Review of the personal current account market

January 2013
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EXECUTIVE SUMMARY

1.1 Almost everyone has a current account and uses it daily. Quality of service and value for money in this market are hugely important. Consumers and businesses rely on personal current accounts (PCAs) to make transactions. Retail banks also have a wider role in connecting savers and investors through the investment chain and helping the rest of the economy to manage risk. When competition in retail banking is not working effectively, capital is allocated less efficiently and risks are managed less well. A competitive PCA market is critical to the efficient functioning of the UK economy.

1.2 This review has been carried out to understand the changes that have taken place in this market over recent years, including those that have resulted from initiatives the OFT agreed with PCA providers.

Findings and Analysis

1.3 The conclusion from this review is that longstanding competition concerns remain in the PCA market. Concentration remains high, new entry infrequent, and switching low. While there have been improvements around unarranged overdrafts and transparency of charges, charging structures are still complex and comparisons between products remain challenging. Similarly, despite some reduction in error rates, consumers still lack confidence in the switching process. Together, these problems result in a market in which a lack of dynamism from providers combines with consumer inertia to deliver sub-optimal outcomes for consumers and the economy.

1.4 The OFT’s key findings are:

- The market has become even more highly concentrated since 2008. The four large providers\(^1\) now have around 75 per cent of the market, and the financial crisis and recession have weakened the

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\(^1\) Lloyds Banking Group, RBS, Barclays and HSBC.
competitive constraint from the smaller providers. While there have been two new entrants in recent years – Metro Bank in 2010 and M&S Bank in 2012 - neither is yet in a position to provide a significant challenge to the established providers.

- There has been a significant reduction in the level of **overdraft charges**. Overall the OFT estimates that there have been consumer savings of between £388 million and £928 million since the 2008 market study. During this period, unarranged overdraft revenues fell substantially, and despite increased revenues from arranged overdrafts and debit interest, there is a substantial saving for consumers. While the overall reduction is significant and welcome, this appears to be largely the result of pressure from OFT and others, rather than competition between providers. While the OFT welcomes the shift away from hidden and unexpected charges to charges that are clearer and more predictable, overdraft charging structures remain complex and there is more providers could do to simplify charges and make it easier to compare the costs of different accounts.

- Providers have made progress in helping consumers **control** when they use unarranged overdraft facilities and the charges they incur. Mobile technology along with balance alerts mean it is easier for consumers to manage their account and avoid incurring charges. However, awareness of text message alert services is low. Furthermore, opt-outs from unarranged overdraft facilities are not offered across the board – providers typically offer opt-outs on a limited range of accounts which often attract a monthly fee.

- Providers have begun rolling out the **transparency** initiatives previously agreed with the OFT. However, providers have been slow to make progress – three years after these initiatives were agreed, not all customers have received an annual summary. Early indications are that this information will improve consumers' understanding of the costs of their account and therefore aid decision-making but the slow progress in roll-out means the impact to date has been limited.
• There have been improvements in the functioning of the current automated switching process. However, problems still arise, and there remains a perception among consumers that the process is risky and complex. The rate of switching remains low.

1.5 Although progress to date has been slow in many respects, there are a number of significant changes happening or expected in the next year which could provide a more radical stimulus to competition in this market. These developments include:

• Significant structural change by the end of 2013 as a result of divestments from both RBS and Lloyds Banking Group. These are expected to significantly increase significantly the size of one or two smaller providers in the market, or enable new entry. While it is too early to predict their impact, it is possible that these divestments will result in one or more competitors presenting a challenge to the established providers.

• The new switching service (which will automatically redirect payments to the new account as well as offering a full switch in seven working days at no charge to consumers) should be available from September 2013. This service may address both the reality and perception of switching difficulties.

• PCA providers will continue the roll-out of commitments given to OFT and the Government in relation to transparency of cost information and control of overdrafts. Roll-out should be complete in 2013, and this review makes a number of recommendations (set out below) to help ensure that the potential benefits of these initiatives are achieved.

1.6 Looking forward, the OFT’s analysis is that more effective competition – which drives innovation, quality of service and value for money – requires two parallel developments. The first is that it must become easy and risk-free for customers to switch accounts, and consumers must be confident that this is the case. The second is that there must be products and providers worth switching to – the market must be open to
new providers, and they and established providers need to offer genuine improvements in prices, convenience and service quality. The OFT’s believes that the expected developments outlined above have some potential to deliver this, but that the outcome is by no means guaranteed.

**Market Investigation Reference**

1.7 In light of our finding that significant competition concerns remain in this market, the OFT has considered whether a market investigation reference (MIR) of the PCA market to the Competition Commission (CC) would be appropriate at this point. This question was also raised by the Independent Commission on Banking (ICB) which recommended that the OFT should consider an MIR if the retail banking sector had not changed in certain ways by 2015, and in the event that the OFT had not already made an MIR following this review of the PCA market.

1.8 In light of the OFT’s analysis that developments expected over the next year could have a significant impact on competition in this market, the OFT has provisionally decided not to make an MIR at this time. It is noted that this review of the PCA market is only the first step in the OFT’s programme of work in the banking sector (the rest of which is outlined below). The outcome of the planned work should inform the OFT’s judgement as to the scope of any possible future reference, which could include business banking and payment systems. The OFT will return to this question in 2015 or before.

**Recommendations and next steps**

1.9 The OFT has significant concerns about this market and is making a number of recommendations which build on previous initiatives to make PCA costs more transparent, the switching process more reliable and improve the way unarranged overdrafts are provided.

- In relation to switching, the OFT recommends that, in addition to ongoing monitoring to ensure that any problems are dealt with promptly, the Financial Conduct Authority or the Competition and
Markets Authority\(^2\) carry out a review of the effectiveness of the new switching service once this has been in place for at least 15 months. As well as establishing that the system functions as expected, we anticipate that such a review would consider consumer interest and confidence in the system, and whether it results in consumers being more willing to switch when they are dissatisfied with their existing provider. In addition, the OFT recommends that the Payments Council undertake research into the costs of bank account number portability. This would allow the impact of the new automated account switching service to be evaluated alongside other options to further develop the switching process.

- In relation to transparency, the OFT has seen encouraging feedback from customers that have seen annual summaries and believe they could be of greater value if consumers had more consistent access to them. Consequently, the OFT recommends that PCA providers make annual summaries easily accessible throughout the year in both electronic and paper form. The OFT also recommends that the Money Advice Service enhances its PCA price comparison website to enable more accurate and detailed comparisons across PCAs and providers based on a consumer’s own specific needs, and the OFT will assist the Money Advice Service with this.

- In relation to control and overdrafts, text alerts appear to have a positive impact on consumers’ ability to avoid incurring unauthorised overdraft charges, but there is currently a lack of awareness of this service among consumers. The OFT therefore recommends that PCA providers do more to offer their text alert service to all their customers proactively. It also recommends that PCA providers make opt-out of unarranged overdraft facilities available on a much wider range of PCAs. While it is recognised

\(^2\) The Financial Conduct Authority (FCA) will be the new regulator for financial services from April 2013. The Competition and Markets Authority (CMA) is due to be created in April 2014, bringing together the Competition Commission and the competition, markets and some consumer protection functions of the OFT.
that this feature is likely to appeal only to some customers, the OFT considers that the limited way in which this option is currently offered is inhibiting take-up. In light of ongoing concerns over the clarify and predictability of overdraft charges, the OFT recommends that **PCA providers further simplify their overdraft charging structures** so that PCA pricing becomes less complex and easier for consumers to understand.

1.10 We will also work with the industry to **trial the provision of information to customers on interest foregone**. Three providers have agreed to participate in this trial, and we expect to carry out the trial later this year.

1.11 In the meantime, as part of our programme of work on retail banking, the OFT intends to:

- **Carry out behavioural economic research** on the way consumers make decisions and engage with retail banking services. This will build on existing transparency initiatives by improving our understanding of the information consumers need to make choices and how it can best be presented.

- **Study the operation of payment systems**, in the light of innovations since earlier competition analyses and the recent HM Treasury consultation on setting the strategy for UK payments.

- **Study the market for banking services to small and medium sized enterprises** (SMEs), looking at the effectiveness of competition in these markets and the extent to which they meet the needs of SMEs.

1.12 Much of the progress in the PCA market has come about as a result of intervention by the OFT, Government and the Financial Services Authority. Going forward we want to see improvements in this market driven to a much greater extent by competition. The OFT has previously set out, in the context of its programme of work on retail banking, five outcomes it expects to see in the retail banking sector, namely:
• The banking sector is more customer focused. Providers’ products are well-suited to their customers’ needs and are provided in a way that makes it easy for customers to make well-informed decisions about how and when they are used.

• Consumers are sufficiently engaged with their banking services to drive competition. Banks equip their customers to make better decisions about which products they use, and how they use them. This will stimulate banks to compete for customers’ business on things that matter to them.

• Competition between banks (and from non-banks) is driving providers to operate more efficiently and to innovate. Effective competition between banks encourages them to perform more efficiently, meaning that lower costs are passed on to consumers and businesses, potentially in innovative new ways.

• Consumers have a broad choice of provider. The sector is less concentrated, with greater competition from 'challenger' banks and/or new technology providing scope for increased competition from outside the traditional banking model.

• Barriers to entry and expansion are lower. Credible new providers are able to join the market and have reasonable prospects for attracting the scale of customer base needed to achieve the economies of scale required to operate effectively.

1.13 Empowered consumers drive competition, which puts pressure on providers to reduce the price and increase the quality of services offered. This forces providers to operate efficiently and stimulates innovation for the benefit of consumers and the UK economy. We want to see this dynamic process operating well across retail banking markets in the UK. Current account providers need to demonstrate a step-change in their approach to consumers for this to become a reality, and before regulators can step away from their scrutiny of competition in this market.
2 INTRODUCTION

2.1 The PCA market is the cornerstone of the UK’s retail finance system and an essential service for UK consumers. Almost everyone has a current account and uses it daily. Consumers rely on PCAs to provide the basic systems for transactions. Retail banks also have a key role in connecting savers and investors through the investment chain and helping the rest of the economy to manage risk. When competition in retail banking is not working effectively, capital is allocated less efficiently and risks are managed less well. Where this sector is not competitive and is not operating to the benefit of consumers it can generate substantial levels of consumer detriment.

2.2 This review, launched on 13 July 2012, has sought to establish how the PCA market has evolved since the OFT’s 2008 market study, which reported that a combination of complexity and opacity made it extremely difficult for individual consumers to know how much their PCA could be costing them compared with others on offer. Together with perceived difficulties in switching, this had led to low switching rates and reduced incentives for banks to compete on price or develop new products and services.

2.3 This chapter describes the OFT’s previous work on PCAs, in particular the concerns identified and the initiatives put in place to address them, and provides a brief overview of why the OFT has conducted this review of the market. It also describes the work of the Independent Commission on Banking (ICB) and the Government’s Consumer Credit and Personal Insolvency Review. Finally this chapter provides a brief description of the structure of the remainder of this report.

OFT’s mission and powers

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2.4 The mission of the OFT is to make markets work well for consumers. When markets work well, more efficient businesses thrive by providing what consumers want, better and more cost-effectively than their competitors. Businesses that do not offer products that meet consumer needs or do not offer value for money will either need to improve their product offering or risk being forced to exit the market. Through this process, competition drives efficiency and innovation, thereby increasing productivity and economic growth.

2.5 The OFT has a number of tools to meet its objectives. Under section 5 of the Enterprise Act 2002 (EA02) the OFT may obtain, compile and keep under review information relating to the carrying out of its functions. The OFT may use its functions under section 5 EA02 to carry out research into specific or narrow market-related issues. It is under this power that the PCA review has been carried out.

Previous work relevant to the PCA market

2.6 Since 2007, the OFT and others have conducted a number of studies aimed at improving the effectiveness of competition in the PCA market.

Unarranged overdraft investigation

2.7 In March 2007, the OFT opened an investigation\(^6\) into the fairness of certain unarranged overdraft charging terms under the Unfair Terms in Consumer Contract Regulations (UTCCRs) and in July 2007 it entered into a test case with certain banks.\(^7\) The test case culminated in the Supreme Court overturning previous High Court and Court of Appeal


\(^7\) Abbey National plc, Barclays Bank plc, Clydesdale Bank plc, HBOS plc, Lloyds TSB Bank plc, Nationwide Building Society and the Royal Bank of Scotland Group plc.
rulings by finding that unarranged overdraft charging terms could not be assessed in full for fairness.\textsuperscript{8}

2.8 On 22 December 2009, the OFT announced it would not be continuing its investigation under the UTCCRs. However, the OFT continued to have concerns around unarranged overdraft charges and, following the Supreme Court’s decision, the OFT entered into discussions with the PCA providers and other stakeholders to examine ways these concerns around unarranged overdraft charges could be addressed. The outcome of these discussions fed into the follow up report published in March 2010.\textsuperscript{9}

The 2008 market study and follow up reports

2.9 The OFT’s 2008 market study was launched in April 2007 to provide context for the UTCCRs investigation. The report, published in July 2008, identified a number of problems in the PCA market in the UK. Collectively, these problems meant it was not working in the interests of consumers. They included:

- Complexity in the way unarranged overdraft charges were implemented, which made it hard for consumers to predict when they would be charged, coupled with a lack of mechanisms for consumers to exercise control or opt-out of activities that attracted high charges.
- Low levels of transparency on unarranged overdraft charges, forgone interest and other fees and charges - these elements were the least visible to consumers and were not effectively competed on by PCA providers.

