

PCA AND SME BANKING MARKET STUDIES

HSBC RESPONSE TO CMA CONSULTATION ON PROVISIONAL FINDINGS

Executive summary

1. HSBC has previously submitted to the CMA detailed evidence of recent positive developments in both the PCA and SME banking markets, which are driving competition and leading to tangible customer benefits. We welcome these developments, which can be summarised as follows:
 - a) New market entry and expansion. In terms of PCA providers, Metro Bank has successfully entered the market and continues to expand; Tesco and TSB have recently launched, and there are many further new market entries to come,¹ including Virgin Money, Post Office and Atom. There have also been notable successes in the expansion of various SME banking services providers, such as Santander's significant gain in BCA market shares, Metro Bank's rapid expansion, the imminent stock exchange listing of Aldermore, the continued growth of Handelsbanken and the impressive performance of Cambridge and Counties to generate a profit within two years from launch. In addition alternative lending providers are now growing at a very strong rate. While it is unrealistic to expect new entrants to develop a large market share in a very short period of time, the aggregate impact of this new entry on competition is already being felt.
 - b) The introduction of new accounts and services. Particularly in the PCA market, existing providers are innovating and differentiating their products, for example through new mobile payment services, mobile banking, auto-enrolment text alerts, cash incentives to switch, attractive credit interest offers and additional rewards. There have also been innovations in the pricing structures in both the PCA and SME banking products, including the simplification of charging structures. In addition, PCA providers are now subject to competitive pressure from PayPal and other money service providers.²
 - c) The introduction of CASS. The CASS mechanism, which is applicable to all PCA customers and a significant portion of SME banking customers and is offered by 34 bank and building society brands, has made switching easier than ever before, and there is a high degree of awareness among consumers about its benefits (although awareness can and should be increased much further amongst SMEs). For PCAs in particular, an increasing number of customers are multi-banked and the impact of multi-banking on market dynamics is considerable.
 - d) Barriers to entry and expansion are falling. The fixed costs of launching a bank have reduced dramatically with the advent of off-the-shelf IT solutions. This means that IT costs, which previously accounted for up to two thirds of start-up fixed costs, can now be incurred on a variable per-account basis. The importance of branches has diminished as more customers manage transactions online. These

¹ We understand that there are more than 20 authorisations for new entrants pending at the FCA.

² A wide range of new payment technologies, such as Paym, Zapp and Weve, offer alternatives to customers for certain aspects of their PCA needs. Traditional PCA providers are responding with improved offerings of their own. Additionally, a range of large, multinational technology companies are offering new solutions for personal money management, including the option to hold balances on account.

developments mean that new entrants do not need an extensive local branch network to reach a minimum efficient scale. Regulatory barriers to entry have also reduced with the overhaul of the regulatory authorisation process and regulatory capital requirements.

- e) Other initiatives that are already in train. The OFT's transparency and control initiatives for PCAs have all been implemented, and provide very important foundations for customers' ability to shop around effectively. Further enhancements to facilitate comparison of PCAs, for example MiData, are in the pipeline. On the SME side, Government-led action (including legislative proposals) is set to increase the availability of SME credit data and is expected to significantly improve the conditions of competition in SME banking.
 - f) The introduction of the BBI survey for SMEs. The BBI website provides objective, independent and authoritative information on service attributes to facilitate comparison between SME banking providers. This is a significant step towards improving SME engagement levels.
2. A decision to make a market investigation reference (**MIR**) is not one that should be taken lightly. As the CMA recognises, a market investigation will impose a significant burden on both market participants and the CMA, in terms of time, energy and cost. HSBC is concerned that the CMA has taken a backward looking view of both markets and has tended to draw negative inference about outcomes from what is in fact a very mixed evidence base, whilst giving insufficient weight to the ample indicators supporting a more positive conclusion.
 3. In light of the accelerated pace of change in the PCA market, and the offer of undertakings in lieu of a reference in the SME market that are capable of bringing about changes swiftly to increase customer engagement and stimulate competition, HSBC does not consider that the CMA has made the case that the time and cost involved in conducting this market investigation will be justified by any additional benefits that could be achieved at the end of such a process.
 4. Finally, it is important to call attention to the fact that if this MIR is made it will take place over a time frame which will also see very major investment – and intensive diversion of operational and technical capacity – in designing and implementing the retail ring-fence bank structures required by the Banking Reform Act. The uncertainty created by the MIR and in particular the fact that the possibility of structural intervention by the CMA “cannot be ruled out” will pose a major challenge to HSBC’s (and other banks’) ability to plan and push ahead with ring-fence bank implementation.
 5. If, despite all these considerations, the CMA were to make a reference, we hope that the CMA will take a forward-looking, balanced, and evidence-based approach to assessing how competition is functioning in these markets and what impact this is having on tangible customer outcomes. HSBC stands ready to engage with the CMA to help ensure that happens.

PCA market

6. Notwithstanding that the threshold for making a reference is low, HSBC does not believe that the CMA has made out a case for a reference of the PCA market (based on simply revisiting and updating a periodic series of prior market studies). In our view:
 - a) The CMA has not given enough weight to the evidence that this market has changed significantly in recent years and is already on a very positive competitive trajectory.
 - b) There is no evidence that there is a lack of effective competition and that this is producing poor consumer outcomes in this market today, or that this is likely to be the case going forward. (The PCA Market Study Update is notably thin in this respect.)
 - c) The CMA has reached adverse conclusions about the state of competition from what it acknowledges to be a very mixed evidence base. The absence of evidence to support the notion that a structural remedy might be necessary and proportionate is particularly notable.
7. Even allowing for the limited opportunity for fresh thinking and analysis at the market study stage, HSBC is concerned about the lack of analytical cogency or of an even-handed approach to assessing the available evidence in the PCA market update report. If a reference is made, the CMA must gather new empirical evidence and examine that evidence with fresh eyes in order to carry out its statutory assessment properly. Only then can the CMA conclude whether there is, in fact, any adverse effect on competition to be found in this market. In so doing, we consider that the most important issues requiring proper assessment are as follows:
 - a) The continuing positive impact of current and forthcoming developments on competition: for example, mobile banking, auto-enrolment text alerts, new product launches, CASS and multi-banking.
 - b) Competition from new entrants and challengers: the CMA has not examined the extent to which smaller banks exert an aggregate constraint on larger ones, and what size of branch network (if any) is necessary to compete effectively in the PCA market.
 - c) Switching: the CMA has failed to show that the current rates of switching, when one takes account of multi-banking and account churn rates, are an indication of weak competition. Additionally, there is no conclusive evidence that observed switching rates are a reliable indicator of low customer engagement. To the extent that the CMA establishes any such issue, the question remains as to what might cause greater numbers of customers to switch.
 - d) Concentration: the CMA has not demonstrated that concentration is, in and of itself, an issue and, if so, that the current level of concentration in the PCA market is actually resulting in weaker competition or poorer outcomes for consumers. In the event of an MIR, the CMA should consider how comparative data about personal (or SME) banking markets in other countries might be used in this area of analysis.

