A Switch in Time

The evolution of Britain's personal current account market

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CONTENTS

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EXECUTIVE SUMMARY

There are around 70 million active personal current accounts (PCAs) in the UK.[1] There are long-standing concerns that there is insufficient competition among banks in providing these accounts. The Competition and Markets Authority (CMA), investigating these issues since November 2014, recently concluded that banks do not feel enough pressure to compete on price or quality.

Nevertheless the current account market has changed significantly since 2000. In this report, we take six measures of improved competition and track how they have changed. We show clear positive developments in the following areas:

- Product innovation and differentiation: while there is a lot of attention paid to 'Free If In Credit' accounts, their share has been declining, by at least 13 percentage points since 2006; and alternative reward accounts now constitute more than a third of new openings.

- Improved value for money: from our calculations based on successive regulatory inquiry reports, revenue from the average active personal current account has fallen by 17% in real terms over the past eight years.

- More new entrants and new entrants gaining scale: the mid-sized competitors – Santander and Nationwide – have grown their market share since 2006; and there are many new entrants, ranging from branch-based retail banks to online-only entrants.

The areas identified as showing more limited progress are:

- Better customer service: despite service innovation through the use of technology and changes in branches, the CMA finds that a substantial proportion of customers are paying above-average prices for below-average service quality.

- Lower market concentration: while the entry of new providers and the growth of mid-size providers has the potential to reduce concentration, there has been no significant decline so far.

- Higher levels of searching and switching: while 75% of consumers are aware of the Current Account Switching Service (CASS) and 64% are confident in the service it offers, many remain inert and do not actively search for information about other current accounts or face barriers in assessing it and acting on it.

The CMA's final report announces remedies that will tackle these issues and we discuss in the report how they may shape the six measures of improved competition in the future. We also identify some broader issues that are likely to shape the impact of the CMA's remedies. These include:

- Measuring progress: while the personal current account market has benefited from significant product innovation and improvements in value for money for consumers, the market share of the larger providers has not declined significantly. There is no guarantee that the CMA proposals of themselves will make a significant difference to the latter though it is likely that they will improve competition on the other measures discussed in this paper. As such, measuring progress will continue to be a challenge, with diverging views on what good looks like.

- Targeting: more information, available through Open Banking, should facilitate better targeting of product innovation and differentiation to customers. Improving awareness of and confidence in CASS may also need to be targeted through working with specific groups of customers, such as overdraft users, the young and financially disadvantaged. Such targeting may lead to more sophisticated measures of impact than the current metrics for communications activity or overall switching rates.

- Low interest rate environment: the persistence of low interest rates may continue to drive consumer demand for reward accounts that pay higher rates, while advantaging those banks that can afford to compete in that way.

CHAPTER 1: BARRIERS TO COMPETITION AND MEASURES OF PROGRESS

Market competition is fundamental to ensuring that individuals have choice and can find a banking service that meets their needs. A well-functioning market will also drive innovation, uncover lower prices and promote higher quality services.

The new Prime Minister Theresa May has already set out her stall to improve markets for the benefit of customers, including in banking, saying in the speech that launched her bid to be leader of the Conservative Party:

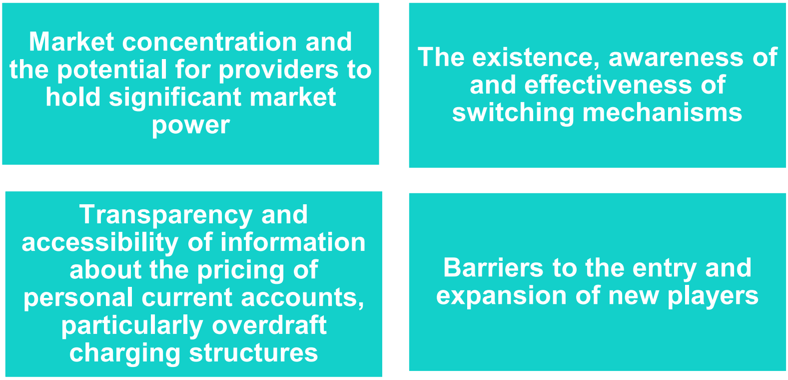
> *I . . . want us to be prepared to use – and reform – competition law so that markets work better for people. If there is evidence that the big utility firms and the retail banks are abusing their roles in highly-consolidated markets, we shouldn't just complain about it, we shouldn't say it's too difficult, we should do something about it.*

Competition in the personal current account (PCA) market specifically has been, since before the financial crisis, a preoccupation for successive governments, competition authorities and regulators. Since 2000 there have been nearly 20 papers, reports and investigations into competition in the sector. The latest, an extensive market investigation by the Competition and Markets Authority (CMA), concluded in August 2016.

Barriers to competition

These can be summarised in four areas, as laid out in Figure 1.

Figure 1: Barriers to competition in the personal current account market



Source: Social Market Foundation (SMF)

A) Market concentration

Britain's personal current account market has been dominated since the late 1980s by four big banking groups – Lloyds, Barclays, HSBC and RBS. The majority of Britain's current accounts are held at one of these providers, with concentration increasing in the wake of the financial crisis.

Commentators, regulators and policymakers have long been concerned that these banks may be able to make excess profits at the expense of consumers because they do not risk losing market share.

B) Transparency and accessibility of information about personal current accounts

Most current accounts in the UK are marketed as being 'Free if in Credit' – customers do not pay a fee for having an account per se. But there are nevertheless costs to having an account. Personal current accounts typically pay no or very low interest rates on credit balances, whereas banks will use those deposits to fund other activities. Fees are charged for a variety of special transactions, like those in foreign currencies. A substantial proportion of income is also generated through fees and interest on overdraft borrowing.

While the Free if in Credit model is popular with customers,[2] this pricing model – as opposed to one, for example, where all customers pay a monthly fee - can make it more difficult for them to assess how much they are paying for their current account and to compare it with offers from other providers. Information about service quality may be similarly opaque.