\textsuperscript{8} Office of Fair Trading vs. Abbey National plc and others. See \url{www.supremecourt.gov.uk/docs/uksc_2009_0070_judgmentV3.pdf} for details.

\textsuperscript{9} See \url{www.oft.gov.uk/shared_oft/personal-current-accounts/of1216.pdf} for details.
• A perception among consumers that switching was both complex and risky, with concerns that the switching process could go wrong.

2.10 In order to address these concerns, the banking industry agreed to implement the following initiatives:

• Steps to improve the switching process and improve consumer confidence in switching provider.

• Steps to improve transparency through the publication of illustrative charging scenarios on banks’ websites, the introduction of annual summaries and increased information on monthly statements.

• Incorporation into the Lending Code of minimum standards on opt-out and best practice guidelines on how to treat customers in financial difficulty who incur unarranged overdraft charges.

2.11 These initiatives were set out in follow up reports published by the OFT in October 2009\textsuperscript{10} (on transparency and switching) and March 2010 (on unarranged overdrafts). The OFT also continued to monitor developments in the market and published further progress reports in September 2010\textsuperscript{11} and March 2011.\textsuperscript{12}

2.12 The objective of these initiatives was to allow consumers to have the right information available, in an easily digestible format, in order to help them to understand the true cost of running their account and hence manage it more effectively. The OFT’s intention was that consumers would become more aware of the costs of their current account and more confident in switching as a means of getting better service so that PCA providers would need to offer more competitive products and innovative services to attract and retain custom. In a market displaying

\textsuperscript{10} See \url{www.oft.gov.uk/shared_oft/personal-current-accounts/oft1249.pdf} for details.

\textsuperscript{11} See \url{www.oft.gov.uk/shared_oft/reports/financial_products/OFT1275.pdf} for details.

these characteristics, more efficient firms can gain market share at the expense of less efficient providers, which is good for consumer welfare and, by providing pressure to reduce costs, UK productivity.

2.13 In its March 2010 follow-up report, the OFT committed to conduct a review of the PCA market in 2012 in order to analyse the impact of the initiatives introduced by PCA providers.

Review of Barriers to Entry, Expansion and Exit in Retail Banking

2.14 This review was launched in May 2010, with the purpose of assisting the OFT and others (in particular the Independent Commission on Banking) to understand better barriers to entry, expansion and exit in both personal and SME banking\textsuperscript{13} markets. The review covered four key themes - regulation, access to essential inputs needed to offer retail banking services, the ability of new entrants to attract customers and achieve scale, and barriers to exit.

2.15 The report, published in November 2010,\textsuperscript{14} found that, while most prospective entrants were able to meet regulatory requirements, and source the necessary inputs to offer retail banking services, new providers faced difficulties in attracting customers and expanding their market share. This was largely due to the reluctance of personal and small business customers to switch providers, their loyalty to established brands, and preference for banks with a local branch. This is important because firms need to be able to grow quickly in order to spread the costs of significant IT investment, often in the form of sunk costs, over a larger customer base.

2.16 Some firms also reported problems around the process of becoming authorised by the FSA to accept deposits, with a lack of transparency and uncertainty causing delays and difficulties in raising funds. However, the FSA had recently revised its authorisation process and we expected that this should lead to greater transparency and certainty. We also

\textsuperscript{13} SMEs are defined as firms with annual turnover of up to £25 million.

\textsuperscript{14} See [www.oft.gov.uk/OFTwork/markets-work/othermarketswork/review-barriers](http://www.oft.gov.uk/OFTwork/markets-work/othermarketswork/review-barriers) for details.
found that existing capital requirements may disproportionately affect new entrants and smaller banks by requiring them to hold proportionally more capital than incumbents. We concluded that, as capital and liquidity requirements are updated, it may be appropriate for the prudential regulators to consider and monitor their impact on competition.

**Travel money super-complaint**

2.17 In December 2011, the OFT published its response to a super-complaint from Consumer Focus on purchasing foreign currency and using payment cards overseas. The super-complaint identified three features which it called on the OFT to investigate: complex and unclear charges applied when using credit or debit cards abroad, the charges applied by some banks and credit card providers for purchases of foreign currency within the UK and the use by some UK foreign currency retailers of phrases promising zero per cent commission and competitive exchange rates.

2.18 The OFT found that charges for purchasing foreign currency and using cards overseas could be confusing and were not transparent to consumers, and that some of the marketing materials used by foreign currency vendors were confusing. To address these concerns, the OFT secured the following:

- Agreement from the five banks that charged consumers for using debit cards to purchase foreign currency in the UK that they would drop these charges.

- A joint agreement from the UK Cards Association and the British Bankers Association, on behalf of their members, that they would give clearer, more accessible information about their charges for using cards abroad.

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Agreement from many foreign currency businesses to review their marketing to make the various costs and conditions that apply clearer, particularly to certain terms used in market material including zero per cent commission and competitive exchange rates.

**Independent Commission on Banking**

2.19 The ICB was established by the Government in June 2010 with a remit to consider structural and related non-structural reforms to the UK banking sector in order to promote financial stability and competition. The ICB, when reporting in September 2011, made a number of recommendations aimed at promoting financial stability and competition in UK banking.

2.20 In order to promote financial stability, the ICB recommended a package of measures, consisting of ring-fencing vital banking services and increasing banks’ resilience, in order to make banks better able to absorb losses; make it easier and less costly to sort out banks that still get into trouble; and curb incentives for excessive risk-taking.

2.21 In order to promote competition in the PCA market, the ICB made recommendations to address problems with market structure, including that the conditions be created for a strong new challenger bank to emerge from the state aid divestment of Lloyds Banking Group, and that a review of prudential regulation be conducted by the Prudential Regulation Authority (PRA) and the OFT to ensure that prudential standards were not unnecessarily raising barriers to entry. The ICB also recommended the implementation of a switching re-direction service, that the Financial Conduct Authority (FCA) and OFT to take steps to improve transparency, and for the FCA, once created, to have an enhanced competition objective.

2.22 The ICB also recommended that the OFT consider making a market investigation reference to the CC by 2015 if it has not already done so and if sufficient improvements in the market have not been made by that time. The ICB noted, however, that such a reference was not
recommended until the impact of the Lloyds Banking Group divestiture, the switching re-direction service and a pro-competitive FCA is known.

**Consumer Credit and Personal Insolvency Review**

2.23  The Department for Business Innovation and Skills and HM Treasury jointly launched a *Consumer Credit and Personal Insolvency Review* in response to the Coalition Government’s commitment to curb unsustainable lending and strengthen consumer protections, particularly for the most vulnerable.\(^\text{16}\)

2.24  The review, which reported in November 2011, obtained commitments from PCA providers that were closely aligned to those the OFT had been encouraging PCA providers to make to improve consumers’ ability to control their use of unarranged overdraft charges. These included giving consumers the option to receive a text or email alert when their balance fell below a certain level, making them aware of a grace period within which they could credit funds to put their account back within their limit to avoid a charge being applied and ensuring consumers could benefit from a small buffer zone within which unarranged overdraft charges would not be levied.

**Why the OFT is reviewing the PCA market**

2.25  The OFT committed in March 2010 to conduct a review of the market as PCA providers had indicated that they planned to make changes to their PCA products over the following one to two years to address the concerns raised by the OFT, but that they were not, at that stage, in a position to set out those plans in detail.

2.26  The purpose of the OFT’s review was to understand whether the PCA market is moving towards an equilibrium that works well for consumers. In particular, the review has assessed whether the initiatives agreed with the banks have been successful at improving the switching process,

\(^{16}\) See [www.direct.gov.uk/prod_consum_dg/groups/dg_187876.pdf](http://www.direct.gov.uk/prod_consum_dg/groups/dg_187876.pdf) for details.
increasing the transparency of personal current account charges and allowing people to manage their accounts more effectively.

2.27 The OFT has also been keen to understand the impact of wider changes in this market since its 2008 market study. These include the impact of the financial crisis and subsequent regulatory changes, and the work of the ICB and the Government’s Consumer Credit and Personal Insolvency Review.

Programme of work on retail banking

2.28 The review of the PCA market also forms part of the OFT’s programme of work on retail banking, launched alongside the PCA review on the 13 July 2012, which is aimed at ensuring that the PCA market, and the retail banking sector more generally, becomes more competitive and consumer focused.17

2.29 The programme of work set out the ways in which the OFT wants to see the retail banking sector evolve:18

- **The banking sector is more customer-focused:** Providers’ products are well-suited to their customers’ needs and are provided in a way that makes it easy for customers to make well-informed decisions about how and when they are used.

- **Consumers are sufficiently engaged with their banking services to drive competition:** Banks equip their customers to make better decisions about which products they use, and how they use them. This will stimulate banks to compete for customers’ business on things that matter to them.

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17 For more information on the OFT’s programme of work on retail banking please see [www.oft.gov.uk/OFTwork/financial-and-professional/retail-banking](http://www.oft.gov.uk/OFTwork/financial-and-professional/retail-banking)

• **Competition between banks (and from non-banks) is driving providers to operate more efficiently and to innovate.** Effective competition between banks encourages them to perform more efficiently, meaning that lower costs are passed on to consumers and businesses, potentially in innovative new ways.

• **Consumers have a broad choice of provider.** The sector is less concentrated, with greater competition from 'challenger' banks and/or new technology providing scope for increased competition from outside the traditional banking model.

• **Barriers to entry and expansion are lower.** Credible new providers are able to join the market and have reasonable prospects for attracting the scale of customer base needed to achieve the economies of scale required to operate effectively.

2.30 To support these objectives, in addition to the review of the PCA market, the OFT has committed to consider the operation of payments systems and SME banking over the next two years. The OFT is also planning to look in more detail at the way consumers make decisions and engage with retail banking services, including through the application of behavioural economics.

2.31 The programme of work was also launched in response to the ICB’s recommendation that the OFT consider making an MIR covering personal and business current accounts to the CC by 2015 in the event that it had not already done so as a result of this review and if sufficient improvements in the market had not been made by that time.19 The PCA review and wider programme of work are aimed at informing the OFT’s response to this recommendation, although a market investigation reference remains a possibility at any time if the legal test is met.20

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19 Independent Commission on Banking, Final Report Recommendations; September 2011.
20 Under Section 131 of the Enterprise Act 2002, the OFT may make a market investigation reference to the Competition Commission where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents,
The OFT’s approach to this review

2.32 The main issues examined in the PCA review are:21

- The implementation of the switching, transparency and control initiatives that PCA providers agreed with the OFT following the 2008 market study, the initiatives agreed following the OFT’s travel money super-complaint and those stemming from the ICB and the Government’s Consumer Credit and Personal Insolvency Review.

- The impact of the various transparency, switching and control initiatives that PCA providers agreed with the OFT and other stakeholders.

- How the market has evolved since the OFT’s 2008 market study, in particular how concentration levels, barriers to entry and expansion, revenue streams and PCA charging structures have altered since the OFT’s last consideration of the market.

- Whether there are further options for helping consumers make more informed current account choices and drive competition.

2.33 The following issues were considered outside the scope of the OFT’s review:

- The packages of measures recommended by the ICB to promote financial stability, as these are regulatory measures for government to consider.

restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. Where that test is satisfied, the OFT has the power to make a reference. In choosing whether to exercise that power, it will have regard to the OFT guidance on market investigation references, (OFT511) and any other relevant factors.

21 In considering these issues, the review has also taken account of relevant developments from the European Commission’s consultation on bank accounts and its review of the Payment Services Directive, 2007/64.
• Matters relating to payment systems or banking for small and medium-sized enterprises, as the OFT will consider what further work is required in these areas as part of its wider programme of work on retail banking.

• The impact of the availability of PCAs and basic bank accounts on financial inclusion, as the OFT’s remit does not extend to social policy issues.

• The selling of packaged accounts, in particular ensuring that consumers are eligible for and understand the add-on benefits, as these are issues have been addressed by the FSA.

• Concerns relating to fraud, as these are mainly matters for other bodies such as law enforcement bodies, the Home Office and the FSA.