SME banking market

8. In the SME banking market, the CMA puts forward no real evidence of poor outcomes for customers. The analysis may be sufficient to pass the “*reasonable grounds*” test, but the CMA has missed an opportunity to drive change rapidly and efficiently through its decision to reject the constructive UIL proposals put forward by HSBC and other banks. This is particularly disappointing given the CMA itself acknowledges that “*if an MIR was made, it could result in remedies not significantly different... from what is proposed in the UILs*”.³ On this basis, it is highly questionable whether a reference would be proportionate, particularly as:
 - a) The CMA says that it has been encouraged by regulatory and technological developments and is optimistic of the further positive impact many of the more recent developments will have in addressing historic concerns.⁴
 - b) It is clear that the way to enhance competition in this market is to stimulate the demand side, providing customers with better tools to engage and compare more easily the offerings of different providers, and giving them much greater visibility of the significantly different options available to them.
 - c) The analysis of structural issues is almost entirely based either on unsubstantiated assertion, or on evidence which is at best mixed, and does not support the notion that a structural remedy might be necessary or proportionate.
9. HSBC considers the general issues outlined in paragraph 7 above apply equally to the CMA’s analysis of the SME banking market. To this end, there remain a series of specific issues for the SME banking market which would need proper assessment in any phase 2 investigation:
 - a) The positive impact of current and forthcoming developments on competition: for example, the Verde/Rainbow divestments, CASS, Government-led proposals and legislation.
 - b) Competition from recent and new entrants: the CMA has failed to examine the extent to which smaller banks exert an aggregate constraint on larger ones, and what size of branch network (if any) is necessary to compete effectively in the SME banking market.
 - c) Customer engagement: the CMA has presented no evidence that customers’ engagement levels with their BCAs (even in the absence of high switching rates) are inadequate and lead to weak competition and/or poor customer outcomes.
 - d) Churn and switching: the CMA has not demonstrated that the current rates of switching equate to weak competition. The CMA has also not addressed the question of why customers are not switching in greater numbers or identified those factors which may encourage SME customers to do so. Evidence presented by HSBC suggests that improvements focused on activating the demand side are

³ CMA Consultation: Provisional decision on market investigation reference (18 July 2014) (**CMA Consultation**), para 4.64

⁴ CMA and FCA market study into banking services to SMEs (18 July 2014) (**SME Banking market study report**), see paras 1.20, 1.21 and 1.39 for example.

likely to have a significant impact. The CMA will also need to address the question of whether the consistently high churn rate (linked to SME business failures) is sufficient to drive competition.

- e) PCA/BCA linkage: the CMA has not established that PCAs are a gateway product for BCAs and whether this has an impact on the contestability of the BCA market.
 - f) BCA/general purpose business loans linkage: the CMA has not established that BCAs are a gateway product for general purpose business loans or that any such linkage has an impact on the contestability of the SME loans market.
 - g) Concentration: the CMA has not shown that concentration is, in and of itself, an issue and, if so, that the current level of concentration in the SME market is resulting in weaker competition.
10. If the CMA proceeds to make a reference, the unduly broad and vague draft terms of reference for SME banking will need to be amended in order to satisfy the requirements of the Enterprise Act 2002.
11. It would also be appropriate for the CMA to consider variations to the 2002 undertakings in light of significant changes in circumstances. In particular, the introduction of CASS has rendered many aspects of the switching undertakings obsolete.

PART A – PCAs

The PCA market has changed significantly in recent years and is already on a very positive competitive trajectory: we consider that the CMA should have given significantly more weight to this in its assessment.

12. HSBC welcomes the CMA's recognition of the wide range of positive developments in the PCA market, including:
- a) New market entry (including Metro Bank and Tesco Bank) and forthcoming new entry and expansion (including Virgin Money, the Post Office and Atom).⁵
 - b) Reductions to barriers to entry and expansion,⁶ including:
 - i. Improvements in the regime for authorising new banks, which have received generally positive feedback.
 - ii. Reduction in IT costs, especially for providers willing to outsource the development of their IT systems. The advent of “bank in a box” IT solutions offered by IT providers means that fixed set up costs are replaced by variable maintenance fees. This in turn reduces the risks of entry and expansion.
 - c) The introduction of CASS in September 2013.⁷ The CMA notes that this has “effectively mitigated the costs and risks involved with the switching process for consumers”. According to the report recently published by the Payments Council

⁵ CMA market study update on Personal Current Accounts (18 July 2014) (*PCA update*), Para 2.62.

⁶ PCA update, section 2.

⁷ PCA update, section 4.

on the first anniversary of CASS⁸, 88% of consumers who have switched felt there was very little effort involved on their part when switching accounts. The CMA also acknowledges that there is “*significant customer awareness of the service*”. This is also confirmed by the Payments Council’s report, which notes that 70% of the public are aware of CASS and of those that have not already switched, 70% are aware of the service.

- d) PCA providers innovating (for example in relation to mobile banking and payment systems) and differentiating their products (for example through enhanced credit interest and cashback offers).
 - e) The implementation of the OFT’s transparency and control initiatives – the CMA acknowledges that these “*have now been virtually rolled out in their entirety*”.⁹
 - f) A rapid increase in the take-up of mobile banking and text alerts, which increase consumers’ control over their accounts.¹⁰ Many banks (including HSBC from November 2014) are now auto-enrolling consumers on to the text alert service, ensuring that even consumers who have not taken the active step of applying for this service will also benefit.
13. Unfortunately, these developments have not been properly reflected in the CMA’s analysis. As a result, the CMA’s conclusions on the state of competition in the PCA market are not sufficiently balanced.