C) Existence, awareness and effectiveness of switching mechanisms

There have been several attempts to build switching systems and protocols which make it easier for consumers and reduce the risks to which they are exposed, from the *Transfer of Direct Debits and Standing Orders* (ToDDaSO) system first established in the 1990s to the Current Account Switching Service (CASS) introduced in 2013.

The new system, in addition to transferring Direct Debits, standing orders and salary payments within seven days of starting the switching process, also provides a series of guarantees that consumers will not be negatively affected if anything does go wrong during their switch, redirects payments from the old account on to the new account if necessary and automatically transfers any balance from the old account to the new.

The existence of a comprehensive switching scheme, however, is not enough to drive competition – consumers must be aware of the service, and confident that it will work. While progress is being made here, with 75% of customers aware of CASS and 64% confident in the service it offers,[3] a substantial minority of people are either unaware that help is available to switch or not convinced that the process is straightforward and risk-free. This latter group are less likely to switch providers as a result, dampening competitive pressures.

D) Barriers to entry and expansion

Finally, the current account market may not be an easy one for new providers to enter. Providers must meet regulatory requirements on capital and corporate governance before being allowed to offer financial services products to customers. They must also secure access to payments services - the networks which handle Direct Debits, standing orders and debit card transactions. They need to have an IT system capable of handling complex data flows, while keeping customer data secure. And, in many cases, they may want to provide a way for consumers to access banking services physically – whether through a network of high street branches or presence in another public space, like a supermarket or Post Office.

Even if these barriers can be overcome, new banks will then face a battle to find new customers. Consumer inertia may make it difficult for new entrants to persuade customers to switch from other providers.

What does good competition look like?

If those are the key barriers to competition then they should orient policy and regulatory action to improve competition. And indeed they have. The recent CMA report, for example, includes remedies that will significantly improve the transparency and accessibility of information about personal current accounts; and the awareness and effectiveness of switching mechanisms.

On the former, this means moving quickly to an Open Banking standard, which will harness the potential of technology to provide customers with greater control of their banking arrangements; compelling current account providers to create a common set of service quality indicators; and the much wider use of customer prompts – pushing information out to customers rather than requiring them to ask for it - especially when they are using overdrafts.

To improve the role of switching in driving competition, the CMA requires, for example, the extended redirection of payments following switching; and a further push on driving up customer awareness and confidence.

But how will we know that these measures are working to improve competition? The rest of our report looks in more depth at the answer to this question.

It is important to go beyond headline measures when doing this. For instance, higher competition will not necessarily be reflected in higher switching; to some extent, the threat of switching will be enough to influence provider behaviour and improve value for money for consumers. A rigorous assessment thus needs to examine a wide range of measures to capture what good competition across the market looks like. We have elected to focus on the following.

- **Product innovation and differentiation** – in the face of stronger competition, we would expect providers to improve the offer of innovative products and attempt to differentiate themselves from competitors. In the personal current account market this may be manifest as use of new technologies, higher interest rates paid on credit balances, new control features or rewards such as cashback. We might also see greater brand differentiation, and increasing spending on advertising.

- **Better customer service** – with a stronger threat of switching, we would expect providers to try harder to keep their customers happy. In particular, we would expect the biggest incumbents, who have lower customer satisfaction levels despite charging higher prices[4], to improve their scores as they work to convince customers not to seek better services elsewhere.

- **Improved value for money** – as consumers increasingly recognise what they are paying for their personal current account and compare this to offers made by other providers, we would expect to see in general a downwards pressure on price. Assuming the Free if in Credit model remains the normal mode of charging, this may present through higher interest rates paid on credit balances, as lower fees on overdraft borrowing, or as other forms of reward like cashback or monthly bonuses. It may also be possible to see downward pressure in prices in reduced revenue received by the banks per current account, and in measures of profitability across the industry.

- **Lower market concentration** – Growing competition around service quality and pricing should reduce the largest banks' share of the market. Innovative new entrants and existing alternative providers should see their market shares increase, reducing concentration.

- **More new entrants, and new entrants gaining scale** – higher levels of switching should make it easier for new entrants to gain scale in the market, and stronger competition should also increase incentives for new innovative providers to enter the market.

- **Higher levels of searching and switching** – greater consumer engagement in the market, along with a wider variety of personal current account products on offer and higher visibility of price and quality differences should motivate a greater proportion of consumers to actively engage with the market and search for alternatives to their existing account. In turn, this may increase the number who actually switch provider.

Improvements over time across these six areas would be indicative of a competitive gain in the market.

In the main body of the report, we now examine how competition has evolved in these areas since 2000, using data from the many competition investigations into the sector. We start our analysis with the publication of the Cruickshank Review at the turn of the century. We attempt also to identify the drivers of these changes – and assess whether repeated inquiries and their attendant interventions have had any impact.

Finally, we discuss the conclusions of the latest CMA report, making some observations on the implementation of its proposed remedies and suggesting some remaining challenges for the evolution of competition in the market.

CHAPTER 2: CHARTING THE COURSE OF COMPETITION IN THE PERSONAL CURRENT ACCOUNT MARKET SINCE 2000

The core measures of competition in the current account market, described in the introduction, are illustrated in Figure 2. To look at how these have changed over time and assess the impact of regulatory interventions since 2000, we have revisited and reviewed the various reports into competition in the current account market and collated data points. Our results are described below under six headings.

Figure 2: Signs of stronger competition in the current account market

Source: Social Market Foundation (SMF)

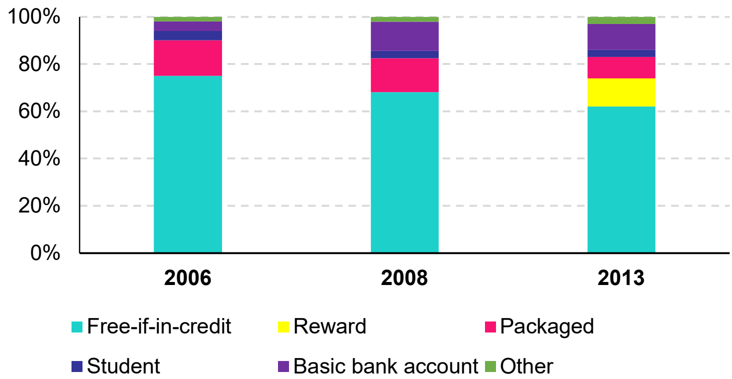
Product innovation and differentiation

Lack of product differentiation has frequently been cited as a signal of weak competition in the personal current account market. In recent years, however, product differentiation has become more marked with the advent of 'reward accounts' and greater technological innovation. By one count, the number of personal current account products on offer has gone up 19% since 2011 and there were 143 products available in 2016.[5] 14 of these offered a gift for switching of £100-£150.

