

ROYAL BANK OF SCOTLAND PLC

**RESPONSE TO THE CMA'S PROVISIONAL MARKET INVESTIGATION
REFERENCE DECISION IN RELATION TO PERSONAL CURRENT
ACCOUNTS AND SME BANKING**

1. INTRODUCTORY REMARKS

Royal Bank of Scotland PLC¹ (**RBS**) is grateful for the opportunity to comment on the Competition and Markets Authority's (**CMA's**) provisional decision to make a market investigation reference (**MIR**) in the SME banking and PCA sectors.

RBS fully supports the CMA's goal of healthy, competitive markets in the UK banking sector and acknowledges concerns in relation to how competition functions for certain aspects of SME banking and PCAs. We consider these concerns to be, at their root, demand-driven, highlighting the over-arching need to stimulate further customer engagement. This principle was at the heart of the Undertakings in Lieu (**UILs**) proposed by RBS and others as part of the market study phase. Although RBS had hoped the UILs would avoid the need for a MIR, it welcomes the CMA's focus, in its provisional decision, on such demand-side issues. RBS does, however, have concerns over other aspects of the CMA's assessment, including its characterisation of the degree of concentration and barriers to entry for both SME banking and PCAs.

Looking forward, were the CMA's provisional decision to be confirmed and an MIR to result, RBS would, of course, cooperate fully with the investigation. In these circumstances, we would encourage the CMA to maintain a flexible approach to its assessment in order to accommodate a number of ongoing initiatives in the sectors as well as to be sensitive to individual market characteristics, such as size and minimum efficient scale. Any MIR should also reflect the significant body of work built up in the course of previous competition assessments in the banking sector in the UK.

The remainder of this response document is structured as follows: Section 2, below, provides comments in relation to particular competitive concerns highlighted by the CMA's provisional assessment; and Section 3 looks forward to possible responses to these concerns, in particular by considering the UILs in this context and looking towards a possible MIR.

2. COMPETITIVE CONCERNS IDENTIFIED BY THE CMA

DEMAND-SIDE ISSUES ARE KEY

Customer engagement

As it has emphasised in previous submissions, []. It therefore endorses the CMA's findings that greater customer engagement would be likely to give rise to a more competitive landscape in the SME and PCA sectors. For example, in relation to SME banking, "[t]he dynamic created by greater SME engagement would drive the

¹ The RBS brands covered by this response include NatWest and RBS (both active in England, Wales and Scotland) and Ulster Bank (active in Northern Ireland). As in previous responses, given its extremely small scale, RBS has excluded Coutts from the scope of this response.

competitive process by ensuring that competitive providers benefit from increased custom, while less efficient and less competitive providers lose it.”²

Transparency

RBS agrees with the CMA’s focus on increasing such customer engagement, by empowering customers to make appropriate decisions. As the CMA notes in the consultation document:

- The SME banking market is characterised by *"SMEs not easily able to access, assess and act on information to ensure that they get the best deal, manifested in low levels of shopping around and switching activity.... This particularly reflects limitations in transparency and the comparability of information on the offers of different providers and SME customers’ ‘inertia’ (i.e. reluctance to shop around between banks and to switch banks)"³*;
- And, e.g., in relation to PCAs⁴: *"Survey evidence of PCA customers suggests that the reluctance to shop around or switch is largely based on a widespread belief that better alternatives are not available"*.

As it has previously set out in some detail, RBS is focused on addressing these issues. For example, in relation to SME banking, it has been the sole funder of the new Business Banking Insight website, at a cost of []⁵, as well as participating in the postcode data and MiData initiatives. RBS has previously submitted details of its main technological changes (both recent and impending), many of which are directly targeted at this issue⁶. Further, RBS and a number of other banks provide information to Defaqto and MoneySupermarket for use on their comparison websites, as well as providing its standard pricing information to MoneyFacts, which provides the Business Account Finder services located on the BBA website.

In relation to PCAs, as well as government sponsored initiatives, RBS has launched a number of specific initiatives to ensure added transparency and control for customers. It has described some of these in detail in its 9 May 2014 submission.