2.34 In carrying out the review we researched and analysed the PCA market and engaged with a wide range of interested parties. The main elements of the OFT’s approach included:

• A general invitation to submit evidence when the review was launched in July.

• An in-depth analysis of key data requested from banks, complemented by meetings on strategic issues.

• Review of a number of bank web-sites, covering the information and materials available as well as considering a number of price comparison sites.

• A telephone-based consumer survey of 1,752 PCA users.

• Discussions with a large number of stakeholders, including the FSA, government departments, industry associations, consumer representative groups, Parliamentary bodies, the European Commission.
Hosting, jointly with the FSA, roundtables on interest foregone.

Evaluation of the 2008 market study

2.35 The OFT has committed\textsuperscript{22} to commission an independent evaluation of the impact of at least one of its previous interventions each year. Evaluations support the OFT’s external accountability by assessing whether the OFT has delivered its objectives cost-effectively. To fulfil this commitment for the financial year 2012-2013, the OFT has evaluated the impact of the OFT’s 2008 market study into PCAs in the UK. The evaluation has been carried out by OFT staff and has been independently reviewed by Professor Stephen Davies, academic advisor to the OFT.

2.36 The evaluation focuses on the impact of the OFT’s recommendations on switching, transparency and unarranged overdraft charges following the 2008 market study. It also considers the impact of the OFT’s follow-up actions on unauthorised overdraft charges, including its investigation into the fairness of PCA unarranged overdraft charging terms under the Unfair Terms in Consumer Contract Regulations 1999, the Test Case. The evaluation relies primarily on PCA providers’ data, desk-based research and a consumer survey conducted by IFF in September 2012.

Assistance provided during the review and evaluation

2.37 We are grateful for the assistance provided to us throughout the review and evaluation from PCA providers, industry associations and consumer representative groups. The OFT has liaised closely with the FSA and Her Majesty’s Treasury (HMT) throughout this review.

2.38 The OFT also has liaised with the European Commission during 2012 concerning respective work on retail banking. The EC is expected to publish legislative proposals in early 2013 following its consultation in

\textsuperscript{22} The Business Plan 2011-15, adopted as part of the SR10 settlement, commits the OFT to commission an independent evaluation of the impact of at least one of its previous interventions each year.
2012 in relation to access to bank accounts, as well as seeking to improve transparency and provide comparable account fees and easier bank account switching.\(^{23}\)

**Report structure**

2.39 The rest of the report is structured as follows:

- **Chapter 3** provides background material considering the types of PCA available and the sources of revenue for PCA providers.

- **Chapter 4** examines the structure of the PCA market, as well as competition and barriers to entry.

- **Chapter 5** outlines how the revenues from and the level of unarranged overdraft charges have altered since 2008. The chapter also considers whether consumers are now better able to understand and control the incurring of overdraft charges.

- **Chapter 6** outlines how the real and perceived problems with the switching process have altered since 2008. The chapter also explores the potential impact of the ICB’s New Automated Switching Service.

- **Chapter 7** examines the impact of the OFT’s transparency initiatives and whether they have helped consumers to understand the costs of using their PCA. The chapter also summarises the outcome of industry roundtables held on interest foregone and the next steps on this issue.

- **Chapter 8** reports on progress made by card providers and foreign currency vendors on implementing the initiatives that followed the OFT’s travel money super-complaint.

• **Chapter 9** sets out OFT’s provisional decision not refer the PCA market to the CC for a detailed inquiry.

2.40 There are three annexes to this report which relate to the consumer survey:

- **Annexe A** provides technical information relating to the consumer survey undertaken by IFF on behalf of the OFT.
- **Annexe B** provides details of the questionnaire used by IFF in the consumer survey and the pilot testing conducted.
- **Annexe C** provides data tables of the results of the consumer survey.
3 OVERVIEW OF THE PERSONAL CURRENT ACCOUNT MARKET

3.1 The PCA market is the cornerstone of the UK’s retail finance system and an essential service for UK consumers. There are approximately 76 million accounts in the UK, of which 61 million are used regularly. The OFT estimates providers earned £8.8 billion in revenues from PCAs in 2011 – equivalent to £139 per active account.

3.2 This chapter considers the different types of PCA available. It examines the sources of PCA providers’ revenue, and how this varies across different types of account and groups of consumer. It also considers the importance of PCA revenues within the retail banking sector.

3.3 The key findings from this analysis are that overall revenues have not changed significantly since the OFT’s 2008 market study, but there has been a change in the makeup of this revenue. There has been a reduction in interest on credit balances and unarranged overdrafts, although these two elements are still the most important part of PCA revenues. Whereas in 2008 lower income consumers paid a much greater proportion of overdraft charges, revenues from these charges are now more proportionate to the level of consumer income. More broadly, we have found changes in revenues across retail banking, with a decline in revenues from savings and a rise in revenues from mortgages.

Types of personal current account

3.4 A PCA is an account for consumers’ personal finances that provides the facility to hold deposits, receive and make payments using cheques, debit cards, Direct Debits, standing orders, and continuous payment authorities, as well as to use ATMs and transfer money. Additionally, many PCAs have overdraft facilities.24

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24 Overdrafts may be arranged or unarranged. An arranged overdraft facility occurs when the PCA provider has agreed in advance that a customer has a right to draw on their account to create an overdraft up to an agreed level if they wish to do so. An unarranged overdraft facility
3.5 The vast majority of consumers have a PCA - 94 per cent of UK adults have at least one\textsuperscript{25} and 40 per cent have more than one.\textsuperscript{26} In total, there are over 76 million PCAs in the UK, of which more than 61 million are used regularly.\textsuperscript{27} Since 2007, the number of PCAs has risen by 9.4 per cent, greater than the rate of population growth in the UK. We have not examined this growth in any detail, but the most likely explanation for this is that consumers are increasingly holding more than one PCA.\textsuperscript{28}

3.6 Our 2008 market study found that the most common pricing model for PCAs was the standard account, often known as a free-if-in-credit account. This account type has no regular fee for the account or using core services, but charges are levied for overdrafts and for certain other services, such as using payment cards abroad and banker’s drafts. Although often referred to as free-if-in-credit, anyone holding a positive credit balance potentially forgoes some interest that could be earned by holding their money in a savings account, or another account with a higher rate of interest. As such, the OFT considers the concept of free-if-in-credit banking to be a myth that misrepresents the cost of these to accounts to consumers.

3.7 The standard account is the most common type of PCA, as can be seen from Table 3.1 below, accounting for 66 per cent of the market in 2011. However, when a comparison is made between 2007 and 2011, they account for a smaller proportion of new accounts being opened.

3.8 Packaged accounts offer a range of other services such as travel insurance or car breakdown cover alongside the standard facilities of a PCA. A monthly fee is often charged for these accounts to reflect the additional services offered. Packaged accounts comprised 14 per cent of

occurs when the PCA provider extends credit to a customer when their PCA balance exceeds a pre-arranged limit or if no such limit has been agreed.

\textsuperscript{25} Packaged and Current Accounts – UK, June 2012, Mintel.

\textsuperscript{26} OFT consumer survey, 2012.

\textsuperscript{27} OFT analysis of responses of data from PCA providers. An active account is one which has had a transaction in the previous three months.

\textsuperscript{28} The number of PCAs may increase further in the future as a result of the introduction of Universal Credit later in 2013.
all PCAs in 2011, similar to their share in 2007, but they now represent a higher share of active accounts.

3.9 Premium accounts provide the functionality of standard accounts with some additional benefits. These can include higher credit interest rates, discounts or better rates for linked financial products, access to financial advisers or other improvements in service. Such accounts are intended for consumers with higher incomes and are often restricted to such consumers through the use of qualifying criteria or monthly fees. These represent a small proportion of total accounts, although the higher number of new accounts indicates that they are growing in use.

3.10 Student accounts are similar to standard accounts, in that they carry no upfront fee, but tend to offer more extensive and lower cost overdraft facilities. Providers may be willing to provide attractive offers to students in the expectation that (given low rates of switching) they will remain with the same provider once they enter employment. As shown in Table 3.1, in 2011, student accounts represented a higher proportion of new accounts than their share of total accounts, which may indicate growth in this area.

3.11 Basic bank accounts also carry no upfront fee but typically have reduced functionality compared to a standard account, offering no cheque book or overdraft facility. We note that while basic bank accounts accounted for a similar proportion of the market in 2007 and 2011 (12 per cent of all accounts), in 2011 they represent 17 per cent of new accounts and may also therefore represent a growing proportion of the market.

3.12 Youth accounts are available to consumers typically under 18 years of age and provide access, transfer and storage facilities for money but, due to the age of the customers, often have restricted functionality (for example, they may not have debit cards, cheque books or overdrafts).

29 In some cases there may be associated conditions, such as minimum amounts to be paid in each month, in order to maintain eligibility for these accounts. For example, some providers charge a monthly fee or restrict benefits if certain criteria, relating to incoming funds or the number of Direct Debits on an account, are not met.
Youth accounts will often represent a consumer’s first relationship with a bank, and this may explain why they account for a greater share of new accounts being opened.

Table 3.1 Types of PCA

<table>
<thead>
<tr>
<th>Account type</th>
<th>All Accounts 2007</th>
<th>All accounts 2011</th>
<th>Active(^\text{a1}) accounts 2011</th>
<th>New Accounts 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard</td>
<td>68%</td>
<td>66%</td>
<td>67%</td>
<td>55%</td>
</tr>
<tr>
<td>Packaged</td>
<td>13%</td>
<td>14%</td>
<td>17%</td>
<td>11%</td>
</tr>
<tr>
<td>Premium</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>Student</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>5%</td>
</tr>
<tr>
<td>Basic</td>
<td>12%</td>
<td>12%</td>
<td>9%</td>
<td>17%</td>
</tr>
<tr>
<td>Youth</td>
<td>2%</td>
<td>3%</td>
<td>2%</td>
<td>8%</td>
</tr>
<tr>
<td>Other</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
</tbody>
</table>

**Source:** OFT analysis of data from PCA providers – proportions of total numbers of active accounts.

**Note:** An active account is defined as one which has had a transaction in the previous three months.

3.13 Beyond our desire for increased transparency and greater understanding among consumers of the cost of PCAs, the OFT does not have a preference for one business model or type of account over another. Our focus has been on increasing transparency and improving switching so that consumers are better placed to drive competition between PCA providers. Having a range of different PCA types may enable providers to serve the varying needs of different consumers.

3.14 Concerns have been expressed recently about the free-if-in-credit model and suggestions have been made that regulators should force PCA providers to move away from this business model. We consider that the range of PCAs available to consumers is likely to be better determined by market forces than regulatory bodies and we do not currently have evidence that the benefits of a forced change would be sufficient to justify regulatory intervention on this scale in the PCA market.

3.15 It is of course open to providers to change the business models that they use in providing PCAs to consumers. We note that there may be a first-mover disadvantage for any provider that ceases to offer free-if-in-credit
accounts, as consumers would be expected to switch to other providers. This may give rise to a desire among providers for co-ordinated action to change the prevailing business model. The OFT would have concerns with any such co-ordinated action, given the OFT’s role in enforcing the 1998 Competition Act and Articles 101 and 102 of the Treaty on the Functioning of the European Union.

**PCA revenues**

3.16 Across the market as a whole, we estimate that total revenue from PCAs was £8.8bn in 2011, which reflects a fall of less than one percent from 2007. However, revenues were around nine per cent higher in 2008 and 2009, before falling back in 2010 and 2011.

**Sources of revenue from PCAs**

3.17 In examining the sources of revenue from PCAs, we consider, among other factors, the net credit interest and net debit interest. These net revenues include an element of the cost of funds, and the financial crisis and recession had significant effects on these costs across the retail banking sector.

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30 Revenue data in this paragraph is based on responses to our questionnaire to banks.

31 This section does not consider profitability. As set out in our 2008 market study, it is difficult to assess accurately the profitability of PCAs due to a lack of available data. PCA providers previously told us they typically assessed profitability at the wider retail banking level. Banking also involves significant common and joint costs (for example, from running a branch network) and, rather than attempt to standardise an approach to splitting these across retail banking services, it was considered more appropriate to focus on revenues. We have followed the same approach in this review.

32 For this section we have only considered the revenues of banks who were able to break down their revenue for the full period requested (2007-2011). The total revenue for these banks was £8.3bn. This compares with aggregate revenues of £8.8bn for 2011.