One significant form of innovation is the reward account. This offers a range of benefits to current account users, including cashback on certain purchases, higher monthly interest or a monthly bonus. As illustrated in Figure 3, this type of account has taken market share from both Free if in Credit accounts (which generally pay much lower interest) and from packaged accounts (those offering additional benefits like mobile phone and travel insurance or breakdown cover, for a fee).

These reward accounts made up 12% of the personal current account market in 2013; a proportion which is expected to increase as they constitute 34% of all new current accounts opened in 2015.[6] By contrast, the proportion of Free if in Credit accounts declined from 75% in 2006 to 62% in 2013.

Figure 3: Change in types of current accounts used over time



Source: SMF analysis, OFT 2008, OFT 2013, CMA 2015; Note: CMA 2016 contains updated 2015 figures for some categories of accounts but suggests that these are not comparable to previous years.

But the move towards reward accounts may be a double-edged sword for competition. Although these accounts provide consumers with a motivation to search the market and switch, they may simultaneously make it more difficult to assess the value on offer. Reward accounts typically have complex conditions around eligibility – for example, that a certain amount must be paid in each month to quality, that interest will be paid at differing rates on different amounts of deposits, or only paid up to a certain level, or that there must be a certain number of direct debits leaving the account each month. These eligibility constraints, together with the wide variety of bonuses on offer, may make it difficult for consumers to assess which of the many reward accounts available on the market represents the best deal for them.

Technological improvements, notably the growing prominence of the smartphone, have also changed the market. All main current account providers now compete on smartphone apps, and consumers increasingly check in with their bank on the go. This is gradually beginning to change the relationship consumers have with their current accounts: those who use smartphone apps check their balance and transactions much more frequently than those who continue to rely on paper statements or desktop internet banking.

Over time, this technological engagement and new capabilities built around it, for example the potential of third-party aggregators and budgeting apps, may help consumers to become more aware of the ways they use their current account, to gain greater control over their usage and to engage more broadly with the market. Evaluations suggest, for example, that customers who use both text alerts and mobile banking paid 24% less in unarranged overdraft charges.[7]

Equally, these changes in technology are transforming the model of current account provision in other ways too. As the proportion of customers making regular use of a bank branch to manage their current account falls,[8] the mode of service delivery is becoming more varied with some new entrants offering only online and mobile services. In the UK at least three providers will provide current accounts of this type, including Atom Bank, Starling and Mondo. Although First Direct have offered a telephone and online only current account in the UK for some time, the number of internet-only providers entering the market in recent years suggests that there are opportunities for further innovation in the sector, and that new entrants are hoping to deliver this.

SUMMARY: There are signs that the dominant Free if in Credit model is in decline, with all major banking groups offering some form of reward account[9] and many offering incentives to switch. The market share of Free if in Credit accounts is falling. The improvement in product innovation and differentiation is bolstered by technological change which improves consumers' ability to control their current accounts, and the entry of new online and mobile-only providers suggests that innovation is likely to continue.

Better customer service

In a well-functioning market, consumers should only be willing to pay more for a superior product – with either innovation in features or higher quality customer service. Comparison of service levels as reported by customers and pricing suggests however that the correlation between these two factors is weak. As the final report of the CMA retail banking investigation puts it, “a substantial proportion of customers are paying above-average prices for below-average service quality” and “a significant proportion of customers are paying above-average prices who are not very satisfied with their account”. In theory, these consumers ought to be switching to another bank where either a higher price point guaranteed better service, or poorer service was justified by a lower price point.

Part of the problem may be a lack of easily accessible and comparable information on customer service standards across current account providers. There is a proliferation of independent schemes, such as the Fairbanking mark[10], Fairer Finance[11] scores and data is also collected by consumer bodies like Which? and Money Saving Expert. None, however, has gained the status of official rankings, and so they remain relatively inaccessible or unpersuasive to the average consumer. Unless you go looking for them, the chances that you know they are there are relatively slim.

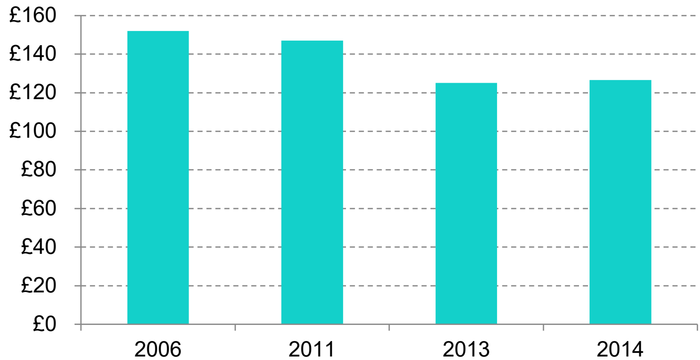
As such the remedies adopted by the CMA are likely to have a positive impact. These include requiring all banks to display a number of core indicators of service quality, notably the willingness of customers to recommend their bank to friends, family or colleagues. Data will be collected twice a year and standardised for ease of comparison across banks.

Nevertheless current accounts may be a product where customers are relatively unresponsive to service quality. Most services they use rely on platforms that are shared across the sector, e.g. Direct Debits; or access to cash via ATMs. Physical contact with the product provider is infrequent, especially as the model of service is shifting from the bank branch to mobile. In practice this may mean that product innovation and differentiation – e.g. the ease of use and functionality of the smartphone app – is a better guide to competition in this market than customer service *per se*.