There is no evidence of poor consumer outcomes: we consider that the CMA places too much weight on “mixed” customer satisfaction data.

- 14. There is no real evidence of negative customer outcomes in the PCA market. The CMA refers to satisfaction levels in its assessment; however, it acknowledges that this evidence is not reliable, and presents a mixed picture.
- 15. The data on which the CMA relies covers complaints made to PCA providers that are notified to the FCA; though it remains unclear if the complaints are specific to PCAs. The CMA itself acknowledges that it was “*unable to collect reliable statistics for the overall number of complaints about PCAs*”.¹¹
 - a) With respect to data presented on complaints to the FOS,¹² as the CMA recognises, only 33% of these complaints are upheld – 67% are not.
 - b) Strikingly, figure 6.1 demonstrates that customer complaints in general have halved between 2010 and 2013 (from nearly 1.2 million to 600,000 p.a.). The CMA does not appear to have attached any weight to this.
 - c) The CMA states that the figure of 600,000 complaints is “*significant*”¹³, but should bear in mind that this figure equates to less than 1 per cent of PCAs held in

⁸ *The Current Account Switch Service: One Year On*, 11 September 2014

(http://www.paymentscouncil.org.uk/files/payments_council/accountswitching/cass_one_year_on_report_-_sept_14.pdf)

⁹ PCA update, section 3.

¹⁰ PCA update, section 3, in particular paras 3.19 to 3.25.

¹¹ PCA update, para 6.20.

¹² PCA update, paras 6.23 to 6.26.

the UK. The CMA has not compared this percentage with complaints data from other service industries to evaluate this point.

- d) The CMA also reports evidence that customer dissatisfaction levels are low: Mintel found that only 3% of PCA holders are unhappy with their existing banks.¹⁴ This means that the vast majority of customers are either happy or not concerned.
16. The CMA considers that there is an inverse relationship between bank size and satisfaction. However, the underlying analysis is weak: (i) the CMA has not stated any details of the *Which?* survey on which it relies (see Figure 6.5), including sample size, timeframe and methodology; (ii) even on the basis of *Which?*'s data, many of the smaller banks do not enjoy considerably higher satisfaction scores; and (iii) the CMA does not take account of the fact that some of the "smaller" banks shown in Figure 6.5 are in fact subsidiaries of the larger banks – for example, first direct, which has the highest satisfaction rating of all the banks, is a subsidiary of HSBC.
17. The CMA also finds no evidence of a link between size and overdraft pricing or revenues per customer.
18. We therefore find it difficult to understand how the CMA can conclude that there are negative consumer outcomes in the PCA market. Indeed, the evidence points towards a wide range of positive consumer outcomes, including:
- a) Considerable technological innovation, including in relation to mobile banking, text alerts and payment services.
 - b) Continual introduction of new product offerings – the CMA notes evidence from the Payments Council that there have been 150 product enhancements across PCA providers between 2011 and 2013.
 - c) Rising customer satisfaction levels – as noted above, overall complaints to PCA providers have halved between 2010 and 2013, and levels of dissatisfaction are fairly low, with complaints representing less than 1 per cent of accounts held in the UK.
19. In our view, the CMA has not attached enough weight to these positive considerations, whilst attaching significant adverse weight to what it views as the negative elements of the "mixed" evidence on customer satisfaction.

There is not enough evidence to justify many of the CMA's provisional concerns about competition in the PCA market

20. The CMA assumes that an extensive local branch network is required to compete on any "significant scale" in the PCA market.¹⁵ However, there is no evidence to support this. In 2010, the OFT found that IT costs accounted for up to two-thirds of all start-up costs, and that these costs were sunk costs.¹⁶ As the CMA acknowledges, it is now possible to

¹³ PCA update, para 6.20.

¹⁴ PCA update, para 6.29.

¹⁵ PCA update, page 11.

¹⁶ OFT review of barriers to entry, expansion and exit in retail banking, November 2010.

enter the market without incurring any significant sunk costs in relation to IT.¹⁷ This has had a transformative effect on the minimum efficient scale – in terms of number of branches - that a bank needs to attain in order to be a viable competitor. Further, as we set out in our previous submissions, banks' costs scale closely to their branch presence. The example of Metro Bank demonstrates that providers wishing to expand do not need immediately to provide a broad branch network across the UK; they can grow their branch network gradually over time, without incurring significant fixed costs.

21. We also urge the CMA to give much greater consideration to the fact that a number of efficient smaller banks can, in aggregate, impose a significant competitive constraint on larger banks. This point does not seem to have registered anywhere in the CMA's analysis to date.
22. The CMA speculates that there is cross-subsidisation in the PCA market “*which may be distortive of competition*”.¹⁸ However, the CMA only reports anecdotal evidence and presents no analysis of whether any such cross-subsidy is distortive of competition.
23. The CMA expresses disappointment that many consumers do not have the option to ‘opt out’ of unarranged overdrafts.¹⁹ However, no evidence is presented that customers would value such an option. Indeed, the CMA acknowledges that it is “*conceivable that many customers will actually prefer to keep the option of incurring an unarranged overdraft*”.²⁰ We urge the CMA to assess whether the growth in the provision of overdraft text alerts on an auto-enrolment basis has further diminished the need to have an opt-out from unarranged overdrafts.
24. The CMA also presents no evidence that customers are confused about current overdraft pricing. The CMA merely speculates that customers are confused, and that this may be contributing to low levels of shopping around. In our view, in order to reach such conclusions, the CMA would require a much firmer evidence base.
25. The CMA also acknowledges that, as with the evidence on consumer outcomes (discussed above), much of the evidence on competitive outcomes is mixed. We consider that this makes adverse findings about the nature of competition difficult to sustain.
26. As regards concentration levels and stability of market shares:²¹
 - a) An HHI of c.1,800 is not particularly concentrated, and will fall to c.1,600 post-TSB divestment. The CMA has also not taken account of the impact of W&G – even if its national market share is only 2%, this will further reduce the HHI.
 - b) The CMA has not considered the aggregate constraint of smaller players – we consider that this is more relevant than looking at the constraint imposed by individual banks.