33 Net interest income on a current account balance represents the difference between income and cost from providing a financial product. On credit balances, it will comprise the difference between the funding benefit earned on the funds held, less any interest paid out to the depositor (net credit interest). On debit (overdraft) balances, it will comprise the difference between interest paid by the borrower and the funding cost of providing the overdraft (net debit interest).
3.18 Many PCA providers use industry or economy-wide benchmarks, such as Libor,\(^\text{34}\) as one component of their accounting cost of providing loans, including overdrafts. These benchmarks have fallen since 2007, reducing a key component of the accounting cost of lending.\(^\text{35}\) Some providers have noted that these accounting costs do not however represent the full opportunity cost to a bank of providing lending in the current economic environment, given (for example) that some providers have experienced a need to improve their loan to deposit ratios and there were significant reductions in liquidity from reduced interbank lending in the financial crisis.

3.19 The 2008 market study found that in 2007 the two most significant revenue sources from PCAs were net credit interest and charges associated with unarranged overdrafts. This remains the case, although their share of revenues has decreased in 2011. Figure 3.1 below shows the change in the significance of different revenue sources between 2007 and 2011.

\(^{34}\) The London Interbank offered rate. See www.bbalibor.com for details.

\(^{35}\) Other components include provisions for consumers not paying back their overdraft.
3.20 Overall the share of net credit interest revenue has decreased by five percent since 2007, but it still represented 43 per cent of total PCA revenues in 2011. During the same period revenues from net debit interest on overdraft balances increased. In 2011 they comprised nine per cent of total PCA revenues, up from seven per cent in 2007.

3.21 Overall unarranged overdraft charges\[^{36}\] have fallen from £2.4 billion in 2007 (29 per cent) to £1.7 billion (20 per cent) in 2011. In addition, over the same period, maintenance charge revenues from arranged overdrafts increased from £14 million in 2007 to £448 million in 2011. More detail on the charges for and revenues from overdrafts can be found in Chapter 5.

\[^{36}\] There are three main types of unarranged overdraft charge; unpaid item charges, paid item charges and maintenance charges, all of which were lower in 2011 than in 2007. An unpaid item charge (UPIC) is levied upon the PCA provider declining a customer’s request to make a payment which, if it had been paid, would have created or extended an unarranged overdraft. A paid item charge (PIC) is incurred when a customer makes a request to make a payment which the PCA provider accedes to and in doing so provides or extends an unarranged overdraft. Maintenance charges are levied in relation to time periods when accounts are in unarranged overdraft, whether months, weeks or days.
3.22 Interchange fee revenue\textsuperscript{37} has also increased, from £568 million (seven per cent) in 2007 to £814 million (10 per cent) in 2011. This is partly due to an increase in the use of payment cards over this period - the number of debit card transactions for purchases in the UK increased by 48 per cent since 2007 to over seven billion in 2011.\textsuperscript{38} There has also been an increase in interchange fees.\textsuperscript{39}

3.23 Revenues from packaged accounts have also increased over the period, from £742 million (nine per cent) in 2007 to just over £1 billion (13 per cent) in 2011. In part this is due to growth in the number of packaged accounts, which as noted in paragraph 3.8, is due to overall growth in the number of PCAs rather than an increased tendency towards consumers using packaged accounts. However, there has also been an increase in the average annual account fee. Analysis carried out by Defaqto,\textsuperscript{40} indicates that the average monthly cost of packaged current accounts may have risen by around 30 per cent over the past five years, a significant proportion of which could be attributed to inflation.

3.24 The FSA carried out a review of packaged bank accounts during 2011 to address concerns around the sale of these accounts. In October 2011, the FSA expressed concerns that it may be too easy for providers to sell customers something they do not understand or need.\textsuperscript{41} In July 2012, the FSA published new rules requiring providers to check whether customers are eligible to claim on insurance cover before selling them a packaged account and to provide an annual eligibility statement.\textsuperscript{42} These rules will come into force from 31 March 2013.

\textsuperscript{37} This analysis is based on PCA providers’ own definition of interchange fee revenue.
\textsuperscript{38} OFT analysis of Table 6.2 UK Payment Statistics 2012, UK Payments Council
\textsuperscript{39} The Visa debit card MIF for EMV Chip fee transactions (the most common type of transaction) was 6.5p in 2006 and is currently 8p. The MasterCard debit card MIF for Chip & PIN transactions (again, the most common type) was 8p in 2008 and is currently 11p.
\textsuperscript{40} A review of personal current accounts – July 2012, Defaqto.
\textsuperscript{41} \url{www.fsa.gov.uk/library/communication/pr/2011/088.shtml}
\textsuperscript{42} Further details are available at \url{www.fsa.gov.uk/library/communication/pr/2012/079.shtml}
Revenues from different types of PCA

3.25 Tables 3.2 and 3.3 show revenues by different types of PCA. Table 3.2 shows the average revenue per account and compares the share of revenue with the share of accounts. Table 3.3 provides a breakdown of average revenue per account by income source for the three most common types of PCA - standard, packaged and basic bank accounts.

Table 3.2 Average revenue per account by type of PCA - 2011

<table>
<thead>
<tr>
<th>Account type</th>
<th>Average revenue per account</th>
<th>Share of revenue</th>
<th>Share of accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard</td>
<td>£146</td>
<td>61%</td>
<td>65%</td>
</tr>
<tr>
<td>Packaged</td>
<td>£300</td>
<td>35%</td>
<td>15%</td>
</tr>
<tr>
<td>Premium</td>
<td>£81</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Student</td>
<td>£18</td>
<td>0%</td>
<td>3%</td>
</tr>
<tr>
<td>Basic</td>
<td>£34</td>
<td>2%</td>
<td>12%</td>
</tr>
<tr>
<td>Youth</td>
<td>£14</td>
<td>0%</td>
<td>3%</td>
</tr>
<tr>
<td>Other</td>
<td>£118</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: OFT analysis of data from PCA providers.

Notes: The share of accounts data presented here is slightly different for Standard and Packaged accounts from that presented in Table 3.1. This is because this table gives data only for those PCA providers were able to split revenues by product.

Table 3.3 Breakdown of average revenue by income source - 2011

<table>
<thead>
<tr>
<th>Revenue component</th>
<th>Standard</th>
<th>Packaged</th>
<th>Basic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Credit Interest</td>
<td>£67</td>
<td>£69</td>
<td>£15</td>
</tr>
<tr>
<td>Arranged Overdraft Revenues</td>
<td>£21</td>
<td>£39</td>
<td>£0</td>
</tr>
<tr>
<td>Unarranged Overdraft Revenues</td>
<td>£25</td>
<td>£50</td>
<td>£14</td>
</tr>
<tr>
<td>Packaged account fees</td>
<td>£0</td>
<td>£103</td>
<td>£0</td>
</tr>
<tr>
<td>Interchange fees</td>
<td>£14</td>
<td>£17</td>
<td>£5</td>
</tr>
<tr>
<td>Total</td>
<td>£128</td>
<td>£279</td>
<td>£35</td>
</tr>
</tbody>
</table>

Source: OFT analysis of data from PCA providers.

Notes: Data for active accounts only.

3.26 Table 3.2 shows that standard accounts generate the majority of revenue, although slightly less than their share of accounts. Packaged accounts generate much higher average revenues, and account for a disproportionate share of revenues, in part because of the fees they attract. Since these fees often relate to additional services, such as
insurance or other products, it is difficult to determine whether users of these accounts are paying more or less than users of other types of account for their PCA services.

3.27 Packaged accounts also generate higher overdraft revenues than standard accounts, as well as slightly higher net credit interest. One possible explanation is that packaged account holders appear more likely to incur overdraft charges. In our consumer survey, 40 per cent of packaged account holders said they had incurred an overdraft charge in the last 12 months compared to only 24 per cent of standard account holders.

3.28 While basic bank accounts represent 12 per cent of total account numbers, they only represent two per cent of revenues. Revenues from these accounts are typically lower than for other account types, due to the limited functionality of many basic bank accounts which limits the ability of providers to earn revenue from the services provided.

3.29 Some PCA providers may find basic bank accounts unappealing to provide, particularly if a significant proportion of those consumers do not move to standard and other account types over time. This may explain why some providers have sought to limit the availability of basic bank accounts they offer (for example by restricting account eligibility), or limit their functionality to make them less attractive and reduce their cost. These changes have resulted in a reduction in choice for certain customers, in particular for undischarged bankrupts.43

3.30 Due to the need for consumers to hold a bank account to be able to receive universal credit from October 2013, the Government has

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43 Consumer Focus in its report, The best of British banking - November 2012, raised concerns that PCA providers were reducing the functionality of basic bank accounts

www.consumerfocus.org.uk/publications/the-best-of-british-banking
announced that it intends to change insolvency law to facilitate the offering of basic bank accounts to undischarged bankrupts.44

3.31 It has also been suggested that the free if in credit model may prompt mis-selling on the basis that the revenues earned from these PCAs are low in the absence of an up-front fee. We have found that standard accounts generate significant revenues for PCA providers (from net credit interest and overdraft charges, among other sources) and therefore it appears unlikely that mis-selling of other financial products would be prompted by low revenue from PCAs. Controlling mis-selling of financial products appears to be more closely linked to the culture, incentives and rewards for staff and prevailing practices among providers.

**Distribution of revenues across income groups**

3.32 In our 2008 market study, we were concerned that low income, low saving consumers were cross subsiding higher income, higher savings ones in their contribution to the overall revenues that PCA providers earned.45

3.33 We have analysed the distribution of charges across consumers to determine whether this situation has changed. Figure 3.2 below shows how revenues vary as the amount of money paid into the account varies.46 It shows that in 2011, the average revenue per active customer

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45 The study found that consumers on low incomes or with less than £1,000 in household savings were significantly more likely to have been charged in the past 12 months for a refused payment. And those with less than £1,000 in household savings were significantly more likely to have been charged in the past 12 months for going into unarranged overdraft.

46 We have used incoming funds as a proxy for income in this analysis. Whilst we believe this to be an appropriate proxy, we acknowledge that it does have some limitations. For instance some individuals on high incomes may have secondary accounts which, although still being active accounts, may be less likely to incur charges. Such accounts may dilute average overdraft revenues for accounts with lower incoming funds. It is therefore instructive to consider other evidence to evaluate whether previous concerns regarding cross-subsidisation remain valid.
was higher for accounts with greater incoming funds. On average, the revenue from accounts that paid in less than £5,000 a year was just over half that on accounts that paid in between £5,000 and £15,000 a year, and around a third of that from accounts that paid in over £15,000 a year.

Figure 3.2 Average revenues of PCAs by incoming funds – 2011

Source: OFT analysis of data from PCA providers.
Notes: Scale is £ per account per year and only covers active accounts. Overdraft costs include both fees and interest. Other revenues include packaged account fees, interchange fees and other revenues.

3.34 Table 3.4 shows the proportion of customers that use both arranged and unarranged overdrafts split by levels of incoming funds as a proxy for consumer income. Those customers with incoming funds of less than £5,000 are about half as likely to use an arranged overdraft as those paying in more than £15,000 per year, but there is little variation in the proportion using unarranged overdrafts.
### Table 3.4 Proportion of customers who used overdrafts 2011

<table>
<thead>
<tr>
<th>Incoming funds</th>
<th>Less than £5,000</th>
<th>Between £5,000 and £15,000</th>
<th>More than £15,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportion of customers that use an arranged overdraft</td>
<td>24%</td>
<td>35%</td>
<td>48%</td>
</tr>
<tr>
<td>Proportion of customers that use an unarranged overdraft</td>
<td>22%</td>
<td>25%</td>
<td>23%</td>
</tr>
</tbody>
</table>

**Source:** OFT analysis of data from PCA providers.

**Notes:** Covers active accounts only.

3.35 Figure 3.3 below shows that for those customers going into unarranged overdraft, the average cost per user is lower for customers with lower incoming funds, and increases together with increases in the level of incoming funds. For those customers that use arranged overdrafts, the levels of average costs per user are much closer to each other than for unarranged overdrafts.

### Figure 3.3 Average overdraft costs per user, 2011

![Average overdraft costs per user chart](image)

**Source:** OFT analysis of data from PCA providers

**Notes:** Covers active accounts only. Arranged overdraft costs per user are calculated by taking total revenues from arranged overdrafts and dividing by the number of customers who used an arranged overdraft. The same methodology was used for unarranged overdrafts.
3.36 Our consumer survey also provides information on the usage of overdrafts, although this data does not allow us to distinguish between arranged and unarranged overdrafts or quantify the costs incurred. This data suggests a similar pattern of increasing use of overdrafts as income rises.

3.37 Figure 3.4 below shows the pattern of overdraft usage across different income levels of consumers. The proportion of people who are permanently or usually overdrawn does not vary by income, while the proportion of people that sometimes or rarely used overdrafts increases with income. Those on lower incomes are the least likely to use an overdraft.