SUMMARY: The evidence from the CMA suggests that customer service is not an active dimension of competition in the current account market. Their remedies hold out the prospect of some change but, due to the characteristics of the product, customer service may continue to be less revealing as a measure of competition.

Improved value for money

Figure 4: Revenue per active personal current account



Source: SMF analysis, Office of Fair Trading 2008, Office of Fair Trading 2013, Competition and Markets Authority 2014, Competition and Markets Authority 2015. Where revenue per active account figures were not available, they have been calculated using the most detailed revenue data available and reported numbers of active current accounts.

Over the past eight years the average revenue from an active personal current account has fallen by 17%.[12] The majority of that price fall came between 2011 and 2013, as illustrated in Figure 4, aligning with the introduction of the Current Account Switch Service and the growth of market share among mid-sized providers. There is also evidence that the proportion of banks' income derived from personal current accounts has fallen over time, dropping from 33% in 2006[13] to 22% in 2011.[14]

This reduction in revenue suggests that providers have faced an erosion of their margins in the current account market in recent years. Further evidence of this comes from the latest CMA report which takes a different metric: revenue per *main* personal current account[15] as opposed to *active* personal current account. These figures – shown below in Table 1 - indicate a 23% reduction in revenue from £230.03 per account in 2011 to £176.62 in 2014.

Table 1: Revenues per main personal current account 2011 to 2014 (2014 prices)

	2011	2012	2013	2014
Net revenue	£230.03	£201.91	£182.42	£176.62

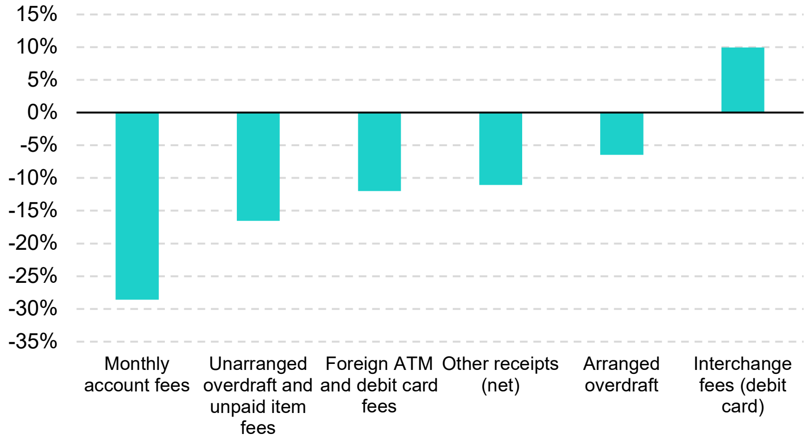
Source: Excerpted from Table 5.7 in CMA final report. CMA calculations based on data submitted by banks in response to data requests.

From the detail behind these figures, it emerges that revenues are declining in part because the amount paid out to customers has increased over time. Interest paid to consumers has risen from 4% of net revenues in 2011 to 10% in 2014, more than doubling the amount of interest earned by the average consumer on their main current account balance in cash terms. This is a clear change from 2006, when 88% of personal current accounts were paying less than 0.5% interest, even though the base rate then was dramatically higher at 4.65%.[16] As interest paid to customers is a payment out of net revenue, this has the effect of dampening the amount of revenue the bank makes per account.

Other payments to customers have also increased: these were negligible in 2011; and accounted for 2% of net revenues in 2014. In cash terms the average customer is now paid 30 times more in cashback and similar inducement payments than was the case in 2011, although this is still a relatively small part of net revenue for providers.

At the same time, we find that the value of almost all fees and charges on personal current accounts fell over the period in cash terms. As illustrated in Figure 5, receipts from all charges and debt interest fell with the exception of interchange fees (the amount stores pay banks for them to process customers' debit card payments). Monthly account fees dropped the furthest, by more than a quarter in cash terms. The next largest reductions were in unarranged overdraft fees and charges and in fees related to transactions in foreign currencies – both of which were the target of OFT actions. Income from arranged overdrafts per account also fell over this period, although less sharply.

Figure 5: Change in cash value of components of net revenue, average main personal current account, 2011-2014



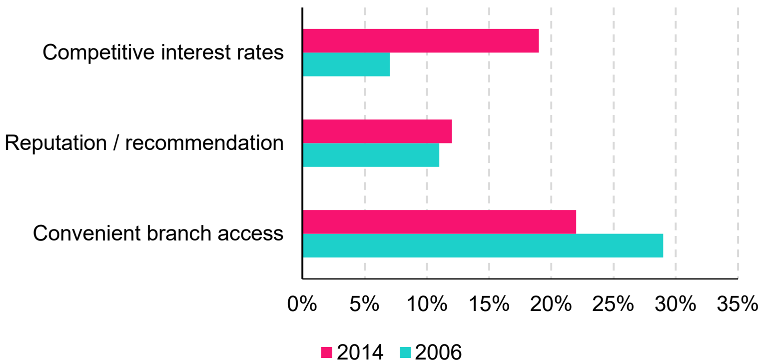
Source: Competition and Markets Authority, 2015, table 5.6, SMF analysis

Another sign of growing competition and better value for money is the higher savings that consumers can make when switching in today's current account market compared with the past. Whereas in 2006 the average consumer could have saved £56 a year by switching to the best value account, this figure more than doubled to £116 a decade later.[17]

These statistics taken together suggest strongly that banks are making less out of personal current accounts than they were a just a few years ago, and that for the average consumer prices have fallen.

Furthermore, looking at consumers' reported reasons for changing current account provider over time – see Figure 6 – it becomes clear that the rewards on offer are an increasingly important dimension of consumer competition in the current account market. Nearly three times the proportion of people (19% in 2014, compared to 7% in 2006) are choosing their personal current account provider because they offer competitive interest rates. By 2015, this proportion had risen to 25%.[18] This suggests that a growing volume of customers are shopping around, which in turn is compelling providers to offer better value. However this appears to be limited to certain sections of the market – while consumers are increasingly driven to switch by the promise of reward payments, only 5% mentioned switching for better overdraft terms.

