

Personal current accounts market study

A consultation paper

16 July 2008

OFT1005con

© **Crown copyright (2008)**

This publication (excluding the OFT logo) may be reproduced free of charge in any format or medium provided that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as crown copyright and the title of the publication specified.

CONTENTS

1	Introduction and background to market study	1
2	Main findings from the study	3
3	Issues on which views are sought	6
4	Evaluating remedies	11
5	The consultation process and next steps	13

1 INTRODUCTION AND BACKGROUND TO MARKET STUDY

1.1 The Office of Fair Trading (OFT) launched its market study into personal current accounts (PCAs) at the end of April 2007. Two previous studies expressed concerns about the operation of the market. The Cruickshank Report in 2000¹ concluded that consumers were not adequately informed about their financial products and found it difficult to compare them. The Competition Commission's investigation of the PCA market in Northern Ireland² concluded there was a lack of information and transparency about charging structures and practices. This meant that consumers believed that switching banks was more difficult than it was in practice.

1.2 The main drivers of the market study were:

- the significance of PCAs to consumers and economic growth
- complaints about the level and incidence of current account charges, and
- low levels of transparency and the limited extent to which consumers drive competition in the provision of PCAs.

1.3 The market study has sought to establish a complete picture of the market, drawing together current and past work and building on the many developments already achieved in the industry, to examine whether the market is working well, and, if not, to make recommendations to remedy the problems identified. The OFT believes that the best outcome is a market with strong competition driven by consumers who are actively engaged in securing value for money. This typically requires a higher degree of transparency over products and their conditions and an easy process for switching from one bank to another.

¹ *Competition in UK Banking, a Report to the Chancellor of the Exchequer*, Don Cruickshank, March 2000.

² *Personal current account banking services in Northern Ireland market investigation*, Competition Commission, May 2007.

- 1.4 The study also provides the context for the OFT's Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) investigation into the fairness of terms relating to unauthorised overdraft charges. The first stage of the test case was launched in the High Court in July 2007 to determine whether the 'fairness' test in the UTCCRs applied to terms relating to unauthorised overdraft charges. It did not consider whether the terms are unfair.
- 1.5 The test case judgment, handed down on 24 April 2008, confirmed the OFT's view that terms are assessable under the UTCCRs. This judgment is the subject of an appeal. The question of fairness of the terms under the UTCCRs is not part of the remit of the market study.
- 1.6 Following publication of the market study the OFT will conduct a consultation with stakeholders, details of which can be found below. The aim of this paper is to begin this process by outlining the main findings of the market study and seeking views on both these findings and any potential remedies.
- 1.7 Given various developments in the market as a result of the test case it is likely that some stakeholders will be engaging with the OFT regarding both the market study and the UTCCRs investigation. The OFT will be discussing with these stakeholders how best to take the two processes forward and to ensure that there is minimal overlap. We aim to ensure that overlaps are managed to achieve a resolution for consumers as soon as possible.

2 MAIN FINDINGS FROM THE STUDY³

2.1 We have found evidence of competition in the PCA market but we are concerned that certain features of the market are not working well for consumers.

2.2 The positive aspects include:

- high levels of customer satisfaction
- customers receive many day-to-day services without incurring fees
- internet and telephone banking makes it easier for customers to manage their account, and
- there are a number of providers in the market and evidence of modest competitive pressure on the four established banks by challengers.

2.3 The significant areas of concern are:

- low levels of transparency on fees that make up a high proportion of the payment that consumers make for their current account services, both in terms of their amount, frequency and the manner in which they are levied
- the complexity in the way that these charges are implemented that makes it hard for consumers to predict when they will be incurred
- a lack of simple mechanisms for consumers to control whether they use services for which they are charged
- a significant proportion of consumers consistently incur charges and appear to underestimate both their level and frequency, and

³ The full report can be found at www.offt.gov.uk/pca

- a general perception, not unfounded, among customers that switching is both complex and risky, contributing to low levels of switching between banks and an inefficient allocation of the risks from switching.

