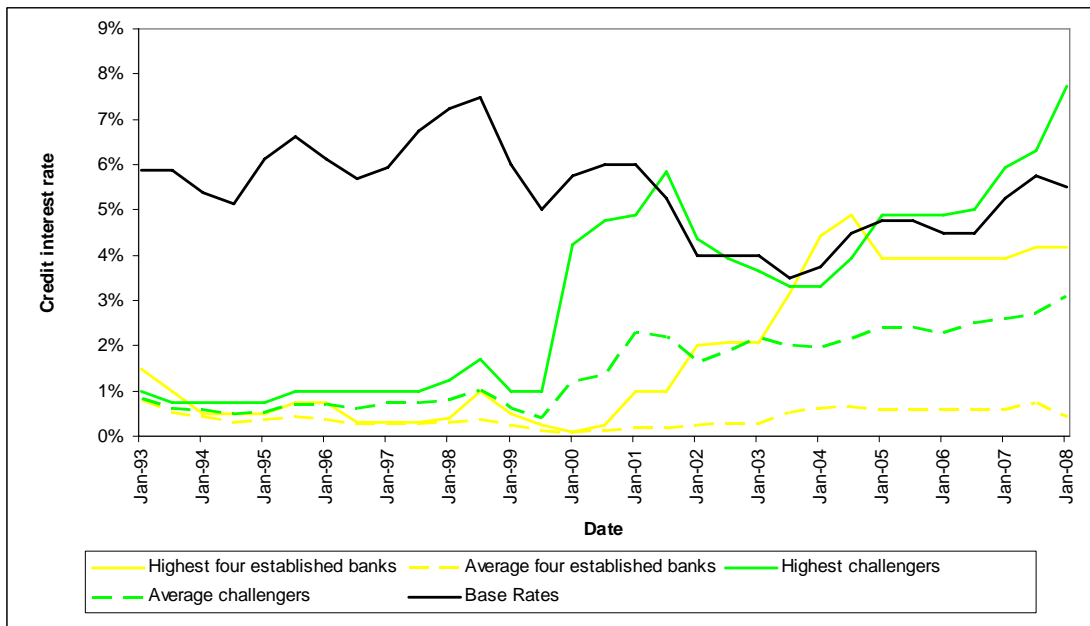


Source: response to OFT questionnaire by five banks<sup>c</sup>

## Credit interest rates

C.17 Figure C.9 shows the highest and average credit interest rates available from the four established banks and the challenger banks compared with the Bank of England base rate since 1993.

**Figure C.9 – Trends in credit interest rates: highest and average rates available from the four established banks and the challenger banks, 1993 - 2008<sup>5</sup>**



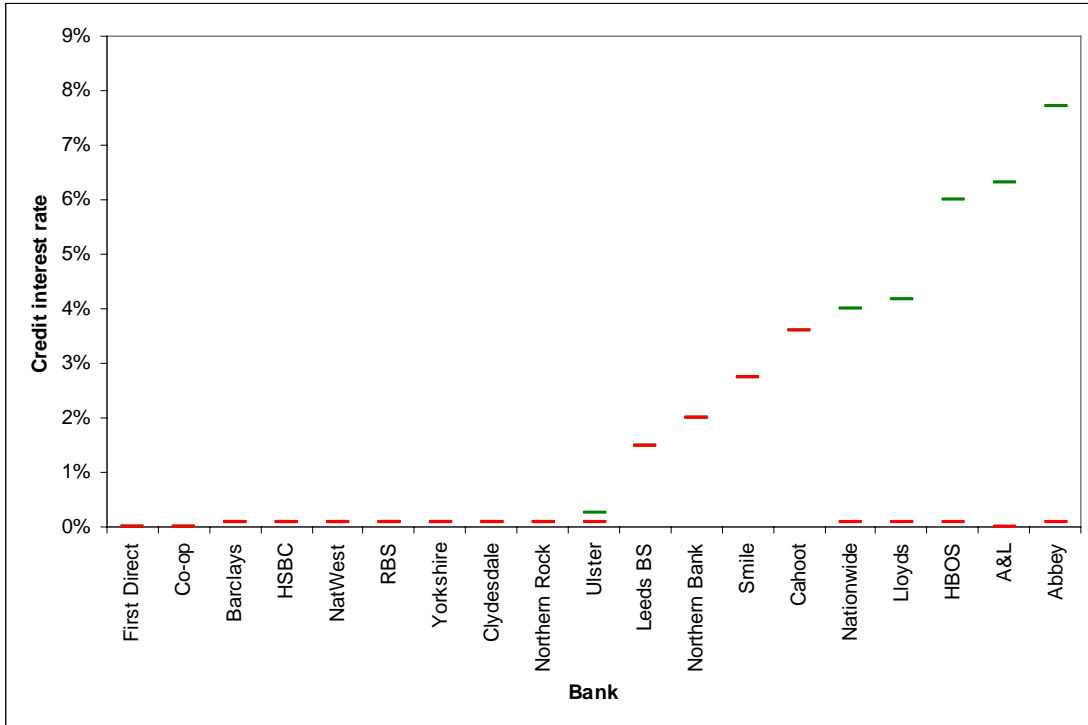
*Source: OFT analysis of Moneyfacts data*

C.18 In 2000 the Co-operative Bank launched its internet subsidiary Smile which offered a credit interest rate of 4.25 per cent. Halifax (now HBOS) and Cahoot followed with higher interest rates. Lloyds TSB introduced an account with a higher credit interest rate in 2003 and now offers just over four per cent on some accounts. However most consumer receive relatively low credit interest rates on their credit balances despite higher rates being available.

<sup>5</sup> Highest interest rates are the highest rate available from a bank in that group. Average interest is the mean of the highest and lowest rates available from each bank in each group. The four established banks are RBS Group, Lloyds, Barclays and HSBC Group. The challenger banks covered are HBOS, Nationwide, Abbey National, National Australian Banking Group and Alliance and Leicester.

C.19 Figure C.10 shows the difference between the highest and lowest credit interest rates offered by banks. Banking groups have been divided by brand.

**Figure C.10 – Highest and lowest credit interest rates available from banks, January 2008<sup>6</sup>**



*Source: OFT analysis of Moneyfacts data*

C.20 It is clear that some banks offer substantially higher credit interest rates than others. The challengers generally offer higher rates than the four established banks. Lloyds TSB does offer a relatively high rate but only [ ] per cent of their accounts receive this level of interest. Higher credit interest rates are also sometimes offered with packaged accounts for which there is a fee.

C.21 Accounts offering higher credit interest rates often have conditions attached, such as the requirement for a minimum monthly payment to be made into the account which, if not made, may lead to a

<sup>6</sup> The higher dash indicates the highest credit interest rate available from a bank and the lower dash indicates their lowest rate. A single dash is used when a bank only offers one rate. These are for free-if-in-credit accounts; different rates may be available for packaged accounts.

lower credit interest rate being applied. Similarly, most of these accounts will pay higher interest rates only up to a certain balance, for example £2,500. The minimum payment requirements for five accounts with the highest credit interest rates available are summarised in Figure C.11.