Further progress will require an ongoing process of demand-side advocacy and behavioural "nudges", such as those which were at the heart of the UIL proposal, or the kind which the CMA describes in paragraphs 4.44 - 4.45 of the consultation document. RBS endorses any such ways of increasing transparency and looks forward to discussing them with the CMA in more detail.

Low switching rates

RBS considers that the low switching figures which the CMA reports [].

² Banking services to small and medium-sized enterprises, A CMA and FCA market study, 18 July 2014, at paragraph 6.3

³ Consultation: personal current accounts and banking services to small and medium-sized enterprises, 18 July 2014 (**Consultation Document**), at page 22.

⁴ Consultation Document, pages 23 and 24.

⁵ Banking services to small and medium sized enterprises, July 2014, at paragraph 7.48.

⁶ RBS's response of 19 November 2013 to the OFT's questions, at question 21.

A major contributing factor to this trend is the Current Account Switching Service (CASS) and its impact on customer perceptions of the ease of switching. Partially as a result of CASS, Santander has added 1.1 million PCA customers in the past year, whilst TSB has recently announced that CASS accounted for 9.2% of all its new account openings in the first quarter of 2014. [] We consider the wider impact of CASS further, below.

Further, RBS notes that there are a number of promising forthcoming developments designed to address low switching rates. For example, HM Treasury is advancing proposals that lenders should be required to share details of SMEs they reject for finance, so those businesses can be approached by alternative lenders⁷. RBS also recently entered into an agreement with a number of larger banks, requiring it to consider requests for a deed of priority or waiver within 7 working days, and for each bank to provide standardised documentation to simplify the process⁸. RBS is concerned that such new initiatives cannot (and should not) be properly assessed before they have had sufficient time to settle down.

CONCENTRATION

Market shares under-represent the competitive landscape

For both SME banking and PCAs, RBS is concerned that the CMA has under-represented the impact of existing and emerging competition. In particular, should the provisional MIR decision be confirmed, []:

- The continued emphasis on the “big four” banks in Great Britain (**GB**) is misleading, as it downplays the constraint provided by other significant existing players such as:
 - For SME banking: Santander, Co-Op, Yorkshire and Handlesbanken, as well as Clydesdale in Scotland; and
 - For PCAs: Nationwide, Santander and TSB, with a 15% market share from the latter in Scotland⁹.
- Equally, Northern Ireland (**NI**) has a unique set of characteristics with a healthy variety of providers, including Bank of Ireland, First Trust, Danske Bank, Ulster and Santander, as well as HSBC and Barclays for SMEs and Nationwide and Halifax in PCAs.
- The CMA has afforded insufficient weight to the impact of:
 - Newer entrants in both SME banking (including Aldermore and Metro Bank) and PCAs (including Metro, Tesco Bank, Virgin Money, M&S Bank and the Post Office);

⁷ <https://www.gov.uk/government/consultations/sme-finance-help-to-match-smes-rejected-for-finance-with-alternative-lenders>

⁸ See the 2014 Budget, at paragraph 2.236.

⁹ PCA market study update report at paragraph 2.21.

- The Rainbow and Verde divestments. The CMA chooses to emphasise the OFT's advice to the Chancellor of the Exchequer in September 2013, that these divestments will have only "limited impact". However, in that same advice, the OFT also concluded that "*Rainbow has the ability to be an effective competitor in a market segment for businesses in the £1-25 million turnover range.*"¹⁰ Further, TSB has attracted much favourable media commentary with its recent IPO and market-leading products. Overall, RBS considers that it must be too early to properly determine the impact of such fundamental structural changes to the industry.
- The plethora of non-bank competitors to RBS's SME business (such as crowd funding and peer-to-peer lending);¹¹
- New models, products and servicing offerings, in both SME banking and PCAs, such as mobile and distance banking. For example, the CMA itself reports that, since 2011, PCA providers participating in CASS have implemented 150 current PCA enhancements¹²;
- The gathering momentum behind CASS. As the CMA's provisional decision notes, on 16 July 2014 the Payments Council published switching data covering the first half of 2014. This showed that the overall switching rate has increased by 16% compared with the same period the previous year. Separate figures released by uSwitch this month suggest a 276% increase in current account switches since last year¹³. Further, research by *Which?* found that 83% of switchers are satisfied with the overall process of switching banks¹⁴. Yet despite its "*very positive impact*"¹⁵ CASS could never be an instantaneous solution, but will instead need time to reach its full potential; and
- The anticipated impact of technology companies. Paypal, Amazon and Google wallets are already starting to provide services akin to traditional PCA providers. Further, with over 800 million cards in iTunes accounts worldwide, Apple's announcement of Apple Pay on 9 September 2014 could mark a paradigm shift in mobile payments. Research prepared by Accenture emphasises how digital technologies are moving into the banking sector and estimates suggest that "*competition from these digital*

