Evaluating the impact of the 2008 OFT market study and UTCCR test case into personal current accounts

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1 AN INDEPENDENT REVIEW OF OFT’S EVALUATION OF IMPACT OF ITS 2008 MARKET STUDY INTO PERSONAL CURRENT ACCOUNTS

1.1 This note reviews the OFT’s current (2013) ex-post evaluation of the impact of its 2008 market study into Personal Current Accounts (PCAs) in the UK.

1.2 Following the market study the OFT had made recommendations of relevance to switching, transparency and unauthorised overdraft charges (UOCs), and also engaged in follow-up action on UOCs.

1.3 In its evaluation, in the light of the evidence since 2007, the OFT now concludes that there have been very significant consumer benefits resulting from a lowering in UOCs; on the other hand, its recommendations on switching and transparency appear to have had little impact. OFT’s headline estimate of the total benefits attributable to the OFT are in the region of £259 million to 619 million per annum,¹ which dwarf the £3.8 million cost of the market study and the follow up work, including the Test Case.

1.4 The purpose of my note is assess the assumptions, analysis and data used in the evaluation, and to comment on its conclusions.

1.5 As a preliminary, I commend the authors on the presentation of the report - for its clarity and transparency. In terms of its systematic assembly of evidence, transparent assumptions and analysis, this is a model evaluation.

Importance of the counterfactual

1.6 Central to any ex-post evaluation is the choice of counterfactual assumption – what would have happened in the absence of an OFT intervention. In this case, comparisons are made between the current position (as at 2011) and 2007. In essence, this is a simple before-after comparison, with the implication that the market would have otherwise remained unchanged had there been no OFT intervention. This is clearly debatable but the authors justify this assumption and explain that results are robust to alternative assumptions about the choice of start year.

¹ Two-thirds of total benefits of £388 million to £928 million are attributed to the OFT
The problem with the simple before-after approach is that some of the inter-temporal changes observed may be accounted for by other exogenous developments in the market over these years. Ideally, these can be controlled for by conducting a difference-in-differences analysis, in which changes are assessed relative to the changes observed in some comparator market (for example, a similar market in the UK unaffected by the intervention, or the same market in another comparable country). However, I am satisfied that there is no such comparator for which data are available.

One justification the authors give for a simple 2007-2011 comparison is that it is likely that the full impact of the intervention had yet to be felt by 2011 and so their estimate of the gains is likely to be an underestimate of the eventual gains in the long-run. This is almost certainly correct, although it does beg the question of whether this evaluation might better have been delayed for a few years.

I now turn to the substantive findings.

Switching

The report concludes that 'While there is an indication that some aspects relating to switching have improved... there is not very strong evidence supporting a substantial and quantifiable impact.' I think this a correct interpretation of the evidence at its disposal, and, in the spirit of conservatism, it is therefore correct in not claiming any benefit on this count in the evaluation.

Here, I would like to make a more general observation. As noted in the report, the often heard view, that more switching is necessarily evidence of an increase in competition, is incorrect. After all, in a well-functioning market, in which all suppliers are already offering their product or service at a competitive price, there is no reason why consumers should switch. Equally, there may be some markets in which consumers are perhaps misled into switching to less competitive suppliers. The relevant question is whether consumers are able to make well-informed decisions and have the potential to switch relatively costlessly if necessary. Of course, it is difficult to measure in any evaluation whether the potential for switching has been increased – what we observe is based largely on what switching actually happened. Moreover, even if it were possible to
measure whether the potential has increased, and the market has become more competitive, it is difficult to see how this can be quantified in terms of consumer benefits. My general point then is that in any ex-post evaluation of an intervention, it will be innately difficult to quantify the benefits flowing from an enhanced potential for switching. But returning to this specific case, there is no hard evidence anyway.

Transparency

1.12 Similar issues are involved here – how, in principle, does one quantify the benefits to consumers of greater transparency by suppliers? Again, as it happens, the report suggests that there is little evidence that transparency has been enhanced. Referring to the provision of monthly and annual summaries, the evidence is patchy, and the report concludes 'that these are too early to evaluate, as these have only been implemented recently and partially.' Therefore, no quantified impact is claimed on this count either – correctly in my opinion.