2.4 As a result, we believe the ability of the market to function well has become distorted in three ways:

- first, there seems to be a substantial cross subsidisation from those consumers who incur insufficient fund charges to those who do not; and to a significant extent this is from socially vulnerable low income, and from low saving, consumers to higher income, higher saving ones
- secondly, the extent of this cross subsidisation means there is a substantial misalignment between the banks' revenue and their costs on many of their products and services. This may lead to inefficiency through under or over consumption of services by consumers, and
- finally, the lack of consumer awareness and switching on the less visible elements provides banks with little incentive to compete on them. This may also have a longer term impact on productivity within the banking sector. Without competition in these areas banks have lower incentives to create new and innovative services.

2.5 Furthermore, given the constraints on competition, and in particular the low switching rates, we are not persuaded that any additional profits made from less visible elements are fully competed away in terms of lower fees in other areas. This raises the possibility that a significant proportion of the profits made on less visible fees are kept by the banks rather than passed back to consumers through more intensive competition.

2.6 The OFT believes that the market may be stuck in an equilibrium that does not work well for many consumers. A significant number of consumers do not know how much they will effectively pay in bank fees

or how individual elements in the charging structure will be implemented, either before or after they are incurred. This limited understanding of key account elements, combined with low confidence in switching, means that the banks have less incentive to provide better offers on charges and interest. Without better offers from banks, however, consumers have little incentive to switch.

- 2.7 Consumers lose in two ways. A minority lose out significantly, but ultimately everyone suffers if the banks have little incentive to compete vigorously by providing better offers on fees and forgone interest.

3 ISSUES ON WHICH VIEWS ARE SOUGHT

- 3.1 The issues raised during the course of this market study can be grouped under three broad headings:
- low levels of transparency
 - complexity over the charging structure making it hard for consumers to predict and control the costs they incur, and
 - low levels of switching.
- 3.2 The OFT welcomes a discussion about each of these areas and would like to hear the views of banks and other financial institutions, consumer groups and other interested organisations during this consultation exercise. We would also like to explore potential measures to address these issues.
- 3.3 The OFT also welcomes comments on our findings regarding the ways in which the market has become distorted and the implications that this has for a well functioning market.
- 3.4 A discussion of each of these areas follows, including examples of the sorts of questions on which we seek views. The examples given are not prescriptive or exhaustive. Rather they are included to facilitate the consultation process by stimulating debate.

Low level of transparency

- 3.5 The findings from our study indicate that, due to a lack of vital information which is held by banks but which is not easily available in a user friendly format, consumers have limited understanding of the true cost of running their personal current account and the potential gains from switching to a new account from an alternative bank.
- 3.6 We would therefore like to consider proposals which, if implemented, would allow customers to have available the right information, in an easily digestible format to help them to understand the true cost of running their account and hence manage it more effectively. We would

like to be able to consider measures which would provide them with the tools to compare accounts more easily and to assess whether they are getting value for money. Our study found apparent high levels of customer satisfaction with the service they receive from banks. We should be interested to hear views on this, and whether comparative data about customer service levels would be helpful.

3.7 Examples of the sorts of questions on which we seek views include, but are not confined to:

- the information consumers would find most helpful to enable them to compare PCAs and to decide whether to switch, or choose account if a new customer, (both generic and customer specific), and whether such information should be available in standardised format, and whether it should be held electronically
- the trade off that may exist between the need for information and the potential for being overloaded
- whether there would be benefits for consumers in having comparative data about customer service levels across banks available, and whether this would improve the competitive process, and
- which elements of customer service are important and how they should be measured.

3.8 We note the initiatives put in place by the banking industry to improve financial literacy and the transparency of information available, particularly via the Banking Code. We note further that in a recent Discussion Paper⁴ the Financial Services Authority (FSA) has proposed to publish the complaints data provided by firms in their regular returns, as well as some of the data gathered by the Financial Ombudsman Service (FOS). The Independent review of the FOS's accessibility and transparency led by Lord Hunt recommends the FSA and the FOS should

⁴ *Transparency as a regulatory tool*, Financial Services Authority, May 2008

work together with industry and consumer stakeholders to enable joint publication of performance data on a firm-specific basis. The FOS Board is minded to accept this recommendation in principle. We too are supportive in principle.