**Figure C.11 – Examples of minimum funding requirements required for higher credit interest rate current accounts, January 2006**

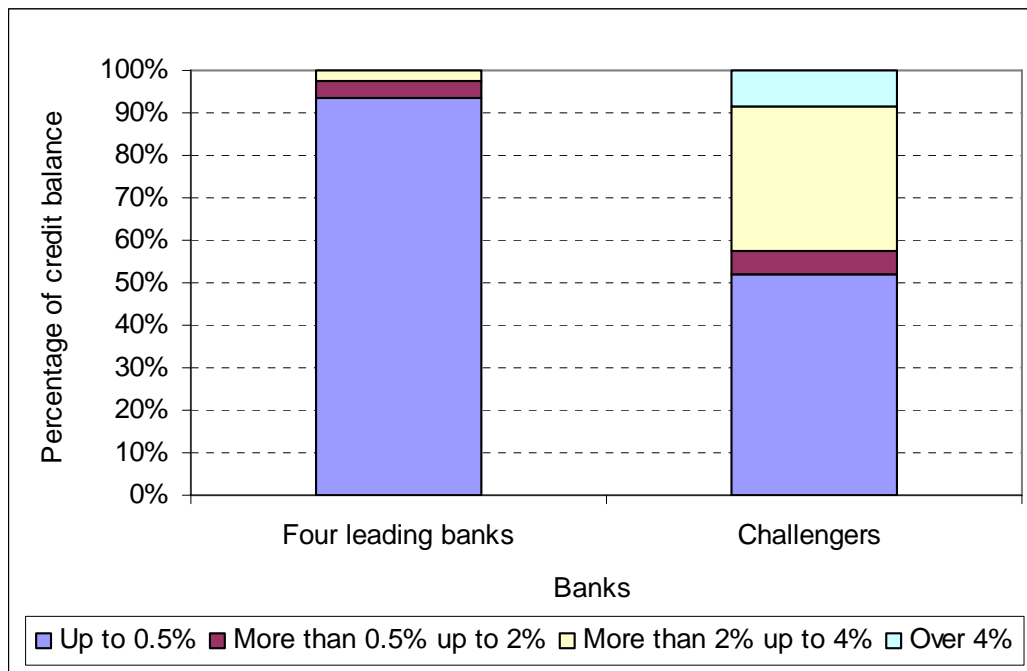
<b>Bank</b>	<b>Credit interest rate</b>	<b>Minimum monthly payment</b>
Abbey National	7.72%	£1000
Alliance and Leicester	6.31%	£500
HBOS	6.00%	£1000
Lloyds TSB	4.17%	£1000
Nationwide	4.00%	£1000

*Source: OFT analysis of Moneyfacts data, January 2008*

C.22 Despite the high rates available on some accounts most accounts received very low credit interest rates. 88<sup>B</sup> per cent of accounts held with the seven largest banks earned less than 0.5 per cent interest on credit balances in 2006.

C.23 Figure C.12 shows the distribution of credit interest rates across credit balances.

**Figure C.12 - Distribution of credit interest rates across credit balances held with the seven largest banks, 2006**



*Source: response to OFT questionnaire by the seven largest banks<sup>B</sup>*

C.24 We can see that, although higher credit interest rates are available the majority of UK consumers' credit balances earn 0.5 per cent or less interest. Of the £87bn<sup>B</sup> held in current accounts with the seven largest banks, 84<sup>B</sup> per cent earned 0.5 per cent or less interest in 2006.

C.25 There is also a substantial difference between the four established banks and the challengers. The average credit interest rate paid by the four established banks is 0.23 per cent. For the three main challenger banks the average is 1.26 per cent. The challengers account for 30<sup>B</sup> per cent of the average credit balance<sup>7</sup> of the four established banks (£20<sup>B</sup> billion compared to £66<sup>B</sup> billion) but pay out 70<sup>B</sup> per cent more interest on these balances to consumers (£257<sup>B</sup> million compared to £152<sup>B</sup> million).

<sup>7</sup> Average daily credit balance over the year.

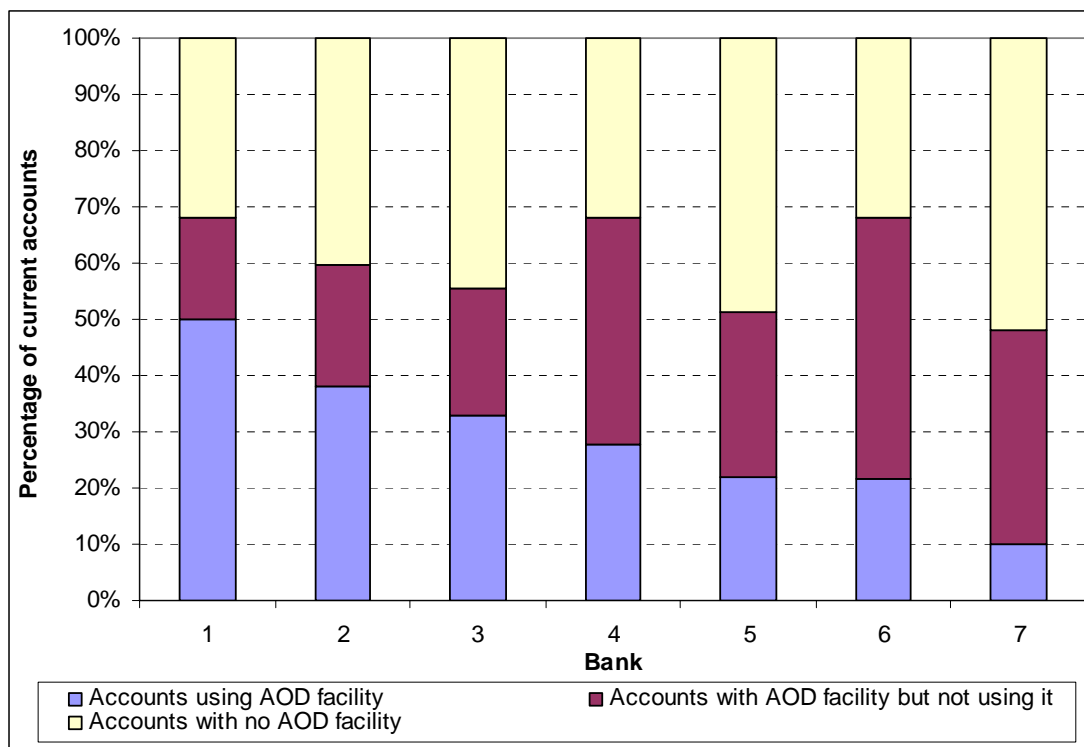
## **The value of credit balances**

- C.26 The largest source of PCA revenue is interest on credit balances which was £4.1<sup>A</sup> billion in 2006 or 50<sup>A</sup> per cent of total PCA revenue. In 2006 the average daily credit balance over the year of the 16 banks surveyed was £97bn<sup>A</sup>. The seven largest banks accounted for 89<sup>A</sup> per cent of the total and the leading four banks 68<sup>A</sup> per cent.
- C.27 The seven largest banks paid £409<sup>B</sup> million in credit interest to their customers in 2006. For every £100 of credit held with these banks over a year, on average a bank generated £4.27<sup>B</sup> in revenue whilst paying their customer 47p<sup>B</sup>. However there is significant difference between the four established banks, which paid 23p on average, and the challengers, which paid £1.26 according to our calculations.
- C.28 Whilst the £4.27<sup>B</sup> is not the same as interest forgone by the customer, as a consumer would not necessarily be able to receive the same level of return as the bank, it gives an indication of the value of a customer's credit balance to the bank.