Figure 6: Consumer reasons for changing personal current account provider, 2006 and 2014



Source: SMF analysis, OFT 2008, CMA 2015

Although the cash value of revenue related to overdrafts has fallen over the past decade, the proportion of income generated by overdraft fees and debit interest has remained relatively constant – hovering around 36% consistently between 2006 and 2013, falling to around 33% in 2014.[19] This suggests that overdraft users continue to bear a disproportionate volume of the costs of providing personal current account services. This is also reflected in the fact that overdraft users could make substantially higher savings from switching than non-users - £153 each year, compared to £116 for non-overdraft customers.[20]

Despite several rounds of intervention in recent years, overdraft fees remain high and there is less evidence that consumers are benefiting from competition in this segment of the market. For example, while the cost of funding to banks has fallen, interest rates on overdrafts have remained high. Attempts have been made to improve the information available to overdraft users, to help them navigate the market and find better value, but so far these have been unsuccessful in driving competition. It appears that there are other barriers beyond lack of information preventing consumers from getting a better deal in the overdraft market.

Firstly, many consumers are unaware or confused about how overdrafts work – for example, there is a widespread perception that as long as customers remain within the agreed limit, then the overdraft is free.[21]

Even for those consumers who recognise the costs associated with their overdraft use, it is very difficult to compare overdraft charges. Recent steps to simplify overdraft charging structures have, perversely, made it more difficult to match up charges across providers, thanks to a growing proliferation of charging structures[22] – for example, some charge daily fees for overdraft use, others monthly fees; some waive fees up to a certain level if money is paid back in a certain time period. This complexity makes it very difficult for consumers to understand what it would cost them to use their overdraft at a range of providers. This task is made more difficult by cognitive barriers which make it difficult for consumers to accurately assess their overdraft usage. For example, many consumers underestimate the amount of time they spend overdrawn, and the likelihood that they will pay charges.[23]

Finally, if consumers overcome all these barriers and find a current account offering a better value overdraft, they have no way of knowing whether they will be able to access this overdraft facility before initiating the switching process. As banks rely on customer data to make decisions on credit worthiness, many banks will not offer the same size overdraft to a new customer as their existing bank might.

Overall, although competition has improved value for money across the current account market, overdraft users continue to face substantial problems. And given that more than a quarter (28%) of customers paid to use overdraft facilities in the last quarter of 2014[24], the lack of competition in this area is inflicting substantial losses on consumers.

Quite rightly therefore, the CMA has chosen overdrafts as a key area where new remedies are offered in its final report. These include requiring banks to automatically provide alerts to all customers when they take an unarranged overdraft; including to the offer of a grace period during which they can take action to avoid or reduce the charges; and at the same time requiring all providers to set a monthly maximum charge for an unarranged overdraft.

SUMMARY: Banks are making less money from personal current accounts than they were just a few years ago. Consumers are paying less and getting more back through higher credit interest rates and bonuses like cashback on purchases. The improved value on offer is also demonstrated through higher savings available to those willing to switch.

However these benefits have not yet spread to all areas of the market, and overdraft users in particular still face barriers in accessing better value for money.

Lower market concentration

The proportion of active current accounts held by the four largest banking groups rose from 2006, so that in 2013 nearly eight in ten current accounts were held by one of the four biggest providers. More recently, this situation has shown some slight improvement. In its interim report, the CMA found that just over 60% of active personal current accounts in 2014 were held at the four biggest banking groups; though it revised this judgement in the final report, suggesting that the true figure was around 70%.

More technical measures of market concentration tell a similar story. The Herfindahl-Hirschman Index (HHI) is a common measure of market concentration, which considers both market shares and the number of players in the market.[25] Concentration levels in the market began to fall back towards their pre-2008 level in 2014. This shift takes the market from being defined as 'highly concentrated' with a Herfindahl-Hirschmann score of 1,800 or more, to 'moderately concentrated'.[26]

New entrants gaining scale, mid-sized players growing their market share and the divestment of TSB from Lloyds Banking Group have all contributed to this reduction in concentration levels. The divestment of Williams & Glyn by RBS group and the further entry of online and mobile-only banks should reduce market concentration further in the coming years. Beyond this, however, further cuts in market concentration will require the success of a broader range of mid-sized brands, and for some new entrants to increase scale.

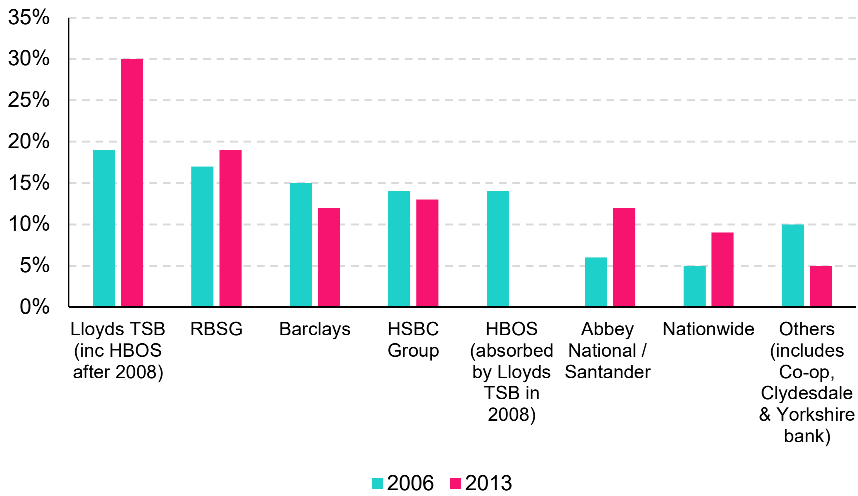
SUMMARY: Market concentration has begun to fall back from its peak in 2010. However, the four largest banking groups still control a substantial share of the market and the stability in their market share is more striking than the change. The limited reduction in market concentration so far has been achieved through the divestment of TSB from Lloyds Banking Group, the growth of mid-sized players and the entrance of new providers. While a further divestment from one of the major banking groups is planned and the other trends should continue, it is too early to say whether market concentration will diminish more profoundly in the future.