¹⁷ PCA update, page 40.

¹⁸ PCA update, page 11.

¹⁹ PCA update, para 3.26.

²⁰ PCA update, page 14.

²¹ PCA update, paras 2.3 to 2.32.

- c) In any case, as the CMA acknowledges, “*there is no clear and simple relationship between concentration levels and competition*”.²² Markets can be very competitive with relatively few players. Concentration is therefore not an issue in and of itself.
27. As regards barriers to entry and expansion:²³
- a) The CMA’s evidence suggests that at most a local branch network is required – there is no evidence that a national branch network is needed to enter or expand. The success of first direct is a case in point.
 - b) The CMA recognises that “*there is no doubt that technological innovation, specifically the recent upsurge in online and mobile app banking, is reducing the usage of bank branches*”.²⁴ The CMA cites evidence that 25% of UK customers would consider using a purely digital (i.e. online) bank.
 - c) In any case, the CMA presents no evidence that there are high barriers to developing a local branch network.
28. The relatively slow but steady growth of challenger banks is not necessarily indicative of barriers to expansion. It may simply reflect prudent business models aiming for sustainable growth over time. Achieving fast growth through excessive risk-taking is unlikely to lead to long-term success, as the experience of Northern Rock shows.
29. As regards alleged difficulties and costs for access to key inputs, particularly payment systems, the CMA acknowledges that the evidence is “*currently insufficient to conclude that smaller or new banks are in fact disadvantaged*”.²⁵ In any case, any such issues fall to be addressed by the new PSR.
30. As regards levels of switching and shopping around:²⁶
- a) There is evidence that CASS is working well and there is high awareness of CASS and confidence in the new switching process. The impact of CASS can be expected to increase over time.
 - b) The CMA appears to overlook the fact that the larger banks are net losers and smaller banks net winners from the CASS switching process.
 - c) The CMA’s assertion that the centralised advertising campaign by the Payments Council is “*now at an end*”²⁷ is incorrect – a budget in excess of £1 million remains for central CASS advertising in 2014. The ongoing switch fee, which is payable by providers that are gaining and losing accounts and includes an element to cover central advertising costs, was set at £1.5 million per annum (subject to annual review) and this should provide long-term funding for advertising.

²² PCA update, para 25.

²³ PCA update, paras 2.33 to 2.75.

²⁴ PCA update, para 2.54.

²⁵ CMA Consultation, para 4.23.

²⁶ PCA update, section 4.

²⁷ PCA update, para 4.17.

- d) Multi-banking is also an important alternative to switching and a key component of the competitive dynamics of the market – this has not been properly explored by the CMA.
- e) The CMA has not yet addressed the question of how many customers look around but choose not to switch. The experience of Lloyds/TSB suggests that many customers are making an active choice to stay with their current providers – and would switch back if reallocated to another bank.
- f) The CMA estimates a churn rate of around 7%.²⁸ We consider that the CMA should take account of this figure in any assessment of switching.

31. As regards transparency:²⁹

- a) HSBC, along with the other major banks, has invested considerable resource in implementing a range of transparency and control initiatives in accordance with the OFT's recommendations, as the CMA recognises. With this in mind, HSBC is surprised and disappointed that the CMA considers that there has not been “*sufficient progress... by PCA providers to enable customers to understand better the costs they incur from their own PCA or to more easily compare such costs between different providers' PCAs*”.³⁰
- b) In addition to these transparency improvements to aid comparability, there are also a significant number of effective comparison websites, including the Money Advice Service and various commercial operators. The MiData initiative will further enhance customers' ability to compare PCAs.
- c) We also find the CMA's position on transparency difficult to reconcile: the CMA welcomes overdraft differentiation but then criticises the possibility of customers being confused over the different charging models. In any event, no evidence is presented that customers are in fact confused by overdraft pricing.
- d) As noted above, there is no empirical evidence that customers would value the ability to opt out of unarranged overdrafts.

The case for intervention in the PCA market is far from being made

- 32. It is not clear that the MIR test has been met for the PCA market. The PCA market is already functioning well and ongoing developments will lead to increasingly better outcomes for PCA customers. There is therefore no need for further regulatory intervention in the PCA market.
- 33. If the CMA nevertheless decides to refer the PCA market for an in-depth investigation, in our view the key unanswered questions which the CMA must address via robust analysis in phase 2 include:

²⁸ PCA update, para 4.50.

²⁹ PCA update, section 3.

³⁰ PCA update, para 3.68.

- a) The continuing positive impact of current and forthcoming developments on competition: for example, mobile banking, auto-enrolled text alerts, new product launches, CASS and multi-banking.
- b) Competition from new entrants and challengers: the CMA has not examined the extent to which smaller banks exert an aggregate constraint on larger ones, and what size of branch network (if any) is necessary to compete effectively in the PCA market.
- c) Switching: the CMA has failed to show that the current rates of switching, when one takes account of multi-banking and account churn rates, are an indication of weak competition. Additionally, there is no conclusive evidence that observed switching rates are a reliable indicator of low customer engagement. To the extent that the CMA establishes any such issue, the question remains as to what might cause greater numbers of customers to switch.
- d) Concentration: the CMA has not demonstrated that concentration is, in and of itself, an issue and, if so, that the current level of concentration in the PCA market is actually resulting in weaker competition or poorer outcomes for consumers.

PART B – SME BANKING

Many historic concerns identified by the CMA in the SME banking market will be addressed by regulatory and technological developments already in train

34. HSBC welcomes the CMA's recognition that many of the historic competition concerns are already being addressed by recent positive developments³¹ in the SME banking market, including:

- a) New entrants and recent expansion (including Metro Bank, Handelsbanken,³² Aldermore,³³ Shawbrook,³⁴ Cambridge and Counties,³⁵ Close Brothers and Paragon) and forthcoming new entry (including TSB, W&G and Atom³⁶). We note in particular that Santander, which the CMA acknowledges is the “*most significant development in the market for liquidity management services*”,³⁷ has made significant gains in market share for BCAs (for SMEs with turnover below

³¹ SME Banking market study report, para 1.10.