**Figure 3.4 Proportion of customers that use an overdraft, 2012**

<table>
<thead>
<tr>
<th>Total household income</th>
<th>Permanently or usually overdrawn</th>
<th>Sometimes or rarely overdrawn</th>
<th>Never overdrawn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to GBP 20,000</td>
<td>![Graph Data]</td>
<td>![Graph Data]</td>
<td>![Graph Data]</td>
</tr>
<tr>
<td>GBP 20,001 - GBP 40,000</td>
<td>![Graph Data]</td>
<td>![Graph Data]</td>
<td>![Graph Data]</td>
</tr>
<tr>
<td>GBP 40,001 +</td>
<td>![Graph Data]</td>
<td>![Graph Data]</td>
<td>![Graph Data]</td>
</tr>
</tbody>
</table>

**Source:** OFT Consumer Survey 2012,

**Notes:** Excludes those who said don’t know or refused to provide an annual household income.

3.38 Figure 3.5 below shows how the likelihood of incurring an overdraft charge varies with income. Although the chart suggests a slight upward trend with income, there was no statistically significant difference in the proportion incurring a charge depending on income.
Overall, the evidence indicates that overdraft charges now fall more evenly across consumers with different income levels, without a significant cross-subsidisation from those with low incomes that was the case at the time of the OFT’s 2008 market study.

The relative importance of PCAs to the wider retail banking sector

Our 2008 market study found that PCAs were a gateway product leading to sales of other retail banking products, such as loans, investments and credit cards. This was confirmed in the 2010 *Review of barriers to entry, expansion and exit in retail banking*\(^47\) which found that

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\(^{47}\) OFT1282 Review of barriers to entry expansion and exit in retail banking, November 2010 [www.of.t.gov.uk/OFTwork/markets-work/othermarketswork/review-barriers](http://www.of.t.gov.uk/OFTwork/markets-work/othermarketswork/review-barriers). The review aimed to examine the existence and extent of barriers in retail banking both to help the OFT in its future work, but also to inform the wider debate and the work of other authorities and bodies such as the ICB.
a large proportion of customers hold other retail banking products with their PCA provider.

3.41 In this review, we have found that the PCA remains an important part of the retail banking environment. PCAs contribute a significant share of overall retail banking revenues and that PCA holders with a provider are an important source of revenues for other retail banking products they offer. We estimate that in 2011 the four largest PCA providers earned 54 per cent of their total retail banking revenues from PCA holders’ use of other retail financial products and services.48

3.42 Figure 3.6 below shows the relative contributions of different products to retail banking revenues in 2008 and 2011.49

**Figure 3.6 Retail banking revenues in 2008 and 2011**

![](image)

48 This was based on analysis of data provided by the four largest providers. Some of these revenues were generated from consumers who opened the PCA after the other financial product or service although, based on evidence we have received, we expect this proportion to be small.

49 These revenues were provided as presented in providers’ annual reports.
**Source:** OFT analysis of data from PCA providers  
**Notes:** This analysis does not include data from providers of other retail banking products who do not offer PCAs.

3.43 As shown above, in 2011, PCAs accounted for around 22 per cent of retail banking revenue, down from around 27 per cent in 2008. As noted in paragraph 3.16, total PCA revenues are similar to their level in 2007, so the main drivers for this fall in relative terms were the increases in revenues from other financial products and services.

3.44 The most significant changes have been the increase in revenues from mortgages, which rose from 12 to 24 percent of retail banking revenues, and the reduction in revenues from savings, which fell from 13 to 4 per cent of retail banking revenues. Both of these changes are likely to be, at least in part, due to the financial crisis and subsequent recession. As noted in paragraph 3.18, the reduction in benchmark interest rates (such as Libor) has tended to reduce the accounting cost of providing loans, although this does not necessarily reflect the opportunity cost to a bank of providing lending. Also, the need by some providers to improve their loan to deposit ratios and reductions in liquidity from reduced interbank lending have put pressure on returns from offering savings accounts.

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50 The impact of the recession on the cost of funds in retail banking is considered in paragraphs 3.17 and 3.18 above.
51 Given the presence of fixed rates in both mortgages and savings products, the average interest rates charged or offered by providers can also take longer to adjust to a change in the interest rate environment.
4 COMPETITION IN THE PERSONAL CURRENT ACCOUNT MARKET

4.1 There have been longstanding concerns about the effectiveness of competition in the PCA market. In 2000, the Cruickshank report on *Competition in UK banking* identified concerns about a lack of effective competition, highlighting high concentration and excess profits. The OFT’s PCA market study identified concerns that a combination of complexity and opacity made it difficult for consumers to assess the cost of their account and make comparisons with others on offer, and together with perceived difficulties in switching, this reduced incentives for PCA providers to compete on price or provide new products and services.

4.2 This chapter considers how competition in the PCA market has evolved since the OFT’s 2008 market study. It examines the structure of the market and how market shares and concentration have evolved in recent years. It also examines quality of service as a metric of competition in the market and considers barriers to entry, reviewing previous evidence from the OFT’s 2010 *Review of barriers to entry, expansion and exit in retail banking*, such as branch networks and levels of consumer engagement with their PCAs. In addition, we present information on a number of developments that may have significant effects on competition and concentration in the PCA market in the coming months.

4.3 The key findings from this analysis are that the OFT continues to have significant concerns about the effectiveness of competition in this market. We have found that concentration levels have increased since 2008 and that significant barriers to entry and expansion remain. In addition, we have found some variation in levels of complaints among providers which indicates that competition on this metric may be limited. Many consumers still have little understanding of the costs of using their PCAs and how these compare to PCAs from other providers. This means that consumers are typically not engaged with their PCA, and combined with a lack of confidence in the process for switching PCAs, means that consumers are not driving effective competition between providers.
The Structure of the PCA Market

4.4 This section seeks to examine the intensity of competition through analysis of the structure of the PCA market, market shares of the main providers and how these have evolved over recent years. High concentration and stable individual market shares are typically synonymous with limited competition.

4.5 The OFT has had concerns regarding concentration in the retail banking sector generally, and the PCA market specifically, for a number of years. The 2008 market study found that the market included four large and well-established providers which competed mainly on quality rather than on price. These providers had a combined market share of around 64 per cent. The 2008 market study also noted that there was a set of challengers which appeared to compete both on price and quality. In 2008, there were indications that some providers were able to gain market share, although this had been a slow process and it was not possible to determine whether this was an ongoing trend. In particular, the 2008 market study highlighted Halifax Bank of Scotland (HBOS) and Nationwide as two providers that had managed to increase their share of the PCA market.

4.6 Concentration has risen further since the 2008 market study, increasing sharply in 2009. The financial crisis and recession affected the viability and balance sheets of a number of PCA providers and this led to a number of mergers and acquisitions. This was noted by the ICB in its report in 2011. It found that, while the share of the four largest providers fell from 74 per cent in 2000 to 64 per cent in 2008, it then rose to 77 per cent in 2010. This rise more than offset the decrease in concentration seen between 2000 and 2008.

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52 The 2008 Market Study defined Challenger PCA providers as PCA providers which were not one of the four established banking groups (Lloyds Banking Group, RBS, Barclays, HSBC).
4.7 Figure 4.1 below shows how concentration levels have changed during the financial crisis and recession. In 2011 the HHI was 1825, a significant rise from the position in 2007 and 2008. According to the joint OFT/Competition Commission guidelines a market with an HHI exceeding 1,000 may be regarded as concentrated while a market with an HHI exceeding 2,000 may be regarded as highly concentrated.55

Figure 4.1 Concentration levels in the PCA market using the Herfindahl-Hirschman index

![Graph showing concentration levels]

Source: OFT analysis of data from PCA providers.
Note: Based on active accounts.

4.8 Figure 4.2 below shows how market shares for the large providers have changed since 2007. Aside from the impact of the HBOS merger with Lloyds TSB, the collective and individual shares of the four large providers in the market have been relatively static and have not changed significantly since 2007. It is only outside the four large providers that more significant change can be seen. Nationwide appears to have increased its market share over the period, whilst the combined share of

54 As measured by the Herfindahl-Hirschman Index which is the sum of the squared market share of each provider. A monopoly leads to a score of 10,000, whilst perfect competition leads to a score just above zero.

other providers appears to have declined, with much of the changes in smaller providers being linked to the effects of the financial crisis and recession.

Figure 4.2 Market shares for the largest PCA providers, annual snapshots 2007 - 2012

Notes: Although Santander purchased Abbey National in 2004, it did not trade as Santander until 2010. The Mintel data reflects this. The data is based on annual snapshots of concentration from consumer surveys carried out at the times specified. Therefore, while the figure shows gradual changes in market shares, in practice, these would have been more immediate in effect than indicated above.

4.9 The most significant merger during this period was that of Lloyds TSB and HBOS, which brought together the largest and fifth largest providers in the PCA market. The 2008 market study had found HBOS to be a notable source of competition in the PCA market at that time. The OFT’s investigation of the anticipated merger found that there was a realistic
prospect that it would lead to a significant lessening of competition in relation to PCAs.56, 57 Other notable changes in the market since the 2008 market study include the acquisitions made by Santander, which had entered the UK market by purchasing Abbey National plc in 2004. In 2008 it purchased Alliance and Leicester together with the deposits and branch network of Bradford and Bingley following its nationalisation. All three brands became branded as Santander during 2010.

4.10 Figure 4.2 above also shows that the combined market share of the four largest providers is 74 per cent, with Lloyds Banking Group accounting for almost twice the share of the second largest provider, RBS. Outside these four, the growth of Santander, discussed above, means it now has a market share of 11 per cent, similar to the position of HBOS before the financial crisis and recession.

4.11 The indication from these measures of concentration is that there has been limited competition in this market since 2008, with some significant challengers having been acquired during the financial crisis. This, combined with the high and stable shares of three large providers and the increasing share of Lloyds Banking Group, has exacerbated the OFT’s concerns regarding the effectiveness of competition in this market.

**Competition on service levels**

4.12 Separate to the structure of the market and levels of concentration, it can be instructive to examine the metrics of competition used to compete for new customers in a market. In the PCA market, the two metrics are quality of service and costs of the PCA.

4.13 The 2008 market study found that the large PCA providers competed mostly on quality of service rather than price, while smaller providers 56 See [www.of.gov.uk/OFTwork/mergers/decisions/2008/LloydsTSB](http://www.of.gov.uk/OFTwork/mergers/decisions/2008/LloydsTSB) for details. 57 The Secretary of State considered that the stability of the UK financial system outweighed the competition concerns identified in the OFT’s report, and therefore decided not to refer the case to the Competition Commission.
were more likely to compete on the basis of both price and quality of service. In particular, the study found that although smaller providers tended to offer better credit and debit interest rates than their larger counterparts, there was no statistical difference in customer satisfaction\textsuperscript{58} between the four established banks and the challengers.\textsuperscript{59}

4.14 In other chapters of this review we consider a number of measures of the costs of PCAs, including overdraft costs and credit interest foregone. We also consider the limited extent to which consumers are aware of and understand these measures of cost, with low engagement and switching resulting. Given limited consumer knowledge and the fragmented nature of pricing, it is difficult to assess the extent to which measures of cost, and the differences in them between providers, could be used as a proxy for the intensity of competition in this market. This section therefore focuses on examining available measures for the quality of service provided.

4.15 Looking directly at consumer satisfaction, there is data from Mintel which suggests that in January and March 2012 there were variations in overall satisfaction with different providers. The proportion of consumers rating their provider as either good or excellent varied between 36 per cent and 65 per cent, while the proportion of people that who rated them either unsatisfactory or poor ranged from five per cent to 21 per cent.\textsuperscript{60}

4.16 Other than examining satisfaction, the extent of complaints made about PCA providers may be an indicator of the intensity of competition in this market.

\textsuperscript{58} Customer satisfaction was measured with respect to customer service and the bank treating you fairly overall.

\textsuperscript{59} The 2008 market study also noted that the level of service or quality is not easily observable by most consumers.

\textsuperscript{60} Figure 96, Packaged and Current Accounts – UK, Mintel, June 2012. Based on internet users aged 16 or over and who had used a brand and expressed an opinion.
4.17 For consumers dissatisfied with the service received from their PCA provider, the first point of complaint should be with the provider themselves. Providers have redress mechanisms in place to respond to the complaints received. In the event that a consumer is not satisfied with the response from their provider, they may take their complaint to the Financial Ombudsman Service (FOS).\textsuperscript{61} The FOS will reach a determination on whether it finds in favour of the consumer or the provider in relation to these complaints.\textsuperscript{62}

4.18 While PCA providers do not typically publish details of the complaints made to them, the FSA publishes data based on the number of complaints made by consumers to their provider, both an industry wide basis, and for individual providers.\textsuperscript{63} In addition, the FOS publishes data on the number of new cases it opens, what products the cases concerned, the number of cases closed, and the outcome of these cases.