New entrants and more new entrants gaining scale

Although the largest banks have seen only a modest decline in their market share in recent years, there has been an increase in the choice of providers available to consumers. The Competition and Markets Authority found that there were 20 PCA providers in the UK in 2013.[27] A range of new online-only providers are waiting in the wings, including Atom Bank, Starling and Mondo, now completing the work of building their platforms and acquiring licences. Altogether 20 further providers have registered with the Prudential Regulation Authority to seek banking licences. While not all of these providers will offer current account products, the number of providers choosing to provide current accounts for the first time in recent years is promising. New entrants like Metro Bank, M&S Bank, Virgin Money, Post Office Money and Tesco Bank have all taken the decision to offer full current accounts rather than focusing exclusively as some previous entrants have done on savings accounts and credit cards. This is a significant contrast to the situation in 2000 when competition in the current account market was first examined by Don Cruickshank, when there had not been an organic entry to the banking market in over a hundred years (that is, not a provider who was already providing banking services overseas or other financial services).

For these new entrants to be investing in serving the current account market, they must believe there is space for new competitors to gain market share. However they are likely to face a battle to gain market share – no new provider has yet breached the 5%[28] barrier, arguably the minimum required to make current account provision efficient.[29] Instead, it is mid-sized banks who have been gaining market share – most notably Nationwide and Santander, as illustrated in Figure 7. Indeed, the broader trend since 2006 has been for smaller banks that were already in the market to lose market share – largely a result of consolidation among smaller building societies and former building societies in the wake of the financial crisis.

Figure 7: Change in shares of personal current account market, 2006 – 2013



Source: SMF analysis, OFT 2008 and CMA 2015

Despite these difficulties, recent developments may help to reduce some of the barriers to entry. For example, providing a network of high street branches is now less important that it was and this dramatically reduces operating costs for would-be banks. The proportion of consumers saying that accessibility of a branch was important when choosing a bank has fallen from 29% to 22% between 2006[30] and 2015.[31] This may favour new entrants – particularly given that incumbents face significant pressure at local levels to keep branches open. Technological change may enable new entrants to target particular segments – for example, Metro Bank targets affluent customers interested in a superior branch experience, while Atom Bank plans to target those under 35 who routinely use mobile apps. This may allow them to develop a slimmer cost base than incumbents and provide a competitive advantage. The ability to take advantage of new 'bank in a box' IT solutions also introduces a potential benefit for new entrants, as incumbents continue to battle with legacy systems.

Together, these advantages are allowing the newest, smallest challengers to run with a much lower cost-based than incumbents: smaller challengers had an average cost-to-income ratio of just 53% in 2014, compared to 63% at the five biggest banks.[32] This is not to say life is easy for new entrants: new banks still face barriers in the amount of capital required to operate, accessing payments systems on equal terms and acquiring new customers when such a large proportion are inert.

SUMMARY: There are a large group of new providers, with different business models. Starting with the entry of Metro Bank the market now looks more competitive. Though no entrants has yet gained significant scale, new technologies and the decline of bank branches are likely to help entrants to compete with large incumbents.

Higher levels of searching and switching

Levels of switching rose directly after the introduction of the Current Account Switch Service (CASS) in September 2013, but have since fallen back to around 3% per annum. This figures do not, however, include softer switches outside the service, including those where the old account is left open (a 'partial' switch), those opening an account for the new time, those switching within the same bank ('internal' switching) and those opening an additional account ('multibanking'). When these are included, the CMA estimates that the churn rate across the market as a whole (ratio of new accounts to stock of existing accounts) is approximately 7%.[33] This remains about the same as that reported by the Independent Commission on Banking in 2011.[34]

Looking across a longer time period, switching rates look more promising, suggesting a more gradual and long-standing trend towards greater searching and switching: the proportion of people who switched at least once in last five years has doubled since 2006, from 13%[35] to 26%.[36]

Despite these improvements, a large number of consumers remain inert when it comes to their personal current account. More than half (57% in 2014[37]) have stuck with their main personal current account for more than a decade, albeit that figure has dropped from 65% in 1998[38]. While remaining with your bank is not per se a problem, if you have other options available in the market and regularly review them, there may be barriers to searching and switching.

Many consumers still lack the motivation to take the first steps and do that search. The introduction of annual statements and enhanced information on statements, both recommended by the OFT following their 2008 investigation into the personal current account market[39], has for the most part failed to create a trigger point that prompts people to look around the market.[40]

Equally most people (91% in 2015)[41] are satisfied with their current account, and trust their own bank (85%). Though levels of trust in the broader sector are lower: less than half trust banks in general.[42]

One way of characterising this interaction of attitudes is to see it as the coming together of a Trust Loop – based on satisfaction with the present provider, leading in turn to loyalty and trust – and an Inertia Loop – based on a perception of risk about the sector as a whole.[43]

Consumers who overcome this inertia to search the market may experience other barriers. Although information on charging structures is now easily available online, assessing and comparing this information is challenging for many people. Nor, despite transparency initiatives implemented following the OFT investigation in 2008, has it become much easier in recent years.

For example, on overdraft charges, pressure to simplify led to positive changes at provider level but they are still very difficult to compare across banks. Scenario pricing has not proved any more helpful: caveats and technicalities like waivers make pricing overdraft scenarios very difficult, and very few consumers check them anyway.[44] The introduction of reward accounts, while improving value for those who are able to navigate the market, has also made comparison more complex, creating a tangle of eligibility conditions. Consumers inevitably need to know a lot about the way they use their current account to calculate the costs and benefits of any given current account product. They are now able to download their information from their account provider's website thanks to the government's midata scheme. The process of using this data to compare accounts, however, is clunky. Awareness and uptake of midata has been very low.