## **Arranged overdrafts**

- C.29 The arranged overdraft limit is the borrowing limit that a current account customer has agreed with their bank. The customer may then make transactions that take their account into debit close to this limit, for which they normally pay interest, without incurring additional charges.
- C.30 While 62<sup>B</sup> per cent of active accounts have an agreed overdraft facility, 32<sup>B</sup> per cent used it in 2006. Figure C.13 shows how the proportion of active accounts with arranged overdraft facilities and their use varies between the seven largest banks.

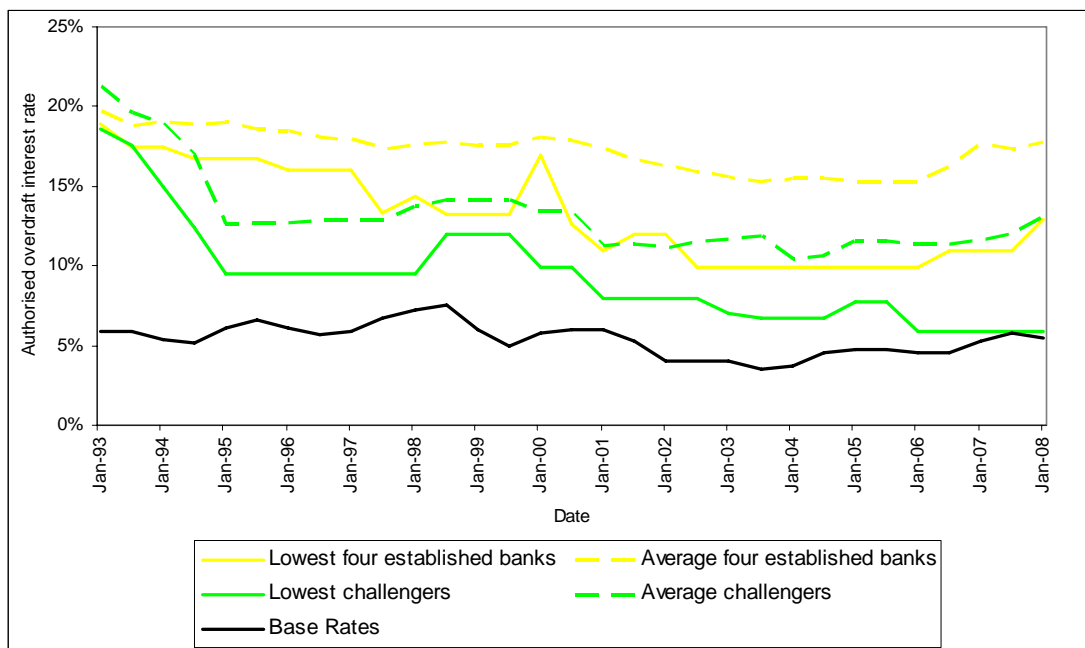
**Figure C.13 – Number and use of arranged overdraft facilities with seven largest banks, 2006**



Source: response to OFT questionnaire by the seven largest banks<sup>B</sup>

C.31 The cost of an arranged overdraft to an account holder depends on its size, duration and the interest rate charged by the bank. Figure C.14 shows how arranged overdraft interest rates have changed over the past 15 years. Figure C.15 shows the variation in the highest and lowest rates available in January 2008. These charts illustrate that the challenger banks generally offer lower arranged overdraft interest rates than the four established banks.

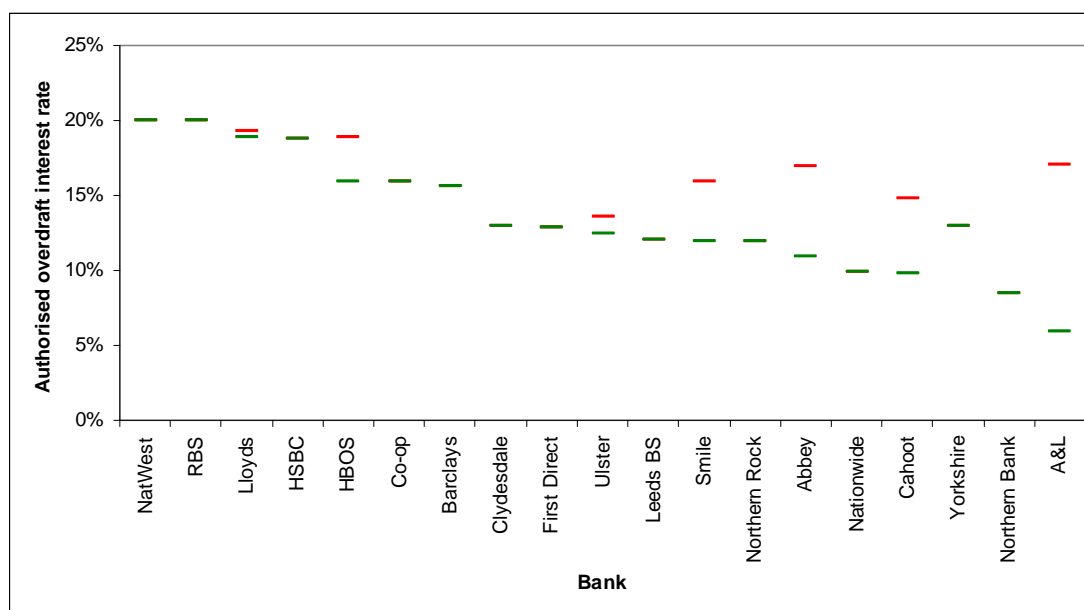
**Figure C.14 – Trends in arranged overdraft interest rates: lowest and average rates available from the four established banks and the challenger banks, 1993 - 2008<sup>8</sup>**



Source: OFT analysis of Moneyfacts data

<sup>8</sup> Lowest interest rates are the lowest rate available from the bank in that group. Average interest is the mean of the highest and lowest rates available from each bank in each group. Four established banks are RSBG, Lloyds, Barclays and HSBC Group. The challenger banks covered are HBOS, Nationwide, Abbey National, National Australian Banking Group and Alliance and Leicester.

