CPI's Europe Column Presents:

UK Retail Banking Investigation Fails to Meet Challenger Banks' Expectations

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"Free-if-in-credit" ("FIIC") banking was at the core of the recent UK CMA market investigation on retail banking. FIIC is becoming increasingly common across Europe and, although it could be itself a sign of fierce competition, it can also act as a barrier to entry to new players. The CMA opted for not regulating FIIC. Instead, they focussed their proposals in reducing consumers' switching costs as a way to promote competition. Alan Davis and Matt Evans analyse the main conclusions of the investigation and highlight the soft approach of the CMA to retail banking competition, in contrast to previous more radical interventions in other industries. – Juan Delgado

New market entrants and challenger banks have criticized the UK Competition and Markets Authority's ("CMA") recent market investigation of competition in retail banking for not addressing the core issues and failing to improve the outcome for consumers. After an investigation lasting 18 months, the CMA provisionally concluded that, although there is a lack of effective competition in the market, it is not necessary to impose structural remedies, such as breaking up the largest retail banks or requiring them to cease offering so-called "free-if-in-credit" ("FIIC") banking. Instead, the CMA has proposed a number of remedies to improve customers' knowledge and awareness, encourage them to switch providers, and make it easier for them to do so.

A market investigation is a tool used by the UK competition authorities to carry out in-depth reviews of markets as a whole to identify whether there are any features that have an adverse effect on competition. There have been calls for the UK retail banking market to be reviewed for some time. The four largest banks account for more than 70% of active personal current accounts ("PCAs") and 80% of Business Current Accounts. This level of concentration has remained stable for many years and the statistics show that very few customers switch providers (only 3% of customers switched in 2014).

The problem of weak customer engagement when it comes to shopping around for better prices and switching suppliers was at the heart of the CMA's investigation. The CMA concluded that this consumer inertia affects competition negatively. In particular, it results in a lack of switching, an absence of incentives for banks to innovate through better products and prices, and greater difficulty for new entrants to gain a foothold in the market.

Challenger banks have long argued that the FIIC model plays a key role in consumer inertia on the basis that it is misleading to consumers because it does not provide a true picture of what they are being charged and makes them less likely to switch. In particular, they argue that the FIIC model is in fact cross subsidized by charges imposed on customers, for example, who fall into unauthorized overdrafts.

However, the CMA found that there was evidence that FIIC accounts offer a reasonable deal to many consumers and no convincing evidence that they distort competition. The CMA pointed to the fact that some UK banks already offer accounts with bank charges and a system of rewards that compete with FIIC accounts. Moreover, customer surveys showed that a high proportion of customers were satisfied with their main PCA provider.

The CMA also acknowledged a number of positive competitive developments – including new entrants, innovative products, the rise of digital banking, and new data and price comparison tools – to address the customer engagement problem and stimulate greater competition. The CMA also noted existing tools and initiatives in the market aimed at facilitating switching, such as the Current Account Switch Service.

The CMA concluded that incumbent banks have market power over their existing customers that enables them to charge higher prices, but it did consider that the current level of concentration among the four largest banks of itself is harming competition or customers. It also did not find evidence of coordinated behaviour among banks.

Nevertheless, the CMA concluded that these positive findings were still insufficient to address its concerns about a lack of effective competition and switching in the market. In market investigations, the CMA has a wide range of options to remedy adverse competition effects, including price caps and even breaking up companies, as it has done in a number of cases, notably in the UK airport and cement sectors. The CMA considered these options, but concluded such remedies would not be justified or proportionate in the circumstances and would not necessarily help to resolve the competition concerns identified.

Instead, the CMA focused on measures aimed at empowering consumers and encouraging them to make more rational choices. The proposed remedies are intended to provide consumers with better information about how to switch providers, the options available, and how to compare them. For example, the CMA has proposed a requirement on banks to prompt customers to review the service they receive from their bank through individual messages at certain "trigger points," for example when a customer has incurred charges as a result of an unauthorized overdraft, when there has been a local bank branch closure, or when there has been a breakdown of service due to IT glitches. It also wants to make it easier for customers to compare bank products by improving or putting in place new price comparison website tools, as well as giving customers easy access to their banking history to use to shop around. It also proposes requiring banks to raise public awareness of switching bank accounts including through advertising, and better sharing of information with credit reference agencies, banks and financial advisers to make it easier for SMEs to shop around for loans.

The CMA identified comparable concerns and reached similar conclusions (including in relation to remedies) in a recent market investigation of the UK retail energy sector. In both markets, smaller new entrants and challengers to the larger incumbent suppliers have expressed concern that the lack of more radical, industry-wide intervention by the CMA will make it more difficult for them to develop a critical market presence and for real competitive benefits to be delivered to consumers. This has also led to some political criticism of the CMA for having failed to take sufficiently strong measures to tackle competition concerns in these markets.

In some previous market investigations, the CMA (or its predecessor body) has intervened more radically to require divestments of assets – BAA Airports, aggregates and private healthcare – though in the case of the latter, a successful appeal has resulted in a remittal of the remedies decision to the CMA for reconsideration. The CMA, under the market investigations regime, has some of the most powerful interventionist tools available to it of any competition authority in the world. However, it does seem that in recent practice it finds either that it cannot justify the full use of those powers or, given the legal challenges to their use, make it more wary about doing so except in cases where the evidence strongly supports it.

In the meantime, the UK Government has welcomed the CMA's provisional conclusions as a first step towards a more competitive market. As part of an initiative to boost competition in the UK economy across a variety of consumer-facing markets, the Government has also announced a number of additional steps to support more competition in banking to enable new entrants, as well as to engage consumers in banking which will boost demand and competition. Despite the relatively light-touch approach of the CMA to remedies, it seems unlikely therefore that the competitive and regulatory pressure on the larger incumbent suppliers of PCAs will go away.