Even those who are motivated to search the market and able to find a product that suits them better may fall at the final hurdle – the ability to act. The Current Account Switch Service, recommended by the Independent Commission on Banking[45] in 2011 and implemented in 2013, was intended to reduce anxieties about the process of switching. CASS has successfully reduced the practical barriers to switching, removing the need to re-route Direct Debits and incoming payments and providing a guarantee against harm to the consumer if something goes wrong in the process.[46] The proportion of switchers satisfied with the switching process has risen from 78% in 2007[47] to 85% in 2015.[48]

But, while mechanical barriers to switching have been largely removed through CASS, more subtle barriers to action remain. Consumers may be concerned about the impact of switching banks on their credit score or ability to obtain loans. This concern is all the more pressing for those who rely on overdrafts.

Even in its final report, the CMA does not offer a solution to this challenge. It does though recognise it; and its remedies include seeking undertakings from Bacs, which runs CASS, to work with CASS participants to review the switching process for overdraft users. The CMA also envisages that it may be possible in the future for providers of personal current accounts to offer online tools that indicate to a potential switcher whether they are likely to be eligible for an overdraft.

SUMMARY: High levels of consumer satisfaction combined with other reasons for inertia mean that the increase in searching and switching rates has been limited. Barriers to action persist at many stages: motivating consumers to act; accessing the necessary information; processing this information; and making the switch.

Summary: Changes in current account competition

Tracing our six measures of competition over the last decade, we observe significant progress on production innovation and differentiation; improved value for money; and more new entrants. Issues remain, including market concentration and barriers to higher levels of searching and switching.

In the conclusion, we look at how the CMA's recommendations may drive further progress; and the challenges that lie ahead for the personal current account market.

CONCLUSION: SUPPORTING COMPETITION IN THE CURRENT ACCOUNT MARKET

In the main body of this report, we explored how six prominent signs of competition have evolved in the UK's current account market since the turn of the century.

Table 2: Summary of the evidence of competition in the personal current account market

Product innovation and differentiation	Evidence of growing competition, introduction of reward accounts and new delivery models
Better customer service	Little evidence that customer service has become a dimension of competition. Information problems persist.
Improved value for money	Falling revenue per current account and evidence of savings for consumers. But overdraft users could benefit more.
More new entrants and new entrants gaining scale	Evidence of growing competition from large group of new entrants. Gaining scale is the next challenge.
Lower market concentration	Mid-sized banks gaining market share but largest banking groups still dominate and new entrants yet to acquire scale.
Higher levels of searching and switching	High levels of consumer satisfaction combined with other reasons for inertia mean the increase in searching and switching rates has been limited. Barriers to action persist.

The latest report from the CMA introduces new remedies that will drive further change. It is difficult at this stage to estimate precisely what the impact will be, though the key measures and their intended effects can be summarised as follows:

1. Foundation measures

These include the adoption of a new Open Banking standard that facilitates the provision and sharing of information about customers. Solving these 'discovery' problems is likely to have a positive impact on a number of the areas identified above, e.g. when more information about customers is readily available, the cost of product innovation and differentiation reduces and the opportunity of marketing innovative products to new customers improves. We might expect for example that there will be more 'niche' current account products, with the rewards or services tailored to the needs of specific customer groups.

By the same mechanism, Open Banking is also likely to help new entrants to plot a strategy for acquiring new customers and growing in size. In time this may lead to lower market concentration; though it may be that the large current account providers will themselves respond quickly and boldly to the new competitive environment. However, even if they do not cede market share, other benefits of improved competition should become visible – for example, improved value for money.

The CMA has also required a shift on the provision of information about service quality, requiring all providers to supply a common data set every six months. We found little evidence of better customer service driving competition; and the CMA remedies in this area may now provide some progress.

2. Current account switching measures

While we have observed steady progress on awareness and confidence about switching since the introduction of CASS, the CMA concludes that there is more progress that can be made. Its remedies include changes to the governance of CASS, placing it under the regulatory oversight of either the Payment Systems Regulator or FCA; and requiring that the management committee has an independent chair and representatives of consumer groups and intermediaries.

The current 36 month redirection period for payments on switching will become indefinite, to ease the concerns that some customers have about something going wrong when they switch accounts; and there will be further work with CASS participants to review the account switching process for customers with overdrafts. This is envisaged to contribute to higher levels of searching and switching; and may in time drive improved value for money.

3. Overdraft measures

On top of the remedy on switching for customers with overdrafts, the CMA requires of all banks that any customer using an unarranged overdraft is alerted to it and given a grace period before any charges begin to take action to reduce or eliminate those charges; and that they participate in future trials led by the FCA on increasing overdraft customers' engagement with their overdraft usage and charges. All providers must also set monthly maximums for the charges levied on the use of an unarranged overdraft. The CMA has not set a sector-wide maximum but rather expects that the maximums adopted by each bank will become a price point for customers to compare when choosing between current accounts or considering a switch.

The impact of these remedies will primarily be seen through improved value for money, where we observed that overdraft costs are an outstanding issue; and potentially through product innovation and differentiation, i.e. as overdraft costs become more visible to customers, and a bigger factor in guiding their future behaviour, then this aspect of the current account offer may change more rapidly than in the past.

Outstanding challenges in the current account market

The CMA remedies are wide-ranging and, while they do not include any of the 'big bang' changes that some have advocated such as breaking up the big banks or introducing account number portability, they are likely to be far-reaching.

Nevertheless, as they are implemented over the next few months, here are some issues that may shape debate and discussion.

- **Measuring progress**: often the idea lurking behind advocacy of greater competition in the current account market is that the larger banks should become smaller, either through structural change or the growth of competitors. The CMA remedies do not guarantee that their market share will decrease; and this is likely to leave ongoing disquiet among some market participants, commentators and politicians. Yet, at the same time, it may be that the CMA remedies, plus the continuation of market trends since 2000, do lead to greater benefits for customers measured in other ways, including those where we have already observed progress, such as improved value for money and product innovation. If we are to get beyond thinking about competition as purely a function of one metric - market share of the largest groups - then monitoring these other measures will be critical.