**Figure C.15 – Highest and lowest arranged overdraft interest rates available from banks, January 2008<sup>9</sup>**



Source: OFT analysis of Moneyfacts data<sup>10</sup>

## Unarranged overdraft charges

C.32 The second largest source of revenue for banks is income from insufficient funds charges. These are of two main types: transaction charge and overdraft excess charge.<sup>11</sup>

- **Transaction charges** are incurred at the time of the transaction and may be debited immediately (as they are incurred) or at a later date.<sup>12</sup>
  - **A paid item charge** is levied when the bank pays an item which creates or extends an unarranged overdraft.<sup>13</sup>

<sup>9</sup> The higher dash indicates the highest credit interest rate available from a bank and the lower dash indicates their lowest rate. A single dash is used when a bank only offers one rate. These are for free-if-in-credit PCAs; different rates may be available for packaged accounts.

<sup>10</sup> Data on Alliance and Leicester's arranged overdraft interest rate is from October 2007

<sup>11</sup> Due to data constraints we are able to identify between these charges in some cases but not others.

<sup>12</sup> Although certain paid item charges are presented as 'per day', they are effectively levied per item with a maximum of one a day. If there is no transaction during the day, no paid item charge would arise.

- **An unpaid item charge** is levied when the bank declines to pay an item that would, if paid, create or extend an unarranged overdraft.
- **Overdraft excess charges** are incurred at the time the account is in unarranged overdraft during a specified period, and are typically debited in the following charging period. There may be one per month or day.

C.33 An unarranged overdraft occurs when a consumer goes into overdraft without prior arrangement, or exceeds an overdraft limit previously agreed with their bank. Unarranged overdrafts will typically incur charges and face higher interest rates (on the unarranged balance) than do arranged overdrafts.

- 26<sup>B</sup> per cent of accounts held with the seven largest banks went into unarranged overdraft in 2006.<sup>14</sup>
- The average unarranged overdraft balance over the year was £50<sup>A</sup>.
- According to information from four banks, the average amount of time spent in unarranged overdraft was 45 days per year.<sup>15</sup>
- The daily average unarranged overdraft balance for all 16 banks surveyed was £680<sup>A</sup> million.

C.34 How the charges are applied varies; some banks cap the number of charges that an account can incur per month, provide a buffer zone within which charges would not be incurred, or automatically refund the first charge incurred in a specified period.

C.35 Table C.16 shows the levels of paid item, unpaid item and overdraft excess fees charged by the seven largest banks in 2008 as well as

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<sup>13</sup> Some banks levy a separate paid item charge in respect of guaranteed items, such as a cheque backed by a cheque guarantee card or a debit card transaction, the payment of which is effectively guaranteed to the merchant.

<sup>14</sup> As stated in C.11, 23 per cent of PCA were charged an unarranged overdraft fee in 2006. The difference between these two figures is due to leniency by the banks.

<sup>15</sup> For those that used unarranged overdrafts.

what limits are placed on the maximum amount charged per day or month. Not all banks levied all these types of charges: while some banks did not charge paid item or excess fees all banks levy unpaid item fees. The size of some charges depends upon the size of a transaction requested or the size of the unarranged overdraft balances (UOD).

**Table C.16: Levels of charges with the seven largest banks.**

	Unpaid item fees	Paid item fees	Excess fees
<a href="#">RBSG</a>	£38 per item (max £114 per day)	£30, max £30 per day and £90 per month <sup>16</sup>	£28
<a href="#">Lloyds</a>	£20, max £60 per day		£15 + daily fee (UOD £0-£25 = £6, UOD £25-£100 = £15, UOD £100+ = £20, max ten per month)
<a href="#">Barclays</a>	£35, max £35 per day	£30, max £90 per month	
<a href="#">HSBC</a>	Depends upon size of transaction (£10 or less = £0, £10-£25 = £10, £25+ = £25)	£25, max £25 per day	
<a href="#">HBOS</a>	£35, max £105 per day	£35, max £105 per day	£28
<a href="#">Nationwide</a>	£30	<sup>17</sup>	£20 per month
<a href="#">Abbey</a>	Depends upon size of transaction (£0-£10 = £5, £10-£20 = £15, £20-£30 = £25, £30+ = £35)	Depends upon size of transaction (£0-£10 = £5, £10-£20 = £15, £20-£30 = £25, £30+ = £35)	£25 per month

*Source: Review of terms and conditions listed on bank websites, March 2008. Some of these charge levels have been changed since review.*

C.36 Figures C.17, C.18 and C.19 show the trends in the value of paid item, unpaid item and overdraft excess charges over the past seven

<sup>16</sup> Lloyds charge a paid item charge of £35 for transactions that are guaranteed.

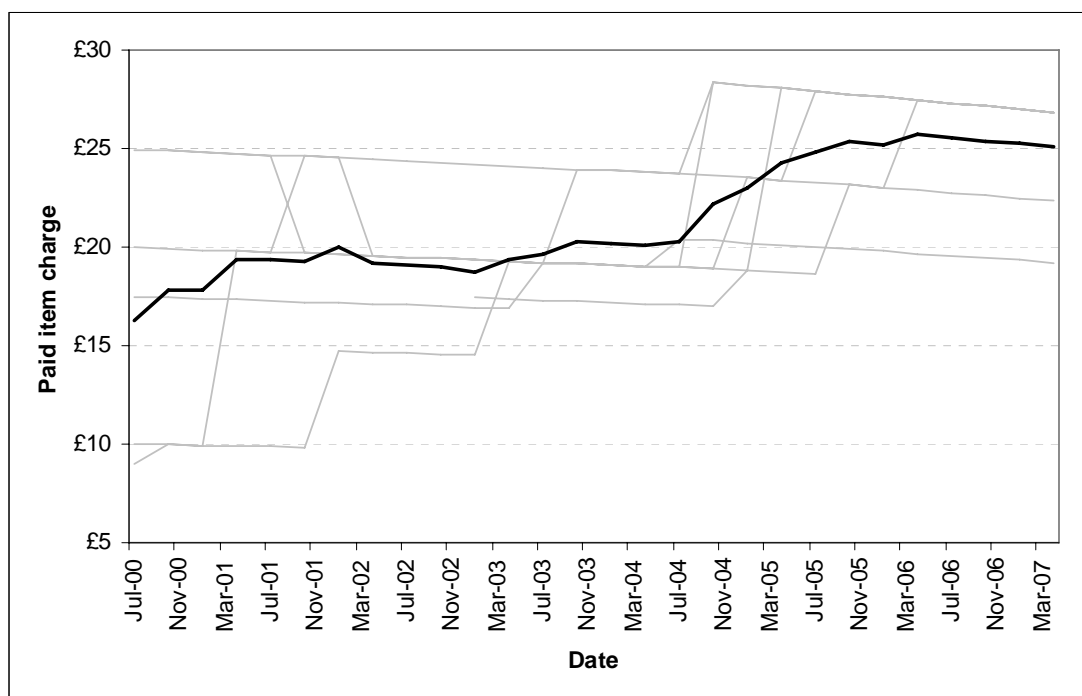
<sup>17</sup> Nationwide charge a paid item charge of £21.50 for transactions that are guaranteed.

years adjusted for inflation.<sup>18</sup> The black central line shows the average charge level and the lighter grey lines show the charge levels of the banks who apply them. Where changes have been made, the general trend has been upwards.