¹⁰ OFT letter to The Rt Honourable George Osborne MP, Chancellor of the Exchequer, dated 11 September 2013, at page 14.

¹¹ RBS set out full details in its response to the OFT's submission of 19 November 2013.

¹² PCA market study update report at paragraph 4.71.

¹³ Current Account Switch Service results in threefold increase in switching, 3 September 2014, available at: <http://www.uswitch.com/blog/2014/09/03/current-account-switch-service-results-in-threefold-increase-in-switching/>

¹⁴ Which? Real consumers survey, April 2014.

¹⁵ Andrea Leadsom, Hansard Report:

<http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm140429/text/140429w0002.htm#1404307000159>

*players could erode as much as one-third of traditional bank revenues by 2020*¹⁶. [].

The impact of this changing environment on RBS has been considerable. For example, in GB alone, even before the divestment of the Rainbow business, RBS's share of SME customers below £2m dropped from [] to [] between 2010 and 2013, while its share of SME customers above £2m has dropped from [] to [] in the same period. On the PCA side, RBS's share of new PCA business is currently [] below its share of existing business¹⁷.

BARRIERS TO ENTRY AND EXPANSION

{}. In particular, given the recent pace of regulatory and demand-led change in this field, it is too early to determine the extent to which these changes will impact the competitive landscape and accordingly the extent to which additional intervention may be required.

Although RBS looks forward to engaging on these issues in detail, should the provisional decision be confirmed, it wishes to make only some specific observations at this stage¹⁸:

- **Access to key inputs:**
 - RBS is pleased to note that the CMA does not expect its concerns over payment systems to persist into the future “*assuming that the new Payment Systems Regulator is able to remedy any problem that does exist*”. []. Payment systems will be the sole focus of the Payment Systems Regulator (**PSR**) which will have sufficient powers to deal with any relevant potential competition issues, including the question of whether access to payment systems is a perceived barrier to entry or expansion.
 - The CMA also provisionally identifies limited access to information on the creditworthiness of SMEs as a feature which could give rise to competition concerns. Again, RBS would urge the CMA to work closely with HMT on its Credit Data reform package, as well as the Bank of England on its recent consultation document on the same¹⁹. As with the other areas identified below, there is a real risk of regulatory duplication and uncertainty in this area.
- **Branch networks:** RBS welcomes the CMA's acknowledgement that “*there has recently been a huge increase in the usage of banking methods other than*

¹⁶ The Everyday Bank, A New Vision for the Digital Age, undated, available at: <http://www.accenture.com/SiteCollectionDocuments/PDF/Accenture-The-Everyday-Bank-A-New-Vision-for-the-Digital-Age.pdf>

¹⁷ 23 May Submission para 1.4 (a)

¹⁸ The CMA also notes that low levels of switching themselves constitute a barrier to entry and expansion, making it difficult for smaller and newer providers to acquire sufficient numbers of profitable customers. RBS has set out its views on this subject in the preceding section.

¹⁹ Should the availability of UK credit data, be improved? A Discussion Paper, May 2014

through branches, in particular through online and mobile banking methods.” Notwithstanding that the number of branches in the country has reduced by 1,000 since 2009²⁰, RBS accepts the CMA’s conclusion that branch networks are still important for some models of distribution for SME banking and PCA products. Nevertheless, it considers that the traditional model is changing faster than the CMA’s provisional decision has recognised. Customers made 316m online bill payments last year, along with 293m account transfers and 152.6m direct debit and standing order creations or amendments²¹. Indeed, as the CMA itself recognises, there has been an exponential rise in customer engagement with mobile banking over the past few years, with less than 50m mobile banking logins in 2011, rising to 900m in 2013.

