
Questions and answers for OFT personal current account market study

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Market study background

Q.1 Why did the OFT carry out a market study?

The factors that influenced our decision to carry out a study were:

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

The market study looked at the provision of personal current accounts in the wider context of competition and price transparency, to enable us to fully assess perceived problems and identify any enforcement or other action the OFT should take or make recommendations for other changes to the market.

It therefore enables the OFT to consider the extent to which consumers drive competition, about which the OFT raised concerns in its response to the Banking Codes review 2007.¹ The Competition Commission also found that consumers were not actively searching or switching in the market for personal current accounts in Northern Ireland.

Q.2 How does the market study relate to the UTCCRs investigation into unarranged overdraft charges?

We have conducted a market study alongside a UTCCRs investigation so that we can fully understand all aspects of the current account market, and therefore, fully understand what effect any action by the OFT may have on this market in order to try to avoid any undesirable consequences as far as possible.

Q.3 How does the market study affect consumers in Northern Ireland, Scotland and Wales?

The market study covered the whole of the UK and the main UK banks. We have not specifically focused on NI due to the recent CC report. We expect our findings will have relevance to NI, Scotland and Wales.

¹ www.offt.gov.uk/shared_offt/reports/financial_products/oft903.pdf

Q.4 What are the roles of the FSA and FOS in all this?

The Financial Services Authority (FSA) regulates the financial services industry and in particular deals with how banks handle complaints. Like the OFT, it does not handle individual complaints but it does have an interest in ensuring that complaints about past actions are satisfactorily dealt with.

The FSA is a Qualifying Body under the UTCCRs, meaning it too has the power to enforce them, where appropriate.

The Financial Ombudsman Service (FOS) has responsibility for dealing with individual complaints by customers. While both organisations hold different roles, we have been working together to ensure that this process is as well coordinated as possible.

Market concerns

Q.5 How concerned is the OFT about potential waterbed effect?

The OFT recognises the possibility of waterbed effects.² That is one of the main reasons for conducting the study alongside the UTCCRs investigation so that we can better understand any implications of that work for current account pricing generally, and try to avoid any undesirable consequences so far as possible

Q.6 What legislation can be used to ensure that banks don't just introduce annual fees to all or some accounts or increase rates to all or some accounts to compensate for lowering default charges to cost?

Banks are free to operate whatever business models they choose, subject to compliance with consumer protection laws and that might include annual fees. Such a model would not necessarily fall foul of legislation providing the fees were made clear in the contract. Up front charging is also subject to the pressures of competition.

Q.7 Don't any of the big four banks offer high credit interest PCAs?

Some do however many of their existing customers are not opting to take these, are unaware, or are unable to take these offers. Most of the big four's customers receive less than 0.5 per cent credit interest (90 per cent (or 33m) of PCAs at the big four received less than 0.5 per cent in 2006)

Q.8 When considering switching rates, did the OFT take account of people opening a PCA with a new bank but not closing their old account?

In our report we define switching to include consumers who have switched provider for their primary PCA requirements, even if they have kept their old account open. In our survey over half (53 per cent) of recent switchers said they kept their old account open. Amongst all switchers, one in five (21 per cent) had opened their main PCA in addition to an existing one.

² Effect whereby regulation of one of the prices of a multiproduct firm causes one or more of its other unregulated prices to change as a result of the firm's behaviour

Q.9 There does not appear to be much to gain by switching from one current account to another. Would you like to see more switching- if so why?

We acknowledge that switching rates in the PCA market are unlikely to reach the levels seen in other financial sectors however we feel that low switching rates have an implication on both competition and efficiency. Where consumers are reluctant to change providers, firms have less of an incentive to compete vigorously because of opportunity to win new customers and the risk of losing existing customers is reduced. In addition new entrants into the market offering potentially better deals have less opportunity to expand.

Q.10 Are you saying banks deliberately make switching difficult?

No we are not. When people do switch the process tends to be relatively easy and trouble free, but a significant minority of consumers do have problems, particularly with direct debits and standing orders. What is worrying is that in our survey this was more likely to be the case for those that used bank switching services than those that made their own arrangements.

Q.11 Most customers appear to be satisfied with their accounts and the service they get - why the need for further action?

It is true that the provision of PCAs in the UK has many positive features:

- high levels of customer satisfaction
- customers receive many day-to-day services without incurring a charge, and
- internet and telephone banking makes it easier for customers to manage their account.