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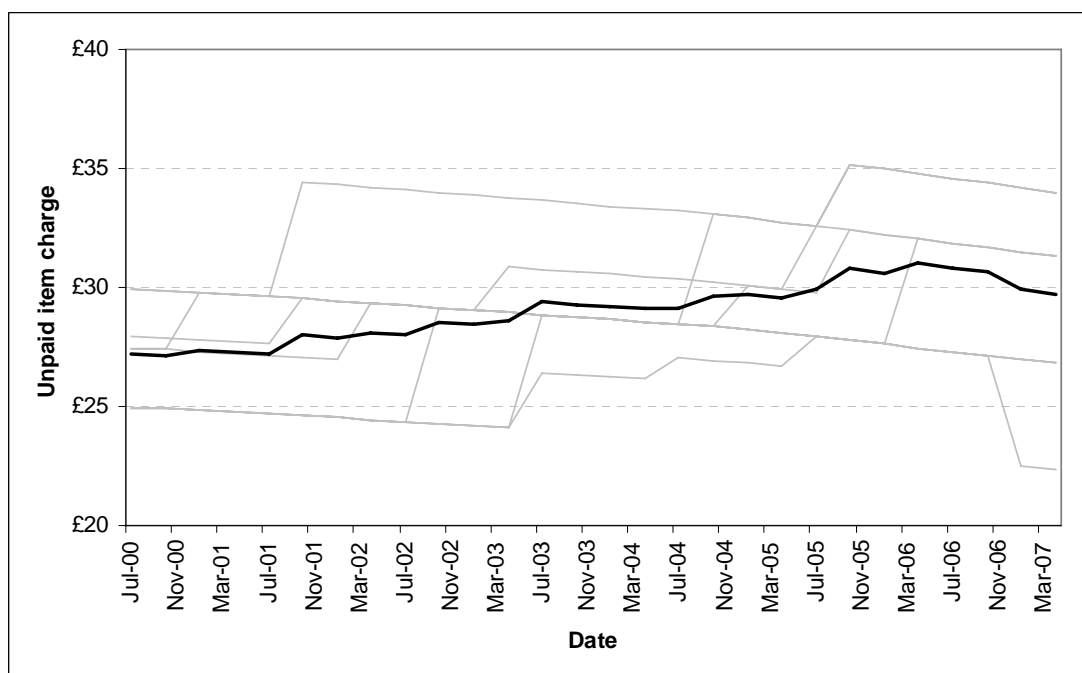
<sup>18</sup> These figures show the value of these charges in 2000 prices. How these charges are applied however is often has a more significant impact on how much consumers pay than there absolute level.

**Figure C.17 – Trends in paid item fees, 2000 - 2007**



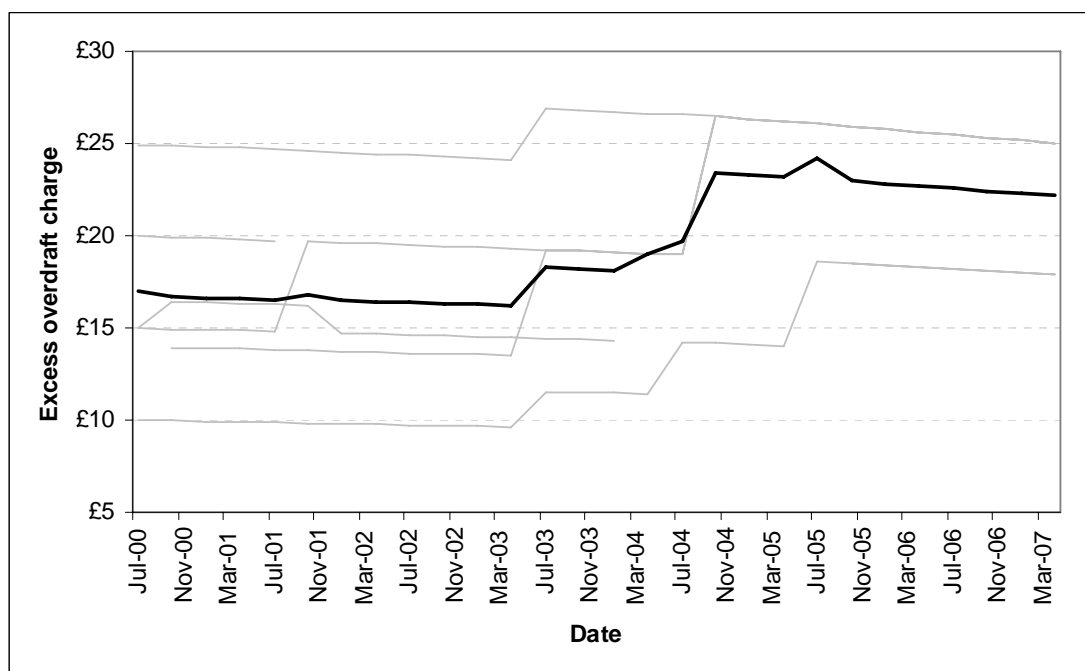
Sources: response to OFT questionnaire by the seven largest banks and ONS inflation data<sup>B</sup>

**Figure C.18 – Trends in unpaid item fees, 2000 - 2007**



Source: response to OFT questionnaire by the seven largest banks and ONS inflation data<sup>B</sup>

**Figure C.0 – Trends in excess fees, 2000 - 2007**

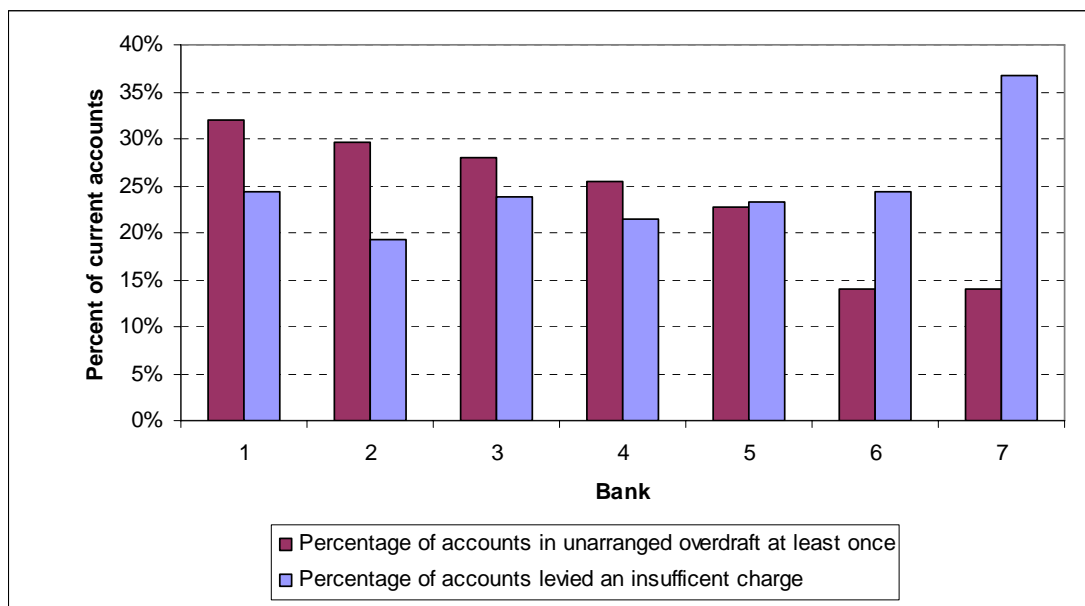


Source: response to OFT questionnaire by the seven largest banks and ONS inflation data<sup>B</sup>

C.37 The following two figures show the differences in the application of insufficient funds charges between banks. Figure C.20 shows the percentage of active accounts that were in unarranged overdraft at least once and the percentage that incurred an unarranged overdraft or returned item charges for each of the seven largest banks.

