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Dear Sir/Madam,

### **CMA consultation on PCAs and banking services to SMEs**

Tesco Bank values the opportunity to provide input into the Competition and Markets Authority consultation. Today, Tesco Bank offers a full range of retail banking and insurance products and serves 6 million customers throughout the UK. Having taken full control of the business in December 2008, we have invested over £600m in building the bank – establishing our banking and insurance platform, migrating customers from The Royal Bank of Scotland and most recently the build of our first personal current account (PCA) which launched in June 2014.

We have entered the current account market at a time of considerable change in the industry. The recent introduction of the seven day Current Account Switch Service (CASS) for instance has removed a historic barrier to account switching and has made encouraging progress in its first year. Technological innovations such as Paym and the increasing adoption of online and mobile channels are rapidly changing the way in which customers interact with their bank. As growth returns to the economy, we are seeing an increasing number of new propositions on offer - including our own transparent account offering credit interest, Clubcard rewards and tools to help customers avoid charges. We consider that each of these are positive developments for competition.

#### **Response to questions:**

As Tesco Bank operates in the PCA market but does not offer current account services to SMEs, this response will focus specifically on the relevant PCA questions. However, there are elements of our response that may have wider application across the industry.

1. Do you consider that the CMA's analysis of the suspected features of concern in the market for PCAs is correct (see paragraph 3.6)?

Tesco Bank's concerns in relation to competition in the PCA market relate to the following features:

- a) Market concentration - The study highlights a perceived supply-side issue with the degree of market concentration. While more competitors in the market can create a platform for more choice, if there is insufficient transparency and comparability, and a tendency for new players to behave like established ones, the real choice for customers will remain relatively

unchanged. Therefore, further structural reform i.e. divestments, would not necessarily improve levels of competition in the PCA market.

- b) The established “free in-credit” current account banking model creates a barrier to entry which is very difficult for new entrants not to conform to in order to compete. This barrier is heightened by incumbents who are able to support competitive new business offerings at the expense of existing customers. Additionally, the perception that your PCA is “free” is a key contributing factor to the lack of customer engagement in assessing the value they derive from their account.
- c) Transparency and comparability - We agree that there are issues with transparency, complexity and comparability of product offerings making it harder for customers to shop around. Our research indicates that customer propensity to switch increases as they become aware of what could be gained or saved by switching - a third of customers, who previously had no intention to switch their current account, would be likely to if they knew they could be earning £45 - £50 every year in credit interest<sup>1</sup>.

In order to improve transparency and comparability, we advocate:

- The introduction of an industry wide standardised set of PCA comparators. These would take account of the all round proposition – credit interest, rewards, fees, charges and service – and would enable customers to compare the value of their accounts over a more meaningful comparison period, three years for example. The introduction of these comparators would likely encourage the simplification of charging structures and in doing so would help customers to more readily compare fees and charges.
  - The Government’s MiData initiative which will go some way to enhancing customer ability to make comparisons based on personal usage. Tesco Bank has committed to delivery of MiData within a year of its launch. As a voluntary initiative, we call upon all PCA providers to sign up. Success will however be dependent on the strength of the comparison tools which use the data and on customer awareness of the initiative. Adoption of the standardised industry comparators cited above together with significant marketing and communications activity are therefore recommended.
  - The provision of switching information across all channels to increase customer awareness of and confidence in the CASS. In the absence of time bound contracts and in the presence of free in-credit banking, this would provide an appropriate customer entitlement to switch reminder.
- d) Branches - The consultation concludes that a branch network continues to be necessary in order to achieve scale in current accounts despite the continued growth of digital channels. We believe however, that the historically strong correlation between the number of branches a provider has and their PCA market share is breaking down.

Tesco Bank has achieved considerable scale in certain products, such as credit cards, in the retail banking market by pursuing an online and telephone based strategy. Building scale in credit cards has been achieved without a branch network as customers are presented with necessary information to compare key features and prices of competitor offers. Five years ago six in ten of our customers bought online, today it’s nine in ten. One in three visits to the Tesco Bank online estate is now on a mobile or tablet device and our highly rated new mobile banking application is averaging over 2,000 downloads every day.

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<sup>1</sup> £45 - £50 is the amount of credit interest paid to an average customer each year, based on the average interest paid by the top 5 interest paying current accounts and an average balance of £1400 (BBA).