³² According to the Financial Times, Handelsbanken is “*one of the fastest-growing banks in Britain...In the six months to June its UK household and corporate loan book grew 13 per cent year on year, while its UK deposits more than doubled.*”

³³ It is widely reported that Aldermore is gearing up for a stock exchange listing later this year.

(<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11042008/Challenger-bank-Aldermore-gearing-up-for-float.html>)

³⁴ It is reported that Shawbrook, which was launched in 2011, is also planning a stock market listing in 2015. (<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/10873305/UK-challenger-bank-Shawbrook-swings-to-profit.html>)

³⁵ Cambridge and Counties made a profit of £1 million in the six months to June 30, its first half-year surplus, compared to a loss of £700,000 in the same period last year. Profits are expected to total between £3 million and £4 million in the year to December 31; and to double in 2015. Cambridge and Counties is forecast to lend a total of £150 million during 2014 and £200 million in 2015. (<http://www.leicesterm Mercury.co.uk/Challenger-bank-set-increase-loans/story-22755600-detail/story.html>).

³⁶ It is reported that Atom, the UK's first all-digital bank, is due to launch to customers in the first half of 2015.

³⁷ SME Banking market study report, para 5.6.

£2m) from 8% to 14% in the 12 months to August 2014 according to the latest Boxclever research.³⁸

- b) Reductions in barriers to entry and expansion in the form of improvements in the authorisation regime and lower-cost IT solutions for new entrants (see paragraph 12.b) above), as well as other proposals specific to SME banking to increase the availability of credit data, including (i) anticipated legislation permitting HMRC to release VAT registration data, (ii) HM Treasury plans to increase access to SME credit data and (iii) industry-wide measures being adopted to ease the process of granting deeds of priority and security waivers. The CMA acknowledges that Government-led action to share keySME credit data, once implemented, “[provides] an effective mechanism substantially to address any of the concerns in these areas”³⁹ and are “likely to go a significant way to addressing...concerns”⁴⁰
- c) As the CMA notes, “the UK alternative finance sector grew by 91% from £492 million in 2012 to £939 million in 2013” and provided £332 million worth of early-stage, growth and working capital to start-ups and SMEs in 2013 alone.⁴¹ It is cautiously predicted that in 2014, the UK alternative finance market will grow to £1.6 billion – 70% more than 2013 figures – and provide £840 million worth of business finance for start-ups and SMEs.⁴²
- d) The introduction of CASS in September 2013 to facilitate switching, which is available to the vast majority of BCA holders, has been “successful from an accuracy and operational perspective.”⁴³ The Payments Council reports that 87% of small businesses said they found it easy to move bank accounts.⁴⁴ The CMA considers that “there is scope for the CASS to go at least some way to addressing certain of the actual and believed costs of switching”⁴⁵ and that “it will, over time, have a greater impact”⁴⁶.
- e) The launch of the Business Banking Insight survey in May 2014 by the British Chamber of Commerce and the Federation of Small Businesses to increase transparency over service levels and facilitate comparisons, which the CMA recognises is “a valuable development in helping SMEs compare providers”⁴⁷ and “has the potential to alter shopping around and switching behaviour”⁴⁸.
- f) Significant investment by banks in service delivery, particularly mobile and digital technologies such as “Pingit” and “Paym” and innovations in pricing structure.⁴⁹

³⁸ Boxclever Small Business Banking Benchmark, August 2014.

³⁹ SME Banking market study report, para 5.137.

⁴⁰ SME Banking market study report, para 5.134.

⁴¹ SME Banking market study report, para 3.29

⁴² SME Banking market study report, footnote 52 quote Nesta (2013): *The Rise of Future Finance*

⁴³ SME Banking market study report, para 8.60.

⁴⁴ *The Current Account Switch Service: One Year On*, 11 September 2014, page 3.

⁴⁵ SME Banking market study report, para 8.50, 8.51.

⁴⁶ SME Banking market study report, para 8.63.

⁴⁷ SME Banking market study report, para 7.52.

⁴⁸ SME Banking market study report, para 7.51.

⁴⁹ SME Banking market study report, para 9.39.

35. These developments are all positive indicators that the fundamentals of SME banking market are sound. While the CMA finds many of the developments encouraging⁵⁰ and expresses optimism over their future impact,⁵¹ the aggregate impact of these ongoing significant market developments on easing new entry and expansion further and driving competition between providers appears to have been downplayed in the CMA's overall analysis, which has tended to be backward, rather than forward, looking.

Competition in the SME banking market would be further enhanced by stimulating the demand side

36. The CMA has cited a few surveys as evidence of negative customer outcomes, but has primarily relied on anecdotal evidence and opinions from some SMEs. In truth, the overall evidence presented by the CMA is more favourable than the CMA's conclusions suggest. In particular, there is material evidence of positive customer outcomes, for example:

- a) SMEs are generally satisfied with the quality of transaction services (93% rate the online banking system as "excellent, very good or good"; 87% rate the branch counter service at their main bank as "excellent, very good or good").⁵²
- b) The majority of SMEs are satisfied with their relationship manager (80% rated the overall performance of their relationship manager as "excellent, very good or good").⁵³
- c) There has been significant investment by banks in mobile and online services, including mobile payment mechanisms such as "Paym" and "Pingit" and innovation in pricing structures for BCAs.⁵⁴
- d) For the larger SMEs, there is evidence of greater engagement with their banking provider.⁵⁵

37. Indeed, the CMA itself concludes that the customer outcomes observed "*do not in themselves demonstrate that the market is functioning poorly.*"⁵⁶ As HSBC has previously acknowledged, although the SME banking market is functioning well on the whole, stronger rivalries and better outcomes can be driven further by stimulating the demand side. This includes providing customers with effective tools to engage and compare more easily the offerings of different providers, and giving customers much greater visibility of the significantly different options available to them.

⁵⁰ For example, see SME Banking market study report, para 1.20 ("We have seen some encouraging signs of new entry...and... expansion"), 1.21 ("We have also seen evidence of a number of encouraging developments which mean that barriers to entry or expansion are decreasing"), 1.38 ("We note the improvements to the switching process from the CASS.").