However our study has revealed a number of concerns which we believe warrant consideration of remedial action:

- low levels of transparency over charges and costs coupled with a high proportion of banks total revenues made on such charges and costs
- the complexity of the charges makes it hard for consumers to control the costs they incur, (some consumers pay significant amounts (1.4 million paid over £500 in charges)
- a significant group of consumers that consistently underestimate the level and frequency of banks' charges, and

- a general perception, not completely unfounded, among customers that switching is both complex and risky, contributing to low levels of switching between banks.

Q.12 Banks have recorded record profits in the UK in recent years. Why did you not look into whether banks were making excess profits?

It is very difficult to make definitive statements about the profitability of PCAs in the United Kingdom because most of the costs of providing PCAs are shared with other financial products supplied by the banks. Most providers consider profitability across their entire retail banking operations and do not allocate costs to individual products.

Q.13 Why is there little competition in the market?

Our evidence shows that some price competition does exist between banks on the more visible upfront dimensions such as credit interest rates and authorised overdraft rates. However competition is less focussed on non visible dimensions such as unauthorised overdraft charges. These charges can be complex and are not understood by many consumers. As a result they do not actively focus on these aspects of current account prices when making their purchasing decisions. This reduces the incentives for banks to compete on these less visible charges as consumers underestimate their demand for services that incur such charges.

Next steps

Q.14 Now that you have finished your market study, what happens now?

We have identified a number of issues which we feel warrant further in depth discussion with the industry prior to deciding on the next appropriate step. The OFT has published a consultation paper setting out these issues and some thoughts on potential measures to address them. We plan to consult with the industry for a minimum of three months during which time we hope to have meetings with interested parties so that all the issues raised in the study and potential measures to address them can be discussed.

Q.15 Why haven't you proposed any remedies in your market study report, following the similar pattern seen in previous market studies? Why bother with a long consultation exercise after publication?

We have given considerable consideration to remedies throughout the life of this market study however we were not in a position to take a final decision as to next steps and any appropriate remedies until we had consulted with the industry and other key stakeholders. In so far as it is possible to evaluate, when deciding what to do next, including assessing any potential remedies, we want to ensure that the benefits to consumers outweigh costs, that we have regard to the principle of proportionality and that remedies provide the right productivity incentives for banks. For example, we would not want to advocate remedies that overload consumers with too much information or with information they will not use, or would find confusing. The consultation exercise allows for greater transparency and provides the industry and others to engage with us on the findings of our market study and to assess which measures would bring about the most significant improvements for consumers, and at what cost.

Q.16 Is it fair to expect consumers to carry on paying these charges in the meantime?

We consider that the test case is the best way to achieve the certainty that is needed by all as to what is a fair level for charges for unauthorised overdrafts. Our work does not prevent those who feel they have a grievance from raising their issues directly with their bank in the first instance.

However the normal complaint channels have been affected by the test case as follows:

- to facilitate the test case, in July 2007, the FSA granted a number of banks a waiver. This means that firms who were granted the waiver do not have to deal with complaints about unauthorised overdraft charges for one year, or until the test case is resolved. The waiver does not interfere with firms' obligations under the Banking Code, which sets out how firms should deal with cases of financial difficulty
- for the time being, the FOS has decided not to progress complaints or deal with new ones, other than in hardship cases
- the courts may also stay (put on hold) claims made to them. Whether and when those stays are lifted is for the courts to decide

Q.17 When will this consultation exercise start and how long will it take?

The consultation exercise starts as soon as we publish the market study and accompanying consultation paper. The consultation exercise will last for a minimum of 3 months.

Q.18 What will happen post consultation? Will another report be published?

We will collate responses to the consultation and publish a formal summary of these. Depending on the outcome and progress of the consultation we hope to publish a further report early in 2009. Our aim is for a final report containing recommendations the banking industry will take them forwards. However we will also be considering other routes to implement remedies should that not happen.

Q.19 What remedies do you want the Banks to implement as a result of the market study?