In developing Tesco Bank's current account proposition we listened to over 20,000 customers and determined that there was sizeable customer appetite for a direct proposition i.e. branchless. Our findings are supported by that of Accenture (cited in the PCA study) who state that 25% of customers would consider a purely digital bank. The reasons why customers use a branch also provides a useful insight into their necessity. The most common reason for customers to visit a branch is to make a deposit or withdrawal, followed by making a complaint or to fix a problem. Each of these can easily be facilitated through digital channels.

Whilst we intend to replicate our online/telephone based distribution strategy successfully in the current account market, we believe that a key inhibitor to this is the lack of transparency and comparability. In our view action should be taken to improve this as outlined in section c.

- e) Account Number Portability (ANP) – At this point in time we are unclear on the precise nature of ANP – whether it is a portable account number or a central utility. Based on evidence available to us we do not consider that ANP would deliver significant customer benefits beyond those already offered by the CASS switching guarantee. Furthermore, we anticipate that implementation of ANP will be both costly and complex. We also do not believe the switching mechanism itself to be the barrier to increased levels of competition – the real remaining issues being transparency, comparability and customer inertia.

The introduction of CASS has removed the key barrier to switching provider. It has been in operation for one year and is already showing encouraging signs in terms of customer awareness, confidence and satisfaction with the service and switching has increased by 19%. The industry has also invested approximately £750 million in delivering CASS and we consider that it provides an efficient and effective solution for customers. The implementation costs of ANP are currently uncertain however it is likely that they would be significant. As a new entrant, these costs would create an addition burden that would impact upon our ability to invest in new products and services for customers.

Our research suggests that the majority of customers would be happy to change their bank account number so long as the switching process was both quick and hassle free. In addition, a very small proportion of customers would be willing to pay to keep their account number (through higher charges or lower credit interest).

We would like to see more support provided to CASS to increase customer awareness and confidence. For example, there is an opportunity to fix the disconnect between perception and reality when it comes to errors – around 40% of customers think the switch will be error free versus 89% in reality which are error free<sup>2</sup>.

- f) Tesco Bank has an agreement in place with a clearing bank which has facilitated our entry into the PCA market. We understand that a key objective of the new Payment Systems Regulator (PSR) will be to ensure that the connectivity model (direct or agency) for the domestic UK interbank payment systems does not reduce the range or functionality of services available to customers, regardless of how their financial service provider connects into the payments network. Tesco Bank supports this objective and looks forward to seeing the PSR's proposals. However, we would not want to see the removal of agency relationships, as this may unintentionally create a barrier to market entry unless other more effective access mechanisms were fully developed.

- 2. Do you consider that the CMA's provisional analysis with respect to the exercise of its discretion to refer the PCA market is correct (see Chapter 4)?

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<sup>2</sup> Payments Council

For the reasons set out above, we consider the CMA's provisional decision to refer the PCA market to full investigation to be correct.

3. Do you consider that the CMA's analysis of the suspected features of concern in the SME banking sector is correct (see paragraph 3.3)?

Tesco Bank does not participate in the SME market and therefore has no comment.

4. Do you consider that the CMA's provisional analysis with respect to the exercise of its discretion to refer SME banking is correct (see Chapter 4)?

Tesco Bank does not participate in the SME market and therefore has no comment.

5. Do you consider that the features which the CMA has identified that may prevent, restrict or distort competition, are capable of being effectively and comprehensively remedied by UILs (undertakings in lieu of an MIR) given by the banks (see the features in paragraphs 3.3 and 3.6)?

No UILs have been proposed to address competition concerns in the PCA market. It is essential that any potential remedies to features of concern are well researched from a provider and customer perspective to ensure that the desired results are achieved.

6. Do you have any views on the CMA's provisional analysis regarding proposals for possible UILs being offered in principle by the four largest UK retail banks in relation to SME banking, particularly on the appropriateness, effectiveness and deliverability of such UILs (see paragraphs 4.58 to 4.71 and Annex A)?

Tesco Bank does not participate in the SME market and therefore has no comment.

7. Do you consider that a potential solution to any competition concerns identified may need to consider alterations to the structure of the markets in addition to (or in place of) remedies focused on increasing customer engagement?

No (please refer to response 1a).

In conclusion, Tesco Bank believes a lack of customer engagement on the demand side and a lack of transparency and comparability on the supply side to be the key barriers to customers participating more actively in the PCA market and in switching current accounts. We also note that the "free in-credit" model of current account banking is a contributing factor to competition issues on both sides.

We would be delighted to meet with you to expand on the points raised above and to provide any additional information that you may require. I will be in touch with your office to arrange this meeting and in meantime please do not hesitate to contact me.

Yours sincerely

Louise Johnston  
Head of Compliance, Policy and Guidance