⁵¹ For example, see SME Banking market study report, para 5.134 (*We welcome these proposals... we consider that, once implemented, these proposals are likely to go a significant way to addressing the concerns*'), para 5.137 ("We consider that action currently being taken by the Government provides an effective mechanism substantially to address any of the concerns in these areas if implemented in full.") and para 8.50 (re CASS).

⁵² SME Banking market study report, para 9.17 and Table 9.1 by Charterhouse, Q1 2013.

⁵³ SME Banking market study report, Table 9.2 by Charterhouse, Q1 2013.

⁵⁴ SME Banking market study report, para 9.39.

⁵⁵ SME Banking market study report, para 8.89.

⁵⁶ SME Banking market study report, para 9.77.

38. It is for this reason that HSBC – together with Barclays, Lloyds and RBS – proactively offered a comprehensive package of undertakings in lieu of a market investigation reference (*UILs*), aimed at stimulating the demand side of the market. It is highly regrettable that the CMA has provisionally decided to reject these UILs, which would have been capable of driving change more rapidly and efficiently to deliver further positive outcomes to SME customers, in favour of an expensive and time-consuming market investigation. This is particularly disappointing given the CMA acknowledges that “*if an MIR was made, it could result in remedies not significantly different in their general nature from what is proposed in the UILs*”.⁵⁷
39. Given the positive developments that are already taking place in the market, and the availability of further initiatives to stimulate demand-side issues that will complement the developments and build on progress to date, it is highly questionable whether an MIR would be proportionate. This is particularly so given that the analysis of the structural issues does not provide an adequate basis to support many of the CMA’s adverse provisional conclusions about competition in the SME banking market.
40. The CMA notes that it is open to the participating banks to take appropriate action outside of the context of UILs should they choose to do so. While the UILs represent a good faith intention and commitment from the participating banks to enhance competition and deliver better outcomes for customers, it seems unrealistic that any bank-wide coordinated action would be feasible – or indeed appropriate under competition laws – in the highly uncertain environment of an MIR process at the end of which there is a potential for the CMA to impose remedies should they consider appropriate.

The analysis of structural issues is almost entirely based either on unsubstantiated assertion or on evidence which on balance does not (even provisionally) point to a competition problem

41. The CMA has made certain assumptions about structural issues in the SME banking market and many of the conclusions drawn are reached without supporting evidence. For example, the CMA concludes that “*for providers who seek to achieve a scale retail banking presence to facilitate direct competition with the largest banks, an extensive (and often costly) local branch network appears to be an important prerequisite*”.⁵⁸ It is not clear what amounts to an “extensive” local branch network and, in any case, there is no evidence to support the CMA’s conclusion. The CMA presents some mixed evidence on the need to offer customers access to branches (discussed below) but there is no evidence to support the assertion that the network needs to be “extensive” to compete with larger banks. Indeed, the success of new entrants such as Metro Bank in winning customers from the larger banks suggests that an extensive network is not necessary.
42. The CMA also states that it has seen “*other evidence*” that indicates linkages between BCAs and other products. However, no such evidence is presented, other than a table⁵⁹ showing the proportion of SMEs which obtain other products from their main bank. This is not a sufficient basis on which to reach any conclusions on any such linkage. It is also wholly insufficient to justify widening the draft terms of reference to include an examination of such linkages in phase 2 (see further below).

⁵⁷ CMA Consultation, para 4.64.

⁵⁸ SME banking market study report, para 5.79.

⁵⁹ SME banking market study report, Table 4.3.

Concentration levels and stability of market shares for both BCAs and general purpose business loans⁶⁰

43. There have been significant changes in BCA market shares since 1999 with HHI levels falling to c. 1,700 between 2000 and 2008. The current level in 2013 of c. 1,974 still represents a sizable reduction in HHI levels from 1999 of 2,228, which is largely because of the emergence of Santander.⁶¹ Even if there are indications that market shares have been [relatively] more static in the period between 2010 and 2013,⁶² this needs to be examined in the context of the financial crisis of 2007 and 2009 and the subsequent recession. In any event, the imminent entry and expansion of competitors will further reduce concentration levels. Moreover, as the CMA acknowledges, “*there is no simple relationship between concentration levels and competition (and, in turn, better outcomes for customers)*”.⁶³ It is far from clear that concentration is an issue in and of itself or indicates any lack of intensity of competition, given that markets can be very competitive with relatively few players.

Linkages between PCAs and BCAs

44. The CMA has raised concerns over linkages or a potential “gateway” between PCAs and BCAs but appears to have exaggerated evidence in places and in others failed to fully evaluate the evidence put forward. For example, HSBC presented evidence that [*Redacted*] of its BCAs customers previously had a PCA with HSBC, not “*considerably above 50%*” as the CMA suggests. Further, the CMA does not take account of the much higher numbers of new customers flowing into SME banking than exists in other markets, and that 50% of a large number of new SME customers represents a significant volume of contestable customers. This suggests expansion is easier in SME banking than other markets. This also calls into question the perception, incorrectly held by some SMEs, that ‘*if their bank, with access to their personal records, would not give them a BCA, then no other bank would*’.⁶⁴
45. The CMA has provided no evidence that customers do not shop around for their BCAs or that they focus only on the free banking period. Free banking offers vigorously marketed variously by HSBC and other major BCA providers fundamentally undermine the incumbent PCA provider’s potential “gateway effect” advantage. The PCA-BCA link is therefore overstated by the CMA. (The CMA does not consider the obvious question as to why, if the PCA-BCA link is as powerful as it supposes, a BCA provider who is strong in PCAs would feel it necessary to offer 18 months free banking periods to start-ups - as all the relevant providers do.)
46. In any event to the extent there are residual concerns about such linkages, any “gateway effect” could be further weakened by measures designed to activate the demand side and

⁶⁰ It is not clear why the CMA has redacted (i) the market share data for Northern Ireland (Figure 4.4) and (ii) the shares of supply by turnover bands (Figure 4.8) – as a result, HSBC is unable to comment on this analysis. CMA also does not show the evolution of loan market shares over time. This prevents HSBC from commenting on this aspect of the market.

⁶¹ SME banking market study report, para 4.15.

⁶² SME banking market study report, Figure 4.2.

⁶³ SME banking market study report, para 4.4.