We have not selected any specific remedies because we want to discuss in depth the areas of concern we have identified. We are open to suggestions from the banks and other key stakeholders which will bring about long term benefits to both consumers and the industry. This is the one of the aims of our consultation exercise. We would like to see remedies which result in:

- Greater transparency in current accounts pricing that will enable active and informed consumers to drive competition amongst banks. This in turn will deliver efficiency in supply and value for consumers.
- Banks treating consumers sufficiently fairly and well, within a coherent self-regulatory framework or otherwise, that pre-empts the need for further regulatory intervention.

Q.20 What types of action are open to you?

We hope that we can have an informative debate with the banks on the matter of forward solutions. The OFT will look to carry on the goodwill gained from the OFT chaired Payments Systems Task Force and Credit Card Comparisons Project. These have and will lead to positive changes to the UK banking system. Other routes to implement remedies could include:

- changes to banking code
- recommendations to Government
- market investigation reference to the CC, and
- what action can be taken under the UTCCRs.

Q.21 Have any remedies been implemented from the Competition Commission investigation into PCA's in Northern Ireland?

Our understanding is that all seven of the CC remedies have now been made into an Order. Two sets of remedies (remedies 1 and 2) came into force on 1 July 2008 and the remaining five come into force 1 April 2009

Test case process

Q.22 Where does the test case process fit in?

In July 2007, the OFT entered into a written litigation agreement with seven banks, one building society (the test case banks)³ and the Financial Services Authority (FSA) with a view to bringing an early test case process, **to run alongside our overall investigation**. The aim of the test case process is to ensure that the complex legal issues are resolved in an orderly, efficient and speedy manner. By bringing this action on behalf of consumers we are seeking to gain the legal clarity necessary to achieve the fair and consistent handling of consumer complaints.

At this first stage, the court has been asked to rule on certain legal points of principle in dispute between the OFT and the test case banks, the key aspect of which was whether the fairness of the UOD terms **can be assessed by the OFT under the UTCCRs**. This is called the preliminary issues process.

Q.23 What was the Judgment in the first preliminary issues hearing?

In April, Justice Andrew Smith ruled that⁴ the UOD terms (those which are **currently** found in the test case banks' personal current account contracts):

- **can** be assessed for fairness under the UTCCRs⁵
- are largely in plain intelligible language⁶ and
- are not capable of being penalties at common law.

The court was not asked to consider at this stage the question of whether or not the UOD terms are actually unfair. We are considering this through our overall investigation and, if necessary, it will be dealt with at stage 2 of the test case process.

³ See Q25 for a list of banks taking part in the test case.

⁴ Judgment was delivered on 24 April. The full judgment can be found at www.offt.gov.uk/shared_offt/personal-current-accounts/Bank-charge-judgment.pdf

⁵ If a contract term is a so-called 'core term' (terms that relate to the definition of the main subject matter of the contract or to the adequacy of the price paid for the goods or services supplied in exchange) it will be exempt from the assessment for fairness under Regulation 6(2). The banks argued that relevant terms were indeed 'core terms'.

⁶ Contract terms may also be assessed under the UTCCRs fairness test if they are not written in 'plain and intelligible language'.

At a case management conference in May, the judge gave the test case banks permission to appeal his finding that the UOD terms can be assessed for fairness under the UTCCRs. We are working with courts and the test case banks to ensure that the appeal process happens as quickly as practicable.

Q.24 Why was the second preliminary issues hearing necessary?

Because the April ruling was limited to **current** UOD terms, a further hearing was held in July to determine whether the UOD terms in the banks' **historical and basic bank account** (and certain other non-mainstream current accounts)

- can also be assessed for fairness under the UTCCRs, and
- whether they are capable of being penalties at common law.

The **current** terms and conditions are those in force as at the date of the hearing that commenced on 17 January 2008. **Historical** terms and conditions are a representative selection of previous terms and conditions that are in dispute in the county courts between individual customers and the banks. **Non-mainstream accounts** include for example student and under 18 accounts.

We **do not** yet have any information about when the judgment will be handed down.

Q.25 Which banks are taking part in the test case process?

The following are parties who agreed with the OFT to take part in the test case:

- Abbey National plc
- Barclays Bank plc
- Clydesdale Bank plc
- HBOS plc
- HSBC Bank plc
- Lloyds TSB Bank plc
- Nationwide Building Society
- The Royal Bank of Scotland Group plc.

This selection of banks covers the bulk of the personal current account market (estimated to be over 90 per cent) and their terms and conditions are representative of contracts used currently in the retail banking market.