C.38 The figure indicates that there is a variation across the seven largest banks in the proportion of accounts that enter unarranged overdraft and incur insufficient charges funds. This is due to a combination of factors; banks will not always levy a charge when an account enters unarranged overdraft and some unpaid item charges will be levied before an unarranged overdraft is created.

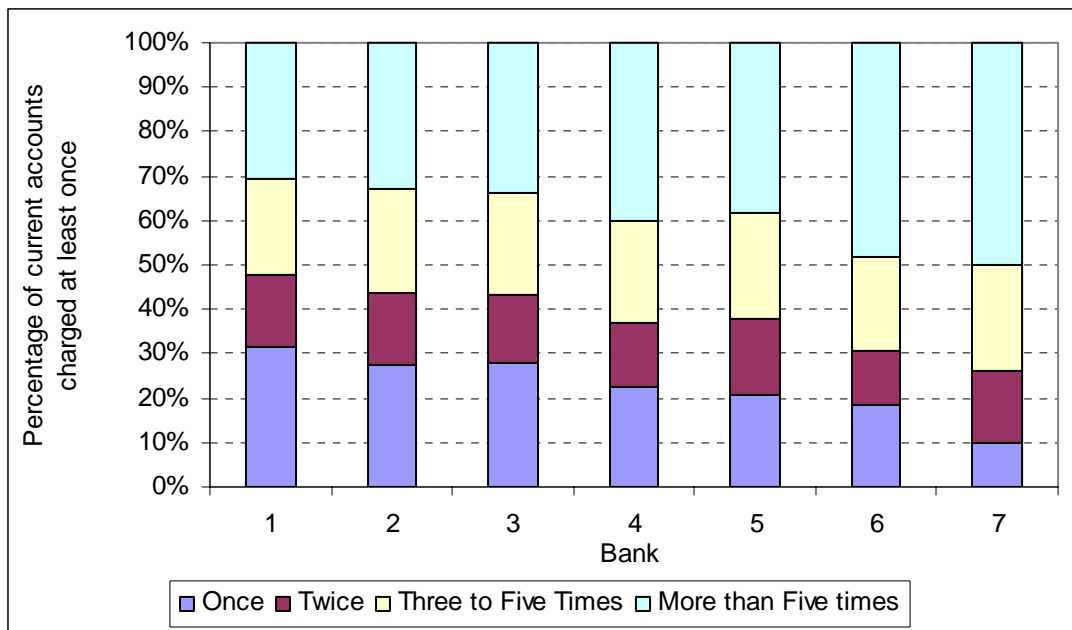
**Figure C.20 – Number of accounts with unarranged overdrafts and paying Insufficient funds charges for the seven largest banks, 2006**



*Source: response to OFT questionnaire by the seven largest banks<sup>B</sup>*

C.39 Figure C.21 shows the distribution of insufficient funds charges by number of charges incurred for those accounts that were charged at least once. We can see that some banks levy more insufficient funds charges than others. The percentage of accounts that were charged at least six times varies from 30<sup>B</sup> per cent to 50<sup>B</sup> per cent of those charged at least once.

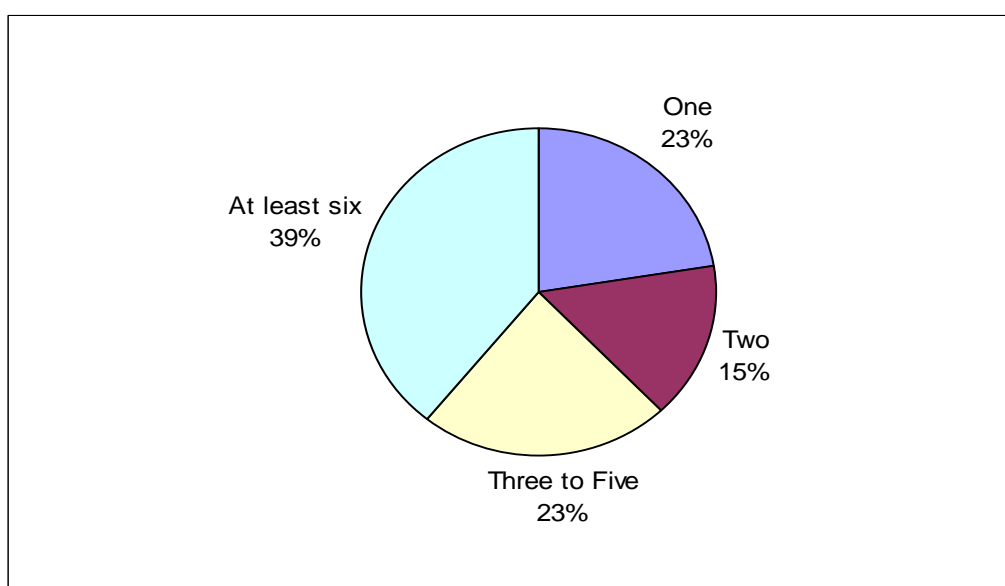
**Figure C.21 – Number of charges incurred by accounts held with the seven largest banks, 2006**



Source: response to OFT questionnaire by the seven largest banks<sup>B</sup>

C.40 Figure C.22, which shows the distribution of number of charges across all banks, illustrates that of those consumers who were charged, 39<sup>B</sup> per cent were charged at least six times compared to 23<sup>B</sup> per cent that were charged once.