⁶⁴ SME banking market study report, para 8.10.

to increase customers' ability to "access, assess and act on" alternative options (as put forward by HSBC and other banks in the UIL proposals).

Linkages between BCAs and general purposes business loans

47. The CMA observes there is a tendency for SMEs to obtain a business loan from their BCA provider,⁶⁵ but has not sought to explore or evaluate the range of the reasons behind this preference or articulate any possible customer harm arising therefrom. There is in principle nothing wrong with SME customers approaching their BCA provider for lending as part of loan selection process.
48. To the extent any "first port of call" advantage is due to the difficulty in exploring options for alternative lenders, any advantage will be progressively neutralised by existing developments that are already in train. These include: (i) anticipated legislation permitting HMRC to release VAT registration data; (ii) HM Treasury plans to increase access to SME credit data; and (iii) measures being adopted to ease the process of granting deeds of priority and security waivers. Additionally, any such advantage could have been further weakened without an MIR by measures designed to activate the demand side, to increase customers' ability to "access, assess and act" (as suggested by HSBC and other banks in the UIL proposals).

Barriers to entry and expansion

49. The CMA has "*seen evidence of a number of encouraging developments which mean that barriers to entry or expansion are decreasing, or are likely to do so in the future*".⁶⁶ The evidence in fact suggests that it is far from clear that barriers to entry and expansion are high or remain a significant concern:
 - a) Local branch network – The CMA acknowledges a "*huge increase in the usage of banking methods other than through branches, in particular through online and mobile banking methods*".⁶⁷ According to YouGov evidence⁶⁸ cited by the CMA, only 30% of new businesses would rate "*convenient branch location*" as an important or very important factor when choosing a new bank – this suggests that this factor is not important for 70% of new businesses. The CMA appears to accept that it is access to local branches that is important, not a national branch network. There is not even any compelling evidence that the establishment of a local branch network is a barrier to new entry or expansion (as shown by a number of recent new entrants, such as Metro Bank, Cambridge and Counties and Aldermore).
 - b) Alleged deficiencies in, and costs for, access to key inputs, particularly payment systems – The CMA acknowledges that the evidence is "*not fully consistent with the concerns expressed... – most particularly there was no evidence that transaction costs were set at a level in excess of prevailing retail prices*".⁶⁹ In any

⁶⁵ SME banking market study report, para 4.40.

⁶⁶ SME banking market study report, para 1.21.

⁶⁷ SME banking market study report, para 5.63.

⁶⁸ SME banking market study report, para 5.64.

⁶⁹ SME banking market study report, para 5.113.

event, any such issues fall to be addressed by the new Payment Systems Regulator.

- c) Information asymmetries on customer credit-worthiness – Given the CMA has acknowledged that legislation which has been introduced by the Government is “*likely to address concerns*” once implemented (see above), there would appear to be no basis for further intervention.
- d) Obtaining finance – The CMA acknowledges that the information available has not enabled it to take a firm view on this issue. However, the CMA notes that Government funding schemes such as FLS are open to smaller providers. The British Business Bank is also providing “*significant support*” to innovative providers of finance to SMEs.⁷⁰

Levels of switching and shopping around

- 50. The CMA recognises that “*actual switching is just one way in which SMEs provide a competitive constraint on banks*”⁷¹ and what is important is customer engagement and their ability to switch if they want to do so. However, the CMA does not properly develop and take this point into account in its analysis.
- 51. The CMA also notes that switching is primarily push-led in response to significant concerns about service,⁷² since SMEs generally believe all banks to be much the same.⁷³ However, research done by the Payments Council suggests that the most common reason for not switching that is consistently cited by businesses (and charities) was because they were happy with their current provider.⁷⁴ There also appears to be a problem with perception rather than reality, as banks are offering differentiated products and different service levels.
- 52. To the extent that limited switching results from difficulties in shopping around, HSBC has acknowledged that more can be done to help SMEs to “access, assess and act” on information about banks’ offerings. Again, this is the reason underpinning the banks’ UIL proposal to develop a comparison website to make shopping around easier.
- 53. Any concerns regarding problems with the switching process appear to be based on misperception rather than reality. As with consumers, satisfaction with CASS was universally high amongst small businesses.⁷⁵ CASS is having an impact and the CMA notes that “*it has been successful from... accuracy and operational perspectives, with 99% of switches being completed within the seven working day timetable*”. CASS may be expected to have greater effect if it is better promoted for SMEs. While the proportion of SMEs utilising CASS has increased steadily since CASS was introduced, the proportion remains low compared with PCA customers and there is room for growth.

⁷⁰ SME banking market study report, para 5.144.

⁷¹ SME banking market study report, para 8.2.

⁷² SME banking market study report, para 8.38.

⁷³ SME banking market study report, para 8.43-8.45.

⁷⁴ In 2014, 76% cited “We have a good relationship with our current bank” as the reason for not switching, compared with 75% and 74% in 2013 and 2012 respectively, *The Current Account Switch Service: One Year On*, 11 September 2014, page 10

⁷⁵ “87% of small businesses said they found it easy to move bank accounts and 86% said they felt in control of the process.” *The Current Account Switch Service: One Year On*, 11 September 2014, page 11

Structural remedies are therefore inappropriate for the SME banking market

54. The only sources cited by the CMA as advocating a “structural solution” are the European Commission (in the context of approving State aid to LBG and RBS) and the Vickers Report (in the context of enhancing the LBG divestment). These are not legitimate examples of support for a structural solution to solve market-wide competition problems which the CMA considers are present: rather, LBG and RBS were required to make divestments in order to address distortions to competition following the receipt of very significant levels of state aid from the UK Government. The European Commission was not commenting on any wider need for a structural solution in the UK SME banking (or PCA) markets.
55. As the CMA is aware, retail banks including HSBC are currently expending a huge amount of time and cost towards implementing the ring-fenced bank proposals required under the Financial Services (Banking Reform) Act 2013. We question the wisdom or proportionality of imposing any additional structural change on the industry within this timeframe and would expect the CMA (and the Government) to take this into consideration. In addition, large-scale divestments by two of the largest banks are already taking place with Lloyds’ spin-off of TSB and RBS’s spin-off of Williams & Glyn. As the CMA will be aware, the processes of these divestments are complex and are taking a long time.