4.19 Figure 4.3 below shows the level of complaints to the FOS in relation to current accounts. As shown, the FOS received relatively few cases relating to current accounts\textsuperscript{64} in the first few years after it was established. The number of new cases increased in 2006/07 and 2007/08 following a number of complaints about unarranged overdraft charges. The number of new cases then fell before rising again in 2009/10 when a number of complaints relating to financial hardship

\textsuperscript{61} See \texttt{www.financial-ombudsman.org.uk} for details.
\textsuperscript{62} Whilst the FOS decision is binding on the provider if the consumer accepts the FOS decision, if the consumer does not accept the FOS decision the consumer is entitled to take the matter to Court.
\textsuperscript{63} When an individual provider has more than 500 complaints. Breakdown by product type, type of provider and reason of complaint are available.
\textsuperscript{64} Based on data from the FOS annual reviews, this data includes both PCAs and business current accounts, although we understand that the vast majority of cases relate to PCAs.
were initiated. Thirty-one per cent of closed cases relating to current accounts 2011/12 were upheld\(^{65}\) by the Financial Ombudsman Service.

**Figure 4.3 Number of new cases received by the Financial Ombudsman Service relating to current accounts**

\[ \text{Source: OFT analysis of data from Annual Reviews of the Financial Ombudsman Service} \]

4.20 It is difficult to interpret a normal level of complaints in relation to current accounts, given the significance of complaints on overdraft charges arising from the work carried out and the publicity this received. However, an uphold rate of 31 per cent does indicate that the majority of providers are acting in a way which can be justified. We note that the uphold rates of the FOS are below those for providers (as considered below). This could imply that providers wish to retain customers and have at least some concern that poor service could lead to switching. This might indicate at least some competition over service levels.

\(^{65}\) Broadly this means the decision was in favour of the consumer. Either the provider was newly found to be in the wrong, or the provider was found to have previously not offered adequate redress.
4.21 Figure 4.4 below shows how the numbers of complaints that PCA providers receive in relation to their banking services varies by PCA provider.\textsuperscript{66} We note that this is broadly proportionate to their respective market shares.

**Figure 4.4 Banking complaints for large PCA providers, 2011**

![Graph showing complaints and market share for PCA providers]

**Source:** OFT analysis of FSA complaints data covering complaints opened on banking.

4.22 Figure 4.5 below shows how the proportion of complaints upheld by providers varies significantly from 35 per cent to over 60 per cent. Given the significant volume of complaints received by most providers, and despite the wide coverage of the subject matter of these complaints, it appears possible that the variation in complaints upheld could be indicative of different levels of service amongst the providers in retail banking.

\textsuperscript{66} While these complaint volumes cover banking services on a broader basis than just PCAs, we note that the large providers are typically present across the retail banking markets and therefore we consider these figures likely to give a broad indication of service levels across providers.
4.23 This finding, while only indicative in nature, may show that, while PCA providers are likely to compete over the level of service they provide to their customers, this form of competition is not particularly intense. If competition on this metric were intense, such variation in measures of quality of service across providers in a market might not be expected to be seen.

4.24 Further to analysing the current market structure, it is important to consider the extent to which this can change over time, either through new entry in a market or through expansion of existing providers. This section sets out the findings of the OFT’s 2010 Review of barriers to entry, expansion and exit in retail banking, as well as considering evidence from this review in relation to consumer inertia and branch networks as barriers to entry and expansion.

4.25 The 2010 review examined four areas of retail banking where barriers to entry might be expected:
• regulatory requirements and processes

• access to essential inputs, such as IT systems, payment schemes, information and finance needed to offer retail banking products

• the ability of new entrants to attract customers and achieve scale

• issues around exiting the market.

4.26 In relation to regulatory requirements, the OFT found that providers did not face significant barriers to entry arising from regulatory requirements that must be met in obtaining authorisation to accept deposits or offer mortgages. However, the OFT was informed that firms faced difficulties and uncertainties arising from the process involved in obtaining authorisation and this had the effect of delaying entry and making it harder to raise capital. The FSA had revised its authorisation procedures to increase transparency and introduce a more modular or staged approach to give greater certainty.

4.27 The OFT also identified the possibility of changes to capital requirements exacerbated differences between incumbents and new entrants, for example, by imposing higher fixed costs of compliance. The OFT noted that it may be appropriate for the prudential regulators to consider and monitor the impact on competition of these changes. The ICB recommended that the Prudential Regulation Authority (PRA)\(^67\) work with the OFT to review the application of prudential standards to ensure that the prudential requirements for capital and liquidity do not unnecessarily limit the ability of new entrants to enter the market safely and grow. Following the ICB recommendation, the OFT discussed this issue with the FSA, which continues to have prudential responsibility until April

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\(^67\) The PRA will be created as a result of the Government’s decision to separate the functions of the FSA into two new financial regulators. The PRA will be responsible for the day-to-day supervision of financial institutions that manage significant risk on their balance sheet. The Financial Conduct Authority will regulate how firms conduct their business. Both will be created from April 2013.
2013. The FSA will be publishing a report on regulatory barriers to bank entry and expansion in the first quarter of 2013.

4.28 In relation to essential inputs, the OFT found no evidence of difficulties in gaining access to industry payment systems, or getting access to accurate information on personal and SME customers. However the OFT did note that as a result of the financial crisis the viability of certain models was threatened due to a lack of interbank lending.

4.29 The OFT also found that while firms had a number of options for establishing IT systems, all of these involved a substantial cost for a new entrant, much of which was unlikely to be recoverable in the event of market exit. While there was no standard minimum scale required to recover these costs, if entrants were unable to attract sufficient numbers of customers to recover these costs they would find it difficult to compete sustainably in the market.

4.30 The 2010 review found that the ability to attract customers and achieve scale was the most significant barrier to entry and expansion. The OFT found that low switching rates, the continued importance of established brands and the value customers placed on a branch network together constituted a key barrier to achieving sufficient scale to be able to recover fixed costs.

4.31 The OFT also considered whether regulations aimed at preventing disorderly exit from the banking sector may have adversely impacted upon competition. The OFT did not receive any evidence in the 2010 review to suggest either of the two main regulations were acting as a barrier to exit, preventing firms from leaving the market.

4.32 Given the OFT’s recent detailed consideration of barriers to entry across the retail banking sector, and as the focus of the review of the PCA market has been on evaluating progress with the initiatives put in place in recent months and years, our analysis of barriers to entry in this

68 The two main regulations were the Special Resolution Regime and the Financial Services Compensation Scheme (FSCS).
review has been limited. We have, however, considered the use of branch networks and consumer engagement and understanding of PCAs as barriers to entry.

**The use of branches and branch networks**

4.33 In considering the ongoing importance of branch networks, we examined how consumers access their PCAs. Figure 4.6 below shows the proportion of consumers that used branches and internet, telephone and mobile banking to access their PCA at least once in 2008 and 2012. As shown, branches are still used by the vast majority of consumers at least once annually, reflecting the fact that there are some elements of personal banking which can most easily be carried out in branches. However, internet and mobile access have grown in importance over the period, and this may account for the decline in telephone banking.

**Figure 4.6 Methods to access a PCA used at least once a year**

![Bar chart showing methods to access a PCA used at least once a year](chart)

**Source:** OFT consumer survey 2008 and 2012

**Base:** Respondents that used any service at least once a year
4.34 Figure 4.7 above shows the proportion of consumers accessing their account using various methods on a weekly basis. According to the 2012 consumer survey, 43 per cent of consumers with internet banking use this facility at least once a week. However, there is still a significant proportion of customers that use branches weekly. Nearly the same proportion of consumers reported using mobile banking to access their account at least once a week.

4.35 The growth of online access to PCAs indicates that many every-day tasks can be completed remotely, without visiting a branch. This ease of access may give consumers an increased ability to see the key features of their PCA on a regular basis and take action more quickly.

4.36 The 2010 Review set out two key ways that branches and the branch network could constitute a potential barrier to entry and expansion. First, consumers considered that a branch was an important service that they expected a PCA to provide. Second, the proximity of branches to either home or work was important for most customers. Therefore, in order to
have significant size in the market, a significant branch network was required.

4.37 During this review we have not seen evidence that the declining frequency of branch usage has led to any reduction in the importance of the availability of a network of branches to individual consumers. Moreover, we have not seen evidence that the proximity of branches is any less important to consumers. We therefore consider that the need for branches and a branch network remains likely to be a barrier to entry and expansion in this market.

**Consumer inertia**

4.38 Consumers have an important role to play in making markets work well. They provide the competitive discipline on providers in the market, ensuring efficient and competitive providers have an incentive to provide competitive price and service levels. Where consumers are not engaged with and do not have a good understanding of products or services, they are less likely to switch to a more competitive offer and drive effective competition. Such a lack of engagement can act as a barrier to entry, since it can make it difficult for new entrants to get sufficient consumers to switch their products.

4.39 In the PCA market, for consumers to be engaged with their PCA, they need to be aware of and understand the costs involved and the implications of this information for their choice of PCA and provider. In our 2008 market study we found that many consumers were not familiar with the costs of their PCA and that many characteristics of these costs made it difficult for consumers to make well-informed decision on whether they were getting a good deal.

4.40 This review has identified some improvements, but many consumers still do not know the key costs of their PCA, such as credit and debit interest rates and charges for overdrafts. We discuss this in more detail in Chapters 5 and 7 in relation to initiatives on control and transparency. Given the importance for consumer engagement and as a barrier to entry and expansion we also cover this briefly below.
4.41 While many consumers do not appear to know the costs associated with their accounts, this information is often available. For example while the majority (74 per cent) of respondents to our consumer survey did not know the credit interest rate on their PCA, 60 per cent of those said they had been provided with the information.

4.42 We found that while awareness levels were higher for those consumers who used an overdraft frequently, the majority of frequent users were often unable to report the key costs of their overdrafts in our consumer survey. Whether different types of consumers know the costs of arranged and unarranged overdrafts is illustrated below in Figures 4.8 and 4.9, and is examined in more detail in Chapter 5.

4.43 This lack of awareness may indicate a lack of engagement with PCAs. Alternatively, it could mean that different ways of providing the information are needed in order to help consumers to understand and retain this information.

Figure 4.8 Knowledge of account costs – arranged overdraft fixed charges

Source: OFT consumer survey, 2012
Base: Respondents with an overdraft that charges
More generally, our survey found that consumers don’t regularly monitor their accounts. As discussed in Chapter 7 on transparency, 21 per cent of consumers either never read or check their statements or only do so occasionally. This may cause problems for consumers arising from their lack of knowledge of their account balance they may incur additional overdraft charges as a result that could be avoided.

A lack of knowledge about key price characteristics, and low consumer engagement with PCAs more widely, has a knock on impact on switching levels. Our consumer survey found that 75 per cent of consumers said they have never switched provider, and of these consumers 75 per cent said they have never considered switching. Chapter 6 provides further details of the factors that prevent consumers from switching.

Some commentators have suggested that the free-if-in-credit model may have contributed to consumers' lack of engagement with PCAs. Possible reasons suggested are that consumers' undervalue the services provided because they consider them to be free, or that the lack of an upfront
charge may reduce the ability of new entrants and the incentives for existing providers to compete effectively over price. While this might be true, at least to some extent, the OFT does not consider that this represents a strong reason at this time for forcing PCA providers to move away from this business model. The findings of this review also show that competition is not effective in this market, therefore, the OFT would have concerns, at least in principle, as to whether competition and switching would be sufficient to constrain the level of such charges were they to be introduced by PCA providers.

4.47 The OFT considers that attempting to understand consumer decision-making, including their willingness to engage with and understand PCAs, represents an important way to seek to improve competition in this market and reduce barriers to entry and expansion. In order to understand how the drivers of consumer engagement and how this could be increased so that consumers are better able to drive effective competition in this market, we are proposing to carry out behavioural economic research on the way consumers make decisions and engage with retail banking services.

Recent entry to the PCA market

4.48 The ICB noted that there had been five new entrants in the PCA market since 2000, which collectively accounted for less than two per cent of the market from 2001 to 2010. There have been two entrants since the 2008 market study.

4.49 In 2010 Metro Bank entered the PCA market, aiming to differentiate itself through offering high service levels. By the end of 2012, it operated 12 branches across Greater London and it has a target of having 200 or more branches by 2020.

4.50 M&S Bank, a 50:50 profit-sharing partnership between HSBC and Marks & Spencer, launched two PCA products in 2012. It uses over 20 Marks

69 See www.metrobankonline.co.uk/About-Us for details.
70 See www.metrobankonline.co.uk/About-Us for details.
& Spencer stores to provide branches for consumers, with the PCA products providing linked discounts and vouchers for shopping in Marks & Spencer stores.  

4.51 Both these providers are very small compared to existing providers. Data from Mintel indicated that, in 2011, the eight largest providers had nearly 11,000 branches between them, and five providers had more than 1,000 branches.  