**Figure C.22 – Number of charges incurred by those charged at least once, 2006**

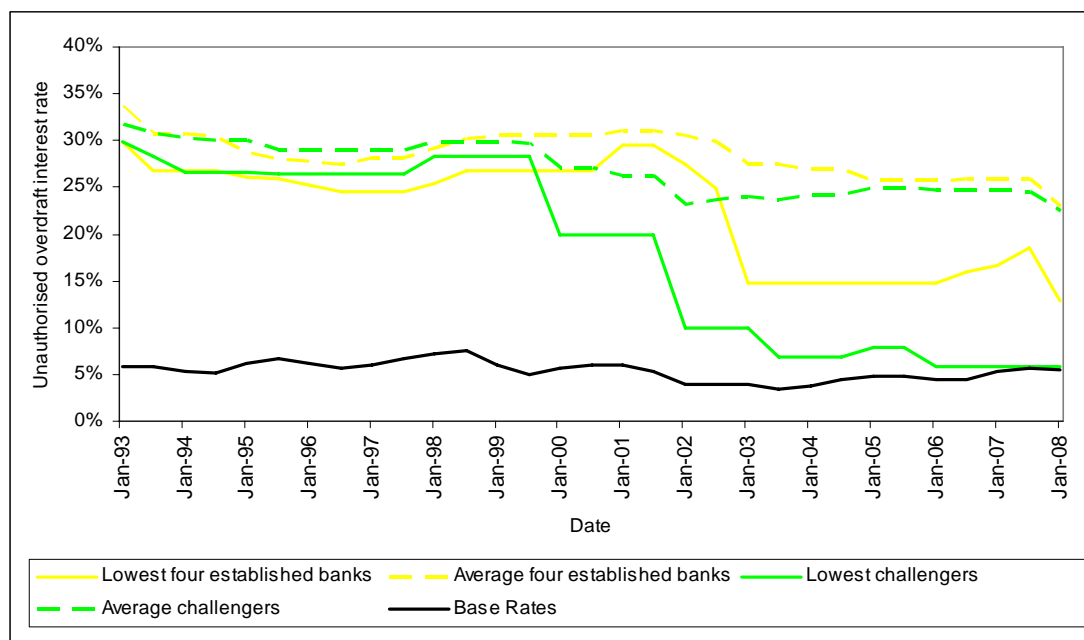


Source: response to OFT questionnaire by the seven largest banks<sup>B</sup>

## Unarranged overdraft interest rates

C.41 Figure C.23 shows the lowest and average unarranged overdraft interest rates available from the leading four banks and from the challengers since 1993. The lowest rates available have improved since 2000 as Alliance and Leicester and HSBC have lowered their rates. However, as we can see from Figure C.24, the majority of banks charge higher rates.

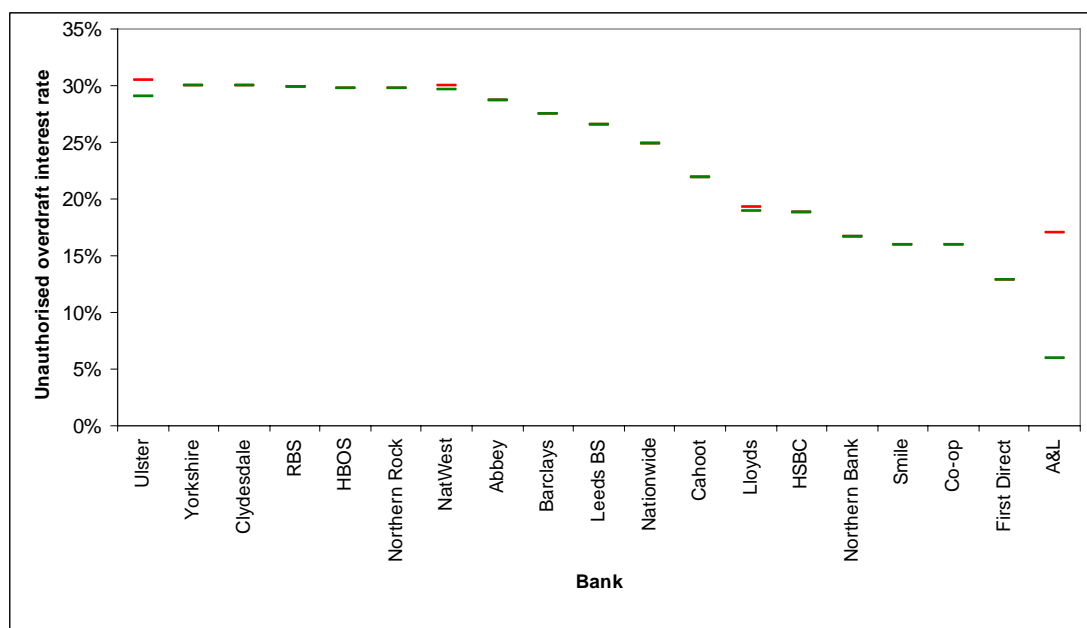
**Figure C.23 – Trends in unarranged overdraft interest rates: lowest and average rates available from the four established banks and the challenger banks, 1993-2008<sup>19</sup>**



Source: OFT analysis of Moneyfacts data

<sup>19</sup> Lowest interest rates are the lowest rate available from the bank in that group. Average interest is the mean of the highest and lowest rates available from each banks in each group. Four established banks are RSBG, Lloyds, Barclays and HSBC Group. The challenger banks covered are HBOS, Nationwide, Abbey National, National Australian Banking Group and Alliance and Leicester.

**Figure C.24 – Highest and lowest unarranged overdraft interest rates available from selected banks, January 2008<sup>20</sup>**



Source: OFT analysis of Moneyfacts data<sup>21</sup>

## Other revenue

C.42 Monthly or annual fees for packaged accounts generated seven per cent<sup>A</sup> of total PCA revenue in 2006. Packaged account customers typically pay a monthly or quarterly fixed charge regardless of whether the account is in credit or overdraft, but do not pay any transaction charges. Customers are also likely to receive preferential terms on other characteristics of the account (for example, on credit interest rates or arranged overdraft rates), may be exempt from some ancillary charges, and often receive other bundled benefits such as free travel insurance or discounts on some purchases. In the UK around 14<sup>A</sup> per cent of active personal current accounts are packaged accounts.

<sup>20</sup> The higher dash indicates the highest credit interest rate available from a bank and the lower dash indicates their lowest rate. A single dash is used when a bank only offers one rate. These are for free-if-in-credit PCAs; different rates may be available for packaged accounts.

<sup>21</sup> Data on Alliance and Leicester's unarranged overdraft interest rate is from October 2007

C.43 Ancillary charges accounted for six<sup>A</sup> per cent of total PCA revenue. These include fees for making transactions abroad, currency conversions and stopping payments, among others.

### **Typical consumer analysis**

C.44 Our typical consumer analysis illustrates how the cost of a current account can vary for different consumers. The cost estimates are based on January 2008 Moneyfacts data on credit and overdraft interest rates and insufficient funds charges of the seven largest banks. Packaged and student accounts are excluded. Cost is the amount that the consumer could expect to pay in interest and charges, and does not include an estimate of interest forgone.

C.45 We use six consumer profiles to illustrate how the cost of using an account varies, depending upon their credit balance, debit balance and whether they have an unarranged overdraft.

C.46 The six profiles we model are:

- **Typical credit consumer without unarranged overdraft (UOD)** who has a typical average credit balance, is never in debit and never has an unarranged overdraft
- **Typical credit consumer with UOD** who has typical average credit balance and an unarranged overdraft
- **Typical debit consumer** who is always in debit but never in unarranged overdraft (they use their arranged overdraft for monthly consumption spending)
- **High credit consumer** who has a high credit balance and is never in debit
- **High debit consumer** who is always in debit, has a large debit balance and also enters unarranged overdraft, and
- **Marginal credit consumer** who stays just in credit, is never in debit or has an unarranged overdraft.