Reduced UOC

1.13 This is the part of the intervention where the report is able to point to evidence of a measurable positive, and substantial, impact for consumers. The evidence is strong and hard to contest. Between 2007 and 2011, ‘unpaid item charges’ incurred by consumers with unauthorised overdrafts fell by £652 million, and ‘unarranged lending charges’ fell by £276 million. Adding these two components of UOCs, yields a total saving in charges, and thus enhanced consumer benefits, of £928 million. The report argues that this can all be attributed to the intervention (reinforced by the FSA and media attention, see below) because the main driver was a fall in the ‘price’, rather than quantity, of unauthorised overdrafts. Had there been a reduced demand for unauthorised overdrafts for reasons unconnected with the intervention, this would have been manifested in a lower volume, rather than a lower price. (Unchanged volume but reduced price implies, incidentally, a zero price elasticity of demand, which is consistent with the view that unauthorised overdrafts are mainly incurred unknowingly and involuntarily by consumers.)

1.14 As the report explains, this should be interpreted as a gross figure – an upper bound – for two main reasons, both of which lead the authors to
moderate the claimed benefits. Both are also premised on a conservative assumptions.

1.15 The first is that the banks, faced with the loss of income from unauthorised overdrafts, responded by increasing their charges and interest on authorised lending. During this period, bank revenues from arranged lending increased by £539 million. Supposing this would not have occurred, absent the pressure to reduce unauthorised lending charges, one should deduct this from the gross benefits.

1.16 The second is that the pressure on banks to reduce UOCs came not only from the OFT, but also from the FSA and ‘media pressure’. Arbitrarily, the OFT in this evaluation deducts one third of the benefits in recognition of these other contributory agencies.

1.17 Making deductions for both reasons reduces the estimate of enhanced consumer benefits to £259 million, or making only the second deduction, to £619 million.

1.18 I have carefully read the report’s reasoning on both of these effects, and I think it is fair and reasonable, erring on the side of over-conservatism. My opinion on the first is that, while one cannot exclude completely the possibility of the waterbed effect which would be necessary to justify the assumption, it is unlikely that the entire, or even a large part of, the increase in charges on authorised lending was provoked by reduced UOCs. Therefore, my preference would be to opt for an estimate towards the upper end of the range. My opinion on the second, and here it is purely a matter of opinion, as opposed to fact, is that the deduction for the contribution of the FSA and the media is unnecessary. My reading of this case is that, without the OFT intervention there might not have been any change in UOCs. This is not to deny that pressure from the FSA and the media were reinforcing factors, but it remains the case, in my opinion, that the OFT’s intervention was a necessary condition.

1.19 Fortunately, it is unnecessary to take a definite stance on this since it is clear that the gains from the OFT intervention are considerable whichever assumptions are used.
Remarks of more general relevance to ex-post evaluation

1.20 I have three more general observations, intended as a contribution to the debate on how evaluations such as this should be conducted.

1.21 First, as implied by some of my previous comments, I think ex-post evaluations should be undertaken with a sufficiently long time lapse after the initial intervention. Especially in cases which involve recommendations, and to some extent voluntary responses by the parties, four years afterwards may be too soon.

1.22 Second, it is conventional to argue that evaluations should be based on conservative assumptions, and throughout this report, there are instances of this. I think this is entirely appropriate for ex-ante evaluations – such as those used by OFT in its ‘Positive Impact’ reports – because ex-ante evaluation necessarily entails positive estimates, being based only on the information available at the time of the original intervention. But for ex-post evaluation, which can in principle result in negative estimated benefits, it might be argued that what is required is the ‘best’, not necessarily a ‘conservative’ estimate. The authors of this report go some way towards this by headlining their aggregate estimate in the form of a range, rather than a (lower bound) point estimate. I believe this issue merits future consideration and debate.

1.23 Third, it is quite often the case that one can point to other agencies (here the FSA and public/media pressure) as contributory drivers of a positive outcome. In these cases, it can be argued, as it is here, that not all of the benefits should be ‘claimed’ by the OFT. While the point is well taken, it is rarely possible to allocate, on any objective basis, a specific quantification to recognise the contributions of these outside parties. In this case, a deduction of one-third is, so far as I can see, totally arbitrary. While one might commend the OFT for modesty, my own view is that such arbitrary deductions undermine the care and consideration with which all other estimations in the evaluation are made. Arguably it would be better to emphasise the ‘team nature’ of the intervention, but to leave the gross figure unaltered.