4.52 Two other companies have publically stated they are considering entering the market. Tesco Bank has identified current accounts as a product they intend to launch in the future. Virgin Money is developing a current account product. Both companies have well-known brands that already have wider experience in financial services markets and if they were to enter the market, it is possible that these brands may generate significant interest among consumers.

Forthcoming changes to market structure

4.53 There are two significant developments due to occur in 2013. Both Lloyds Banking Group and RBS are required to divest parts of their businesses as a condition for the re-capitalisation they received during the financial crisis. These requirements were imposed by the European Commission (EC) pursuant to its State Aid powers. In both cases the divestments must be made to a business with a current account market share of no more than 14 per cent in the UK.

4.54 For Lloyds Banking Group, its divestment represents around 600 branches and a share of 4.6 per cent in the PCA market in the UK and it is expected by the EC to be completed by 30 November 2013. Lloyds

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71 See http://bank.marksandspencer.com for details.
72 Figure 54, Packaged and Current Accounts – UK, Mintel, June 2012
73 See Tesco Annual Report 2012, p21
74 See https://uk.virginmoney.com/virgin/current-account/current-account-interest-form.jsp for details.
Banking Group has agreed non-binding heads of terms with the Co-operative Group. Alongside divesting the TSB and Cheltenham & Gloucester brands, and a balance sheet of £24 billion, the accounts of 3.1 million PCA customers will be transferred, as a result of which the Co-Operative Group may be expected to have a PCA market share of around seven per cent.76

4.55 The RBS divestment represents 316 branches and 1.7 million of the group’s retail customers, equivalent to around two per cent of the UK retail banking market.77 The EC expected the RBS divestment to be completed by 31 December 2013. RBS had planned to sell these assets to Santander but this deal recently fell through.78 RBS has recommenced a process for the disposal of this business.79

4.56 It is not possible at this time to predict the impact of these two divestments. They are both substantial in size and should give the acquirer sufficient scale to pose a more significant competitive threat. While the ICB considered that the market share requirement of the Lloyds Banking Group divestment was sufficient to lead to a viable entity, it also felt the benefits to competition in the UK would be maximised if the entity resulting from the divestiture had a PCA market share of at least six per cent. The ICB also stressed the importance of the resulting entity’s funding position.80

80 The Lloyds Banking Group press release states that following the divestment the Co-operative is expected to approach seven per cent of the PCA market. Furthermore, the divested entity is said to have a balance of sheet of around £24 billion with fully matched assets and liabilities.
4.57 It is also not clear to what extent consumers will be willing to have their PCAs switched through this process to a provider they have not chosen. We will need to wait until the divestments are complete, and consumers’ responses are known, to assess the impact of these changes on the structure of the PCA market.

4.58 The new switching service may also impact on market structure in the longer term, if an improved switching process leads to an increased willingness to switch among consumers. The new switching service is discussed in more detail in Chapter 6.
5 UNARRANGED OVERDRAFTS

5.1 In a market that worked well for consumers, it would be expected that consumers would be able to choose how much of a product or service to buy and when to buy it. The 2008 market study found that complexity in the way that unarranged overdraft charges (UOCs) were implemented made it hard for consumers to understand, predict and control when they would be incurred. Consequently, UOCs were not subject to competition and PCA providers had been able to increase them to the point where they constituted around a third of their PCA revenues.

5.2 This chapter outlines the OFT’s work to date in relation to unarranged overdraft charges. The OFT, following its market study and test case on Unfair Terms in Consumer Contract Regulations (UTCCRs), agreed a number of initiatives with the PCA providers to improve the market. This chapter surveys the implementation and impact of these initiatives, as well as those announced in the Government’s Consumer Credit and Personal Insolvency Review. It also sets out how charges for both unarranged and arranged overdrafts, and the amount of revenue the PCA providers earn from them, have changed since 2007.

5.3 The key findings from this review are that charges for unarranged overdrafts have declined significantly since the OFT’s PCA market study and UTCCR investigation, although charges for arranged overdrafts have increased since 2007 and charging structures remain complex. In addition, while most PCA providers offer increased control through text alerts and mobile applications, most do not offer consumers the ability to opt-out of unarranged overdraft facilities across the full range of PCAs that they offer and, where it is offered, take-up is low.

Concerns identified by the OFT’s PCA market study

5.4 The 2008 market study found that it was difficult for consumers to assess both the likelihood of entering an unarranged overdraft81 and the

81 Unarranged overdrafts were also referred to as unauthorised overdrafts in the 2008 market study.
charges levied by PCA providers for doing so.\(^8^2\) As a result, consumers did not take UOCs into account when choosing a PCA provider and the incentive for PCA providers to compete on these fees was reduced. This had enabled PCA providers to earn additional revenues from unarranged overdraft facilities without affecting demand for their accounts.

5.5 The 2008 market study also found that consumers were not easily able to control whether they use an unarranged overdraft. Estimating the likelihood of entering unarranged overdraft was complex as consumers were not able easily to keep track of their account balances or predict when some payments would leave their accounts.

5.6 To anticipate their balances at any given time requires consumers to take account of a number of factors:\(^8^3\)

- their current balance
- commitments they have already made (for example, cheques that they have written but which have not yet been cashed by the recipient, debit card transactions that have not yet been processed, direct debits and standing orders)
- payments coming in, such as salary and benefit payments.

5.7 They also need to understand how the timing of these items would affect their balance. They might have little control over this (for example, when cheques they had written were presented for payment) or knowledge of the factors underlying it (for example, whether un-cleared cheques were counted by their bank as available funds and when available funds needed to be in place for an overdraft to be avoided).\(^8^4\)

5.8 In addition, working out the cost of using an unarranged overdraft was found to be difficult and time consuming. There were a number of

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\(^8^2\) Personal current accounts in the UK, OFT, 2008, pp.4-5, 82-3.

\(^8^3\) Personal current accounts in the UK, OFT, 2008, paragraphs 4.81 – 4.94.

\(^8^4\) Personal current accounts in the UK, OFT, 2008, Box 4.12, pp. 74-5.
factors that consumers would have needed to know in order to calculate how much they might be charged for using an unarranged overdraft. These included:

- The different types of charges levied by the PCA provider, including transaction charges (per item, whether paid or unpaid) and maintenance charges (related to the time period when an account is in unarranged overdraft, such as a monthly or daily overdraft excess charge).

- How single transactions could result in multiple charges, for example both a charge for making a payment and a monthly maintenance charge (if making the payment creates an unarranged overdraft for the first time in the monthly charging period).

- Whether or not the PCA provider decided to pay an item.

- The order in which transactions were processed.

- Refunds, buffer zones (where an account could go into unarranged overdraft by a certain amount without incurring charges) and charge caps (for example maximum numbers of charges that could be incurred in one day) - many PCAs operated these, in some cases on a discretionary basis, and many customers might not have known about them.

5.9 Customers did not necessarily have all this information, or may have found it difficult to assimilate. The survey conducted for 2008 market study found that 67 per cent of respondents did not know how much their PCA provider’s charges were and a review of the account information available found that it was not sufficient to enable

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85 Personal current accounts in the UK, OFT (OFT1005), 2008, pp.75-77.
86 Personal current accounts in the UK A follow up report, OFT (OFT1123), October 2009, paragraph 3.6.
87 Personal current accounts in the UK, OFT, 2008, paragraph 4.75.
consumers to understand how the charges might be applied. This issue is described in greater depth in Chapter 6.

5.10 Consumers were also not generally able to decline or opt-out of unarranged overdraft facilities on their PCAs. In a survey conducted for the 2008 market study, only seven per cent of consumers that exceeded their arranged overdraft limit suggested that they had chosen to do so.88 More than half of respondents said that they would opt-out of having the ability to go into unarranged overdraft through debit card transactions if they could, and over half said that they did not want a debit card transaction processed that would take their current account into unarranged overdraft.89 Similarly in a Which? survey, 46 per cent of people said that they would prefer to have a payment blocked rather than pay unarranged overdraft fees.90

5.11 The 2008 market study found that UOCs had increased by an average of 17 per cent in real terms between 2003 and 2007.91 They represented a significant revenue stream, with PCA providers earning £2.6 billion (31 per cent) of their PCA revenues from UOCs92 in 2006. The 2008 market study found that the average daily unarranged overdraft balance93 over the year in 2006 was £680 million but involved some £1.5 billion charges in paid item and monthly or daily overdraft maintenance fees.94 This constituted a return of over 220 per cent on the balances.95

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88 Personal current accounts in the UK, OFT, 2008, paragraph 4.65.
89 Personal current accounts in the UK, OFT, 2008, paragraphs 4.96 and 4.97.
91 Personal current accounts in the UK, OFT, 2008, p.4.
92 Personal current accounts in the UK, OFT, 2008, p.43.
93 The sum of daily debit balances divided by the number of days in the year.
94 Excluding £1 billion in unpaid item charges, which are insufficient funds charges levied on any unpaid payment that, if paid, would create or extend an unarranged overdraft.
95 Personal current accounts in the UK, OFT, 2008, p.4.
5.12 The 2008 market study also found that UOCs disproportionately affected consumers in households with lower incomes and/or lower savings. It found that consumers with less than £1,000 in household savings were significantly more likely to have been charged for going into unarranged overdraft in the last year (48 per cent had been, compared with 18 per cent of those with at least £1,000 of household savings). These consumers were also more likely to have been charged for a payment being refused in the previous 12 months (31 per cent, compared with eight per cent of those with at least £1,000 of household savings).96

Unarranged overdraft initiatives

5.13 In November 2009, the OFT indicated that it would be seeking improvements around unarranged overdrafts in three particular areas:97

- **Control**: consumers needed greater ability to manage their finances, both in their own interests and in order to ensure that competition operated more effectively in the PCA market. At a minimum, the OFT believed that consumers must have a real choice about whether or not to have a facility that allowed them to go into unarranged overdraft.

- **Clarity and predictability**: it was necessary to make charges simpler to understand and predict and to make comparisons of the costs of using unarranged overdrafts between PCA providers and with other forms of short-term credit more effective. Having a simple method of describing the charges for unarranged borrowing would enable these comparisons to be made more effectively.98

- **Responsibility**: all PCA providers have a duty not to lend irresponsibly and the OFT was to consider what expectations were

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96 *Personal current accounts in the UK*, OFT, 2008, paragraph 4.111.

97 *Personal current accounts – unarranged overdraft charges Decision on an investigation under the UTCCRs and next steps*, OFT December 2009 (OFT1154) paragraph 4.9.

98 See Chapter 6 for further details.
appropriate for lending through unarranged overdrafts, especially to customers for whom other lending arrangements might be more appropriate.

5.14 The OFT held a series of discussions with the major PCA providers in early 2010. This resulted in PCA providers indicating that there were likely to be significant developments over the next two years, building on changes that had already occurred, that would address the OFT’s concerns regarding control. In particular, the developments would give:

- Customers greater choice about whether or not to have an unarranged overdraft facility
- Greater access to tools that would help customers keep track of their balances, such as text alerts and other improved mobile and internet banking services.

5.15 The OFT also agreed a number of cross-industry initiatives to support changes we expected individual providers to make:99

- **Control**: minimum standards to cover how consumers would be offered the ability to opt-out of unarranged overdraft facilities were developed and included in the Lending Code100 in March 2011. These did not require providers actively to offer an opt-out of unarranged overdraft facilities on all or any of their PCA products but, if a PCA provider did offer such a facility on any of its PCA products, the standards set out how it should be offered to new customers and operated for existing customers.101

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100 The Lending Code is subject to the Lending Standard Board’s monitoring and enforcement regime. All major PCA providers currently subscribe to the Lending Code.

101 *Personal current accounts in the UK progress update*, OFT, March 2011 (OFT1319) Box 2.1 and Annexe A.
• **Clarity and predictability:** an industry Working Group\(^\text{102}\) was also to explore ways to give customers greater control and access to real-time information through improved mobile and internet banking services. A number of PCA providers had already offered mobile text alerts when customers approached agreed limits and mobile applications to help them track their balances.\(^\text{103}\)

• **Responsibility:** best practice guidance for PCA providers in dealing with customers in (or at significant risk of being in) financial difficulty who incurred UOCs was developed by a working group of industry and consumer representatives and included in the Lending Code published in March 2011. This was intended to ensure that these customers did not get into further financial difficulty as a result of incurring UOCs and were able to access lending products most appropriate to their financial situation. It included indicators that customers might be at risk of being in financial difficulty; guidance on how providers could be pro-active in contacting and assisting them; and some potential solutions for providers to assist customers.\(^\text{104}\)

### Other market interventions

5.16 Further to the initiatives already instigated, in November 2011 the Government’s *Consumer Credit and Personal Insolvency Review* announced some commitments to improve consumers’ control of bank charges.\(^\text{105}\) These applied to all full-facility accounts offered by the major current account providers including Barclays, HSBC, Lloyds Banking

\(^{102}\) Subsequent developments in the market around text messaging and mobile applications meant that the industry Working Group was not required.