- **Targeting**: while awareness of and confidence in switching mechanisms has improved, the CMA report suggests that there may be specific work to do in targeting future promotion activity to particular customer groups such as the young or the financially disadvantaged who are more disengaged than the average customer. Thinking about the relation of specific groups to the current account market, rather than treating consumers as a single, undifferentiated group is likely to become even more important as the Open Banking remedies are implemented. These should aid providers and potential new entrants in spotting how and where to differentiate their product and service offer. This differentiation is likely to further improve value for money. It is also likely to mean that headline measures like switching rates or the level of awareness of CASS become less significant than verifying whether specific market segments – who stand to benefit from better targeting – are in fact doing so.

- **Technology**: the shift to online and mobile banking provides the greatest potential to improve customer service over the next few years, though this will have to be combined with the effective provision of physical services for some customers and transactions. There is scope for the lower cost model of online delivery of services to help new entrants, including in acquiring scale. But we should not assume that technology of itself will drive lower market concentration – the largest incumbents for example might be best placed to invest in and deploy service innovations.

- **Low interest rate environment**: the decrease in revenues per account will likely continue, especially when the impact of low interest rates is combined with downward pressure on overdraft charges. On the one hand, this may mean that reward accounts will continue to take market share, providing evidence of product innovation and differentiation and improved value for money, as well as driving switching behaviour. But there may be a growing question as to how sustainable these are; or whether their proliferation disproportionately benefits the larger players, who can afford the lower revenue per account more easily.

- **'Brexit'**: the CMA report largely avoids the question of what Brexit could mean for the current account market. It is too early to say. One noticeable feature of some of the new entrants in the market is that they originate in other parts of the EU – for example, Santander, Sabadell and Handelsbanken - and their entry to the UK and subsequent expansion may have been aided by common EU rules and financial regulation. Brexit may mean that the pool of future new entrants shrinks in size. Regulatory change following Brexit may also consume management time and financial resources among the banks that would otherwise have contributed to greater product innovation or other changes in the market. At the same time, it may be that the lifting of some EU regulation has a countervailing effect. As the nature and terms of Britain's exit from the EU become clearer, any impacts – positive or negative - will become easier to identify.

ENDNOTES

[1] Figure used in Competition and Markets Authority, Retail banking market investigation: final report, (London: Competition and Markets Authority, 2016)
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[4] Competition and Markets Authority, "Personal current accounts: Market study update" (London: Competition and Markets Authority, 2014)
[5] Manifesto, 'Competition and Choice in the Current Account Market', (London: Manifesto, 2016)
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[7] Financial Conduct Authority, "Occasional Paper No. 10: Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour", (London: Financial Conduct Authority, 2015)
[8] Katie Evans, "Balancing Bricks and Clicks: Understanding how consumers manage their money", (London: Social Market Foundation, 2016)
[9] Katie Evans, "Playing the Field: Consumers and competition in banking", (London: Social Market Foundation, 2015)
[10] http://www.fairbanking.org.uk/Current_Projects/Rating.html, last accessed 15/07/2016
[11] http://www.fairerfinance.com/, last accessed 15/07/2016
[12] SMF analysis of data drawn from Office of Fair Trading 2008, Office of Fair Trading 2013, Competition and Markets Authority 2014, Competition and Markets Authority 2015. Revenue per active current account is not provided in straightforward terms in either OFT 2013 or CMA 2015. In OFT 2013, table 3.2 provides Average revenue per account by type of PCA and information on shares of market by types of PCA. This is combined with the total number of active PCAs to calculate average revenue per active PCA. In CMA 2015, we are provided with total revenue from PCAs and the number of active PCAs and combined these to estimate revenue per active PCA. The resulting figure is likely to be an overestimate of revenue per active current account as some revenue may be

derived from inactive PCAs (e.g. unused package accounts, net credit interest on accounts which are not being used for transactions).

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[14] Office of Fair Trading, "Review of the personal current account market", OFT1005rev, (London: Office of Fair Trading, 2013)

[15] The CMA defined main accounts as those with more than £500 paid in each month. This measure is preferred to active accounts as it shows that an account is having income paid in regularly and being used for everyday transactions, and these accounts are the focus of competition between providers.

[16] Office of Fair Trading, "Personal current accounts in the UK: An OFT market study", (London: Office of Fair Trading, 2008)

[17] SMF analysis of OFT 2008, CMA 2016

[18] Competition and Markets Authority, Retail banking market investigation: Provisional findings, (London: Competition and Markets Authority, 2015)

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[20] Competition and Markets Authority, Retail banking market investigation: Provisional decision on remedies, (London: Competition and Markets Authority, 2016)

[21] Jigsaw Research, Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts, (London: Financial Conduct Authority, 2014).

[22] Competition and Markets Authority, Retail banking market investigation: Provisional findings, (London: Competition and Markets Authority, 2015)

[23] Office of Fair Trading, "Personal current accounts in the UK: An OFT market study", (London: Office of Fair Trading, 2008)

[24] Competition and Markets Authority, Retail banking market investigation: Provisional findings, (London: Competition and Markets Authority, 2015). This rate may be slightly inflated compared to the proportion of customers who use their overdrafts in the rest of the year by seasonal (Christmas) spending in the final quarter of the year.

[25] The Herfindahl-Hirschman Index is a measure of market competition calculated by finding the percentage market share of each provider and summing the squares of these shares. A score close to zero indicates a very competitive market, while a market with a single player serving all consumers would score 10,000.

[26] Readings under 1,000 are usually seen as clearly indicating a competitive market, while those between 1,000 and 2,000 usually indicate sufficient competition and are only subject to investigation if a merger triggers a dramatic change in concentration and HHI score. European Commission definitions of

concentration using HHIs, online http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52004XC0205(02) (last accessed 15/07/2016)
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[34] Independent Commission on Banking, Final Report, (London: Independent Commission on Banking, 2011), Table 7.4
[35] Office of Fair Trading, "Personal current accounts in the UK: An OFT market study", (London: Office of Fair Trading, 2008)
[36] Competition and Markets Authority, Retail banking market investigation: Provisional findings, (London: Competition and Markets Authority, 2015)
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