- **Gateways:** PCA presence is not a prerequisite for SME entry – e.g. Handelsbanken has achieved a share of approximately 5% of BCAs from only a limited PCA starting point.

Further, RBS considers that any analysis of gateway products must take into account customer benefits as well as competitive costs. User experience and customer convenience, for example, should not be underestimated, as these are often the primary drivers for such behaviour. This is particularly the case given the significant recent increase in online and mobile banking, as holding several products with one provider allows for easy access from a single website or app, as well as the ability to transfer funds between accounts on the move. The impact of such developments on customer convenience must be reflected in any gateway analysis.

²⁰ BBA figures, cited in CityAM, Monday 18 August 2014.

²¹ BBA figures, cited in CityAM, Monday 18 August 2014.

3. RESPONSE TO COMPETITION CONCERNS IDENTIFIED

UNDERTAKINGS IN LIEU

RBS is disappointed that the CMA does not feel that the UILs as submitted would provide a sufficiently comprehensive solution to those features that it has provisionally identified may prevent, restrict or distort competition in the SME banking sector. RBS is particularly concerned that, in coming to its conclusion on UILs, the CMA could not rule out *“that some of the concerns would be more appropriately remedied by structural measures rather than, or in addition to, behavioural remedies.”*²²

RBS remains of the view that divestiture remedies would be neither necessary, effective nor proportionate in nature. In this regard, RBS is pleased that the CMA has acknowledged the very significant costs and other difficulties associated with forced divestments²³.

As set out further below, [].

FOCUS OF ANY MARKET INVESTIGATION

Should the CMA confirm its provisional decision, RBS encourages it to run any investigation in a sufficiently flexible manner, so as not to overlap with the numerous investigations currently underway. For example, RBS draws the CMA’s attention to:

- The work being undertaken by HM Treasury and the Bank of England into credit data;
- The creation of the PSR;
- The forthcoming review (by the Financial Conduct Authority (FCA) or PSR) of Account Number Portability;
- The forthcoming FCA review of the CASS²⁴; and
- The FCA’s ongoing work on how providers set and monitor overdraft limits and their governance and strategies for so doing.

Although the CMA has recognised the potential of some of these developments²⁵, RBS is concerned that, should the MIR overlap with these areas, not only will it require duplication of effort, it will also risk both inhibiting the operation of these non-CMA processes and giving rise to legal uncertainty. The PSR, for example, will need time to bed down and provide a fresh (and competition-focused) regulatory evaluation of the industry.

²² Paragraph 4.64 of the Consultation Document

²³ Paragraph 4.51 of the Consultation Document

²⁴ See the 2014 Budget, at page 84, available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293759/37630_Budget_2014_Web_Accessible.pdf

²⁵ See, for example, paragraph 4.39 of the Consultation Document.

RBS also notes the comprehensive nature of the CMA's programme of work to-date, as well as the detailed work undertaken in the numerous previous competition-related inquiries in this sector (a recent BBA report identifies more than 30²⁶, although from an RBS perspective the CC's 2006 Northern Ireland PCA inquiry is of particular note). We assume that this "groundwork" will allow the CMA to (in some respects) lessen the burden of information collection, in what may otherwise prove to be a massive, and extremely difficult-to-manage, exercise for all concerned.

THE 2002 UNDERTAKINGS

Lastly, with respect to the 2002 Undertakings, RBS endorses the CMA's provisional conclusion that the implementation of CASS represents a change of circumstances such as to trigger a review of the switching undertaking. In any event, even if the CMA ultimately concludes that a review of the 2002 Undertakings is not an administrative priority, RBS asks that the CMA would nevertheless make clear the extent to which the switching undertaking is superseded by CASS, in order to remove the possibility for confusion. More generally, in relation to the remainder of the 2002 Undertakings, RBS would welcome any simplification of the rules which would reduce their complexity and would propose that any future MIR may provide such an opportunity.

²⁶ Promoting competition in the UK banking industry, James Barty and Tommy Ricketts, June 2014 at Table 1.