Complexity of the charging structure making it hard for consumers to predict and control the costs they incur

- 3.9 Our research has found that, in 2006, 31 per cent of bank revenue came from the charges applied to PCAs on occasions when customers' transactions would or do move them into unarranged overdraft. These charges are hard for consumers to understand, predict and control. As a result there seems to be a significant cross subsidisation from those consumers who incur insufficient funds charges to those who do not.
- 3.10 There are benefits for some consumers in having an unarranged overdraft facility and PCA providers should have the right economic incentive to provide such a facility. We would like to see measures that help consumers have greater control over the incidence of charges allowing them, where possible, to choose whether or not to incur any charges at all.
- 3.11 We would therefore like to consider proposals which, if implemented, would give customers more control over their accounts and thus enable them to manage their finances better. Making the level and application of charges more transparent to consumers will also drive greater competition on charges for those for whom this is a significant cost.
- 3.12 Examples of the sorts of questions on which we seek views include but are not confined to:
- how the balance should be struck between PCA providers facilitating consumer control of their finances and consumers' personal responsibilities for their own actions
 - the factors, if any, that should determine the level of charges (for example, how much risk customers should take for the

consequences of not having the right amount of funds in their account), and

- the measures that would make it easier for consumers to monitor and control their finances.

Low levels of switching

3.13 We acknowledge innovations that have taken place in attempting to ensure a smoother switching process, particularly with the Bacs switching model. However, making switching easier will not, on its own, change the market for the reasons outlined previously. There has to be a desire and willingness to switch on the part of consumers to exert competitive pressure on banks. Even where there is a desire, however, our findings show that consumers have reservations. There is a general perception among consumers that switching is both complex and risky. The results of our survey show that such reservations are not totally unfounded, and are contributing to low levels of switching between banks.

3.14 We would therefore like to consider proposals which, if implemented, would give consumers who have identified potential benefits from switching and have a desire to switch, confidence in the process. We welcome views on whether there are underlying problems with the switching process and on any potential measures to address any problems identified.

3.15 Examples of the sorts of questions on which we seek views include but are not confined to:

- whether a high degree of confidence in switching is important for the market, and, if so, how confidence in switching should be improved (for example, whether data on successful switching should be published)
- whether the impact of confidence in the switching process varies across different types of consumers

- which part of the switching process is most important to get right (for example, how the role of third parties should be addressed), and who should bear the consequences of switching going wrong, and
- whether third parties may have a role in using customer-specific data to help consumers compare different bank offers.

4 EVALUATING REMEDIES

- 4.1 This document invites comments on actions that the OFT or the banks might take for the purpose of remedying, mitigating or preventing any detrimental effects on consumers that may be the result of the findings of the study. Views are sought on the nature of any problems in the PCA market, the benefit that any intervention would be aiming to achieve and the actions that would be required to meet this objective.
- 4.2 The OFT believes that there is a distinction between different types of remedies:
- first there are remedies that support delivery of a well functioning market. These may be remedies that a competitive market might be expected to deliver but that no business has an incentive to implement unilaterally. For example, while a well-functioning market may result in efficient switching procedures, no bank has a unilateral incentive to make it easier for customers to switch away from it to competitors, and
 - secondly, there are remedies that replicate what a well functioning market would deliver. These might help move a market to a better equilibrium but can be more intrusive (for example price setting).
- 4.3 Ideally, remedies that support delivery of a well-functioning market would remove the need to implement remedies designed to replicate that market. In reality there may be a case for putting temporary remedies in place to achieve replication until the remedies designed to deliver a well-functioning market are effective. We would welcome views on this. The contrary position, on which we would also welcome views, is that any such remedies implemented may have the effect of depressing competition in the market.
- 4.4 In considering possible remedies, the OFT will take into account the reasonableness and practicality of any measures proposed, the associated costs and relevant consumer benefits, and any possible unintended consequences in terms of dampening existing levels of competition. For example, such benefits may comprise lower prices,

higher quality or greater choice and greater innovation. Provision of information in standard electronic form that assists with product comparison may benefit consumers but could also impose costs of banks. Any parties wishing to make recommendations should include comments on why they believe the benefits would be likely to outweigh any associated costs.