C.47 Table C.25 summarises for each profile the average credit, arranged overdraft and unarranged overdraft balances, the number of days per year spent in each and the number of insufficient funds charges incurred. The balances for each profile were estimated using average balance data from five banks discussed (see figure C.7 and C.8).

**Table C.25 – Consumer profiles**

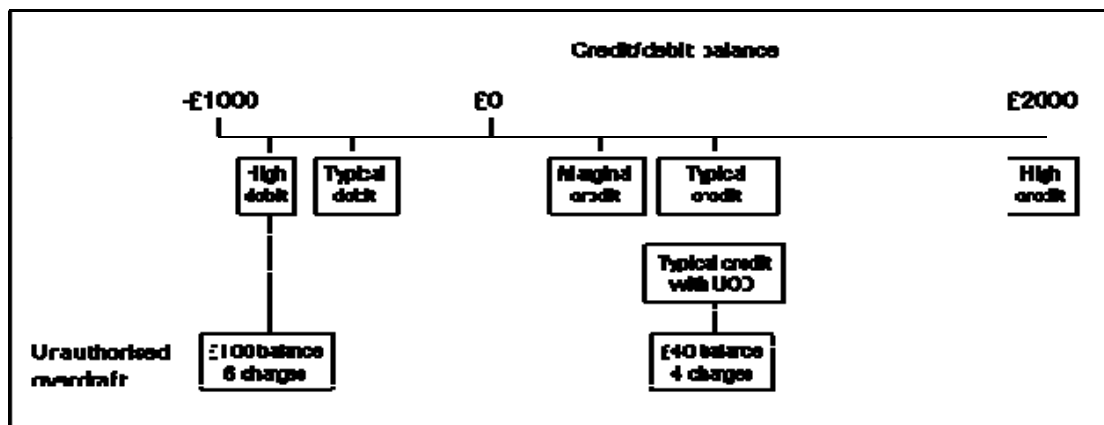
Consumer	Credit Balance	Credit Days	AOD Balance	AOD Days	UOD Balance	UOD Days	Charges
Typical credit without UOD	£830	365	0	0	0	0	0
Typical credit with UOD	£830	345	0	0	£40	20	4
Typical debit no UOD	0	0	£500	365	0	0	0
High credit	£2,000 <sup>22</sup>	365	0	0	0	0	0
High debit with UOD	0	0	£800	315	£100	40	6
Marginal credit	£400	365	0	0	0	0	0

C.48 Figure C.26 illustrates the position of each profile according to their average credit / debit balance, shown on the horizontal axis and whether they have an unarranged overdraft, illustrated with attached labels.

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<sup>22</sup> High credit consumers with an average balance of £2000 are likely to have a maximum monthly balance of over £2,500. If these consumers move to a PCA with a higher credit interest rate they are unlikely to be able to earn higher interest on the amount above £2,500 as this is the upper threshold for most high interest paying PCAs. This average balance therefore represents the *average balance of credit below £2,500*.

Figure C.26 – Illustration of typical consumers profiles



- C.49 For example, the cost of a current account for the **typical credit with unarranged overdraft consumer** was calculated based on the following parameters: a credit balance of £830 for 345 days, an unarranged overdraft of £40 for 20 days, and four insufficient funds charges. The costs associated with these specific parameters were calculated for 12 current accounts from the seven largest banks. For this consumer, the annual cost of a current account ranges from £29 to £97.
- C.50 Annual current account costs and income are summarised in table C.27. The negative numbers indicate the cost of using the account and the positive numbers indicate the amount that a consumer can earn from interest paid. Current cost is an estimate of the typical cost for each profile and is calculated by assuming consumers are distributed across accounts according to their market shares.
- C.51 Note that 'cost' is the amount that the consumer could expect to pay in interest and charges, and does not include an estimate of interest forgone. Interest forgone from not switching is the saving that a consumer would make if they switched from their 'current' account to the account that offers the best value for them. Although this level of saving may not be achievable by everyone, the ability of each consumer to meet the minimum funding requirements of an account was taken into consideration. It can be interpreted as the interest that the consumer is missing out on, if they are in credit, or the potential savings in interest paid and charges, if they are in overdraft.

**Table C.27 – The annual costs of personal current accounts for different consumer profiles**

Consumer	Current cost/ income	Highest value account	Lowest value account	Interest forgone from not switching	Impact of charges
Typical credit without UOD	£8	£64	£1	£56	£0
Typical credit with UOD	-£80	-£29	-£97	£51	£87
Typical debit no UOD	-£88	-£50	-£100	£39	£0
High credit	£14	£116	£2	£102	£0
High debit with UOD	-£297	-£221	-£333	£76	£173
Marginal credit	£4	£31	£0	£27	£0

*Source: OFT analysis using Moneyfacts data*

C.52 The cost of free if in credit current accounts varies considerably between consumers. The **high credit consumer** can actually earn up to £116 per year from their account (though the average is around £14) whilst the **high debit consumer** pays up to £333.

C.53 A key result from this analysis is that whether a consumer uses an unarranged overdraft has a very large effect on the cost of an account compared with differences in credit or debit balances. Whilst a **typical credit consumer** without an unarranged overdraft generally would earn around £8 a year, a consumer with the same credit balance who occasionally goes into unarranged overdraft will on average pay £80.

C.54 The large differences in the savings from switching indicate that interest forgone can be very large for consumers with high average credit balances.

C.55 **Summary of how the cost of a current account varies by use according to our estimates:**

- A consumer with a typical credit balance who is never in debit or unarranged overdraft will earn £8 per year from their account on average but they could earn £56 more if they switched.
- The same consumer who enters unarranged overdraft will pay £80 per year on average but they could save £51 from switching and £87 from avoiding insufficient funds charges.
- A consumer who is permanently in arranged overdraft will pay £88 on average but they could save £39.
- A consumer with a high credit balance will earn £14 per year on average but could make up to £116.
- A consumer with a large debit balance who regularly exceeds their unarranged overdraft will pay £279 per year on average but they could save £76 from switching and £173 from avoiding insufficient funds charges.

## Summary

C.56 Banks generate revenue from a range sources. Of the total PCA revenue in 2006 of £8.3 billion 50 per cent was generated from consumers' credit balances. Insufficient funds charges accounted for 31 per cent. The remainder was generated from overdraft interest, ancillary charges and packaged fees.

C.57 There is a significant difference between the credit and overdraft interest rates available from banks. As a result consumers could benefit by switching account.

C.58 Different consumers pay different amounts for their account. Consumers with large debit balances who incur a large number of charges typically pay the most. Consumers with high credit balances also implicitly miss out on additional interest if they continue using an account paying very little credit interest. Consumers with low credit balances who do not use overdraft effectively pay the least for their account use.