The CMA must address unanswered questions via robust analysis during the course of any phase 2 investigation

56. As noted above, there are many reasons why an MIR would not be proportionate in the SME banking market. If the CMA nevertheless decides to refer the market for an in-depth investigation, key unanswered questions which the CMA must address via robust analysis in phase 2 include:
- a) The positive impact of current and forthcoming developments on competition: for example, the Verde/Rainbow divestments, CASS, Government-led proposals and legislation.
 - b) Competition from recent and new entrants: the CMA has failed to examine the extent to which smaller banks exert an aggregate constraint on larger ones, and what size of branch network (if any) is necessary to compete effectively in the SME banking market.
 - c) Customer engagement: the CMA has presented no evidence that customers’ engagement levels with their BCAs (even in the absence of high switching rates) are inadequate and lead to weak competition and/or poor customer outcomes.
 - d) Churn and switching: the CMA has not demonstrated that the current rates of switching equate to weak competition. The CMA has also not addressed the question of why customers are not switching in greater numbers or identified those factors which may encourage SME customers to do so. Evidence presented by HSBC suggests that demand-side improvements are likely to have a significant impact. The CMA will also need to address the question of whether churn rate for BCAs sufficient to drive competition.

- e) PCA/BCA linkage: the CMA has not established that PCAs are a gateway product for BCAs and whether this has an impact on the contestability of the BCA market.
- f) BCA/general purpose business loans linkage: the CMA has not established that BCAs are a gateway product for general purpose business loans or that any such linkage has an impact on the contestability of the SME loans market.
- g) Concentration: the CMA has not shown that concentration is, in and of itself, an issue and, if so, that the current level of concentration in the SME market is resulting in weaker competition.

If the CMA decides to refer the SME banking market, the terms of reference will need to be amended in order to satisfy the requirements of the Enterprise Act

57. As noted above, HSBC does not consider an MIR for the SME banking market to be necessary, justified or proportionate. However if the CMA does decide to refer this market, HSBC has particular concerns over the scope of the draft terms of reference.

58. HSBC notes that the draft terms of reference for SME banking are unbounded: they cover all retail banking services in respect of SMEs: “*including but not limited to general purpose loans and liquidity management services...*”⁷⁶ The CMA would be exceeding its statutory powers under the Enterprise Act 2002 by making an unbounded reference such as this:

- (a) Section 133(1) of the Enterprise Act requires a market investigation reference to specify “*the description of goods or services to which the feature or combination of features concerned relates...*” The Explanatory Notes to the Enterprise Act 2002 explain that this is necessary “*to focus the [phase 2] investigations on particular areas of concern that the referring authority has identified*”.
- (b) It is therefore not open to the CMA to allow the CMA Panel at phase 2 to frame its own terms of reference by leaving the terms unbounded. Furthermore, the CMA is unable to have formed “*reasonable grounds for suspecting*” a distortion of competition, as required to make an MIR under section 131 of the Enterprise Act, in relation to any markets which it has not examined during its phase 1 market study. The scope of the phase 1 market study was restricted to liquidity management services and general purpose business loans.⁷⁷ The terms of reference for a Phase 2 market investigation can therefore be no wider than these.
- (c) The CMA appears to justify its approach in making an unbounded reference on the basis of “*close linkages between BCAs and various forms of finance available to SMEs [, which make] the imposition of unduly narrow terms of reference for any MIR inappropriate*”.⁷⁸ Aside from the statutory impediments to such an approach, making an unbounded reference is also unnecessary to achieve the CMA’s aim of further exploring linkages between BCAs and forms of finance available to SMEs, to the extent that these affect competition in the BCA market. Such linkages can be explored at phase 2 if

⁷⁶ CMA Consultation, Annex B: Draft terms of reference.

⁷⁷ OFT 1507, Update on proposed scope for SME banking market study (September 2013), para 2.4.

⁷⁸ CMA Consultation, para 5.4.

the terms of reference are properly limited to the provision of liquidity management services (and general purpose business loans). What is not permissible, under sections 131 and 133 of the Enterprise Act is the separate investigation into the functioning of competition in the markets for these other forms of finance, as these have not been assessed at phase 1 (as the CMA acknowledges⁷⁹).

59. Therefore, to the extent that the CMA decides to proceed with a reference of the SME banking market, the terms of reference should be no wider than the provision of liquidity management services and general purpose business loans to SMEs.⁸⁰

The 2002 undertakings should be varied

60. HSBC is supportive of the CMA's initial assessment that there is a change of circumstances such that the 2002 undertakings should be subject to a review to assess whether they should be varied or removed.
61. HSBC agrees with the CMA's proposal to remove the 2002 switching undertakings, as these have now been superseded by CASS. This should be a priority for the CMA, as there is currently a risk of conflict and confusion between the obligations under CASS and the undertakings, not to mention the cost in terms of time and resources required to maintain two overlapping systems. HSBC would support the CMA to undertake a holistic review of further improvements that could be made to CASS.
62. HSBC also supports the release of the undertaking to supply portable credit histories on request. There has been very limited uptake by customers requesting a portable credit history. The low rate of utilisation is likely to be due to the fact that print-outs of account statements serve the same purpose (and provide a more comprehensive set of information). Since the development of internet banking, customers are now able to print off the relevant account statements themselves, without needing to request them from their existing bank.
63. While HSBC does not in principle object to the continued obligation placed on banks pursuant to the transparency undertakings and the bundling undertakings, if a reference is made then as part of that process it would be appropriate for the CMA to consider the continued appropriateness of these undertakings and, in particular, enhancements that could be made to ensure that they continue to deliver the best outcomes for customers.

Conclusion

64. HSBC considers an MIR to be unnecessary and disproportionate in light of the evidence of wide-ranging positive changes in the PCA and SME banking markets and the effective alternatives available to resolve any remaining CMA concerns. Nevertheless, HSBC is committed to serving PCA and SME customers and will continue to engage constructively with the CMA and other regulators to further enhance customer outcomes.

⁷⁹ CMA Consultation, para 5.4.

⁸⁰ Adopting terms of reference wider than these would leave the CMA open to procedural challenge.