5 THE CONSULTATION PROCESS AND NEXT STEPS

Responding to this consultation

- 5.1 This consultation follows the criteria set out in the Cabinet Office's Code of Practice on Consultation:

www.berr.gov.uk/bre/consultation%20guidance/page44459.html

The criteria set out in that code are attached at **Annexe A**.

- 5.2 We welcome comments on the market study report from all sources, but we should welcome views from the banking and retail finance industry, consumer groups and other interested stakeholders. Consultees responding to this consultation are asked to supply a brief summary of the interests or organisations they represent, where appropriate. **Annexe B** contains a list of those individuals and organisations we have consulted. We welcome suggestions for other individuals or organisations who should be consulted.
- 5.3 We ask that any suggested changes or comments on the documents be submitted in writing (by email or alternatively by letter, as indicated below).

The consultation period

- 5.4 The consultation period began on 16 July 2008 and will run until 31 October 2008. This period is in accordance with the criteria set out in the Cabinet Office's Code of Practice on Consultation. All responses and comments should be sent to:

Retail Banking Team
Room 1E
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London
EC4Y 8JX

Email: Retailbanking.study@oft.gsi.gov.uk

Next steps

- 5.5 We will collate responses to the consultation and publish a formal summary of these. Depending on the outcome of the consultation we hope to publish a further or final report early in 2009.
- 5.6 Our aim is for a final report containing recommendations that the banking industry, in consultation with government and other relevant stakeholders, will take forwards. However we will also consider other routes to implement remedies should that not happen.
- 5.7 There are several routes we will consider and would welcome feedback on:
- changes to the Banking Code
 - recommendations to Government or regulatory bodies, and
 - a market reference to the Competition Commission.
- 5.8 Separately, we will also be considering whether failure to adopt any particular future recommendations could lead to enforcement under the UTCCRs or the Consumer Protection from Unfair Trading Regulations 2008. Naturally we would give the businesses the opportunity to remedy any breaches of the law we identified before taking enforcement action.

Data use statement for responses

- 5.9 Please note that we may choose to refer to comments received in response to this consultation in future publications. In deciding whether to do so, we will have regard to the need for excluding from publication, as far as that is practicable, any information relating to the private affairs of an individual or any commercial information relating to a business which, if published, would or might, in our opinion, significantly harm the individual's interests, or, as the case may be, the legitimate business interests of that business ('confidential information'). If you consider that your response contains such information, that information should be

marked 'confidential information' and an explanation given as to why you consider it is confidential. All information received is subject to Part 9 of the Enterprise Act 2002.

- 5.10 If you are replying by email, these provisions override any standard confidentiality disclaimer that is generated by your organisation's IT system.

Annexe A: Cabinet Office's Code of Practice on Consultation

Public bodies are required to perform consultations in accordance with the following criteria wherever possible

- A.1 Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
- A.2 Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
- A.3 Ensure that your consultation is clear, concise and widely accessible.
- A.4 Give feedback regarding the responses received and how the consultation process influenced the policy.
- A.5 Monitor your Department's effectiveness at consultation, including through the use of a designated Consultation Coordinator.
- A.6 Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

Further information on the Code can be found on the website of the Department for Business, Enterprise and Regulatory Reform (BERR):

www.berr.gov.uk/bre/consultation%20guidance/page44459.html

Comments or complaints about the consultation process

A.7 If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

Jessica Precious
OFT Consultation Coordinator
Room 5C/O39
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London
EC4Y 8JX

Annexe B: List of consultees

Banks and Building Societies

Abbey

Allied Irish Bank

Alliance and Leicester

Barclays Bank Plc

Citibank

Cooperative Bank

Coventry Building Society

Handlesbanken

Halifax Bank of Scotland

HSBC

Leeds Building Society

Lloyds TSB

National Australia Bank Group

Nationwide

Northern Bank

Northern Rock

Royal Bank of Scotland

Consumer Organisations

Citizens Advice Bureau

Citizens Advice Scotland

Consumer Council Northern Ireland

Money Advice Scotland

National Consumer Council

Welsh Consumer Council

Which?

Financial Institutions

APACS

British Bankers Association

Building Societies Association

Regulators

Financial Ombudsman Service

Financial Services Authority

Other Government Departments

Department for Business Enterprise and Regulatory Reform

Her Majesty's Treasury