\(^{103}\) **Personal current accounts in the UK unarranged overdrafts**, OFT, March 2010 (OFT1216) paragraph 3.13.

\(^{104}\) **Personal current accounts in the UK progress update**, OFT, March 2011 (OFT1319) Box 2.2 and Annexe B.

\(^{105}\) Consumer Credit and Personal Insolvency Review formal response on consumer credit, HM Treasury and Department for Business Innovation and Skills, November 2011, paragraphs 6-7.
Group, Royal Bank of Scotland and Santander, representing 85 per cent of the PCA market in the UK.

5.17 As a result all customers of these providers would:

- Have the option to receive a text or email alert from their PCA provider when their balance fell below a certain level, giving them the opportunity to manage their spending so as to avoid going into unarranged overdraft. Many would also be able to receive an alert if they did go into an unarranged overdraft, enabling them to take action to rectify their account balance and avoid or minimise charges.

- Be made aware of a grace period within which they could credit funds to put their account back within their limit and avoid a charge being applied.

- Benefit from a small buffer zone within which unarranged overdraft charges would not be levied. This would prevent consumers incurring a substantial charge as a result of going into unarranged overdraft by a very small amount.

5.18 PCA providers committed (building on initiatives already underway) to offer text alerts to all full-facility current account holders by March 2012 and to deliver the other two commitments by March 2013 at the very latest. The Government’s review said that many PCA providers would also be taking this opportunity to refresh their communications with their customers in order to ensure that there was better understanding of the charges they could face and how they could be avoided.

106 The package does not apply to basic bank accounts, as these accounts do not include an overdraft facility.
Implementation and impact of initiatives

Opt-out

5.19 The OFT made it clear that it expected individual PCA providers to begin widely offering their customers the ability to opt-out of unarranged overdrafts. The OFT noted that for some PCA providers, an opt-out facility was only available on accounts that required a monthly fee, but speculated that, as opt-out facilities became more common, PCA providers might increasingly compete on such facilities and they might be offered without a fee.\textsuperscript{107} The 2008 market study also made clear that the OFT did not consider a basic bank account to be a sufficient substitute for a mainstream current account\textsuperscript{108} and this was further reflected in the minimum standards embodied in the Lending Code.\textsuperscript{109}

5.20 Table 5.1 below records the progress of individual PCA providers in providing customers with this facility. As can be seen, of the eight largest PCA providers, only two (Nationwide and Barclays), offer an opt-out facility without an upfront monthly fee\textsuperscript{110} on all accounts that provide overdraft facilities. Many other PCA providers either do not enable customers to opt-out of unarranged overdrafts or only offer customers the ability to opt-out for a fee.

\textsuperscript{107} Personal current accounts in the UK progress update, OFT, March 2011 (OFT1319) paragraph 3.9.
\textsuperscript{108} Personal current accounts in the UK, OFT, 2008, paragraph 4.98, p.77.
\textsuperscript{109} Personal current accounts in the UK progress update, OFT, March 2011 (OFT1319) Box 2.1 p. 13.
\textsuperscript{110} Consumers who opt-out of unarranged overdrafts can still incur unpaid item charges and, in certain circumstances such as guaranteed transactions, paid item charges.
Table 5.1 – Provision of opt-out facility

<table>
<thead>
<tr>
<th>Offer the ability to opt-out?</th>
<th>Not offered</th>
<th>Offered with a fee on some accounts</th>
<th>Offered without a fee on all accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>HSBC</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>First Direct</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lloyds TSB(^{111})</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>HBOS</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RBS</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nat West</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Barclays</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Nationwide</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Santander</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Co-operative</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NABG (Clydesdale, Yorkshire)</td>
<td>X</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** PCA providers’ response to OFT request for information.

5.21 As shown above, the ability to opt-out of unarranged overdrafts has not become as widespread following the introduction of minimum standards in the Lending Code, as the OFT initially hoped. In addition, some providers have not implemented opt-out in the way that was envisaged, and a minority have not implemented it at all.

5.22 Information provided by PCA providers showed that, where offered, the take up rates of opt-out have been low. For most providers, take-up has been less than one per cent.\(^{112}\) We looked at the take up of opt-out facilities in our consumer survey. The results were largely inconclusive,\(^{113}\) but did show that many consumers who decided not to opt-out of an unarranged overdraft, did so because they were rarely, if

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\(^{111}\) Lloyds TSB, Halifax and Bank of Scotland will provide this service free of charge for up to six months to customers displaying signs of financial difficulty.

\(^{112}\) Take up is substantially higher for Barclays.

\(^{113}\) We consider that this was due to a significant proportion of consumers not understanding the concept of an opt-out from unarranged overdraft charges in the survey itself, despite this being explained. Headline results from the survey may not represent accurately the availability of opt-outs across the PCA market, or whether this was used. More weight is placed on evidence from PCA providers on the take up of opt-out provisions.
ever, in unarranged overdraft (45 per cent). Other reasons cited for not opting out included that the unarranged overdraft facility might be needed in an emergency (16 per cent); it provided them with additional funds (12 per cent); disliking payments being bounced back (two per cent); and that an unarranged overdraft was useful, because they didn’t have to keep track of their balance, to ensure payments went through (one per cent).

5.23 Despite this low take-up, the OFT considers that the ability to opt-out of unarranged overdraft remains a useful tool for those consumers that regularly incur UOCs. The OFT is also concerned that take up has been limited by how it has been implemented by some PCA providers.

5.24 The 2008 market study\textsuperscript{114} found that consumers tend to underestimate their use of unarranged overdrafts.\textsuperscript{115} The survey found that 34 per cent of respondents who had incurred a UOC stated that the reason was that they did not expect to use an unarranged overdraft, even though they had done so in the past. This overconfidence may mean that some consumers could underestimate their expected incidence of these charges, therefore asking them to pay for a service that they do not expect to need appears difficult to rationalise.

5.25 The level of publicity given to opt-out facilities may also affect take-up rates. Evidence from the consumer survey shows that awareness of the ability to opt-out among customers of providers that offer this service\textsuperscript{116} is low – only 20 per cent of PCA holders said that their account offered the ability to opt-out, 22 per cent said it did not and 58 per cent did not know.\textsuperscript{117} This indicates that take up of opt-out may be higher if more

\textsuperscript{114} Personal current accounts in the UK, OFT, 2008, paragraph 4.68, p.70.

\textsuperscript{115} We were unable to distinguish between overconfidence about entering unarranged overdraft and overconfidence about incurring a charge.

\textsuperscript{116} Barclays, HSBC, Lloyds Banking Group, NABG or Nationwide.

\textsuperscript{117} 2012 PCA consumer survey. Consumers who said they held their main account with Barclays, HSBC, Lloyds TSB, Halifax, Yorkshire Bank, Clydesdale or Nationwide. Excludes consumers with Basic bank accounts.
customers were aware of this facility and if it were more widely available.

5.26 In conclusion on opt-out, it is clear that PCA providers could do more to offer their customers the ability to opt-out of unarranged overdraft facilities and to ensure they are aware of it. Many consumers currently do not have a real choice about whether or not to have this facility. The OFT, therefore, recommends that **PCA providers do more to make opt-out of unarranged overdraft facilities available without charge on a wide proportion of PCAs that they offer.** While we recognise that this feature is likely to be valuable only for a proportion of customers, we consider that the way in which this measure is currently provided is inhibiting wider take-up.

**Clarity and predictability**

5.27 There have been significant developments since 2008 with the roll-out of various online and mobile services which have the potential to make it easier for consumers to obtain real-time information and exercise greater control over incurring UOCs. As well as receiving text alerts when customers are close to their account limit, customers can also access account information, such as account balances and statements of recent transactions, via mobile phone applications and transfer money quickly via Faster Payments. The provision of such services appears to be evolving relatively rapidly, with some PCA providers driving this proactively, albeit with others moving slower.

5.28 Following the Government’s *Consumer credit and personal insolvency review*, the major PCA providers committed to offer text alerts when their balance fell below a certain level to all full-facility current account holders by March 2012. All PCA providers now offer text alerts to their customers free of charge, with the exception of NABG who expects to offer this service to their customers later in 2013.
5.29 Based on data received by providers we estimate that nearly four million customers have signed up for text alerts.\textsuperscript{118} However, this represents only around five per cent of full facility account users and there are variations in the take-up across different providers. Given that this service is free to most customers and offers the potential to avoid incurring charges, it is perhaps surprising that more customers have not signed up.

5.30 One potential explanation for the relatively low level of usage of text alerts is a lack of awareness of the service among consumers. In our consumer survey, 34 per cent of account holders\textsuperscript{119} said they did not know whether their account offered the service of providing text alerts when customers' balances fell below a certain level. A further 37 per cent said that their accounts did not provide this service.

5.31 Of those who said their bank offered text alerts, 45 per cent used the service, which suggests there may be significant latent demand for this service and much scope for providers to increase its awareness and usage. Take-up is higher among those that said they were permanently, usually or sometimes overdrawn (see Figure 5.1) and for younger customers (see Figure 5.2), who the market study found were the most likely to incur UOCs. This evidence suggests text alerts are being used by those who are most in need of them.

\textsuperscript{118} If a customer has signed up for text alerts with two different providers that customer will be counted twice.

\textsuperscript{119} Excludes basic bank accounts.
Figure 5.1 Percentage that use a text alert service where this is offered, by frequency of being overdrawn

Source: OFT consumer survey.
Base: Excludes basic bank accounts.

Figure 5.2 Percentage that use a text alert service where this is offered, by age group

Source: OFT consumer survey.
Base: Excludes basic bank accounts.
Furthermore, consumers appear to find text alerts helpful. According to our consumer survey, 60 per cent of those that had received a text alert\textsuperscript{120} said that receiving it had allowed them to avoid incurring a charge. Twenty-two per cent of consumers said that they ignored the alert as they were knew they would not go overdrawn, and nine per cent said they still got charged. One provider estimated that customers registered for its text alerts saved over £11 per year on average compared with customers that had not signed up. Another provider said that two thirds of registered customers had been triggered by an alert to take preventative action.

As evidenced, text alerts appear to have a positive impact on a consumer’s ability to avoid incurring UOCs, but there is currently a lack of awareness of this service amongst consumers. The OFT therefore recommends that \textbf{PCA providers do more to offer their text alert service to all their customers proactively}.  

Another key development has been the provision of mobile banking applications which, as with online banking, allow consumers to access key account information via their mobile phone, and in some cases allow payments to be made. In addition, Faster Payments\textsuperscript{121} allow payments between accounts to be made within hours rather than days as had been the case previously. This functionality means that consumers with available funds elsewhere now have the ability to quickly rectify shortfalls of funds by transferring money into their PCA. Therefore, consumers with access to this technology may generally be better able to exert control over the incurring of UOCs than at the time of the 2008 market study.

Based on data from PCA providers, we estimated that in July 2012 there were nearly six million active users of mobile banking applications. The

\textsuperscript{120} Excludes basic bank accounts.

\textsuperscript{121} The OFT notes that many PCA providers had already rolled out the availability of Faster Payments for high value transactions across all accounts prior to March 2010.
data from providers also suggests that the frequency of logins on these applications is high. One provider estimated that their active users log in on average 24 times a month, while daily logins at another provider equate to one for every two active customers.

5.36 Consumers are also adopting mobile banking much quicker than they have other forms of remote banking previously. One provider told us it was able to reach a significant scale of take-up in three months with mobile banking whereas it had taken four years to achieve the same scale with internet banking. Another provider reported 600,000 downloads within four months of launching its mobile application.

5.37 The OFT consumer survey also provided evidence to support the increasing usage of online banking services and mobile applications reported by the PCA providers. It found that 59 per cent of account holders now use internet banking and 18 per cent use mobile technology. These methods are also used more frequently than those that use in-branch banking (at least two or three times a week by 47 per cent of those using the internet and 58 per cent of those using mobiles compared to just six per cent using in-branch banking). Like text alerts, both these methods are also used more frequently by younger consumers, who our 2008 PCA market study found were more likely to incur UOCs. This is shown in Figure 5.3 below.
Figure 5.3 Percentage that use internet banking and mobile technology where this is offered, by age group

Source: OFT consumer survey.

5.38 The major PCA providers have also committed by March 2013 to make customers aware of grace periods, within which they can credit funds to put their account back within their limit and so avoid a UOC being applied, and provide a small buffer zone, within which UOCs will not be levied.

5.39 Some providers have confirmed that they have already informed their customers of the grace periods applicable to their accounts, although some providers have yet to do so. It is therefore too early to draw a conclusion on whether an increased awareness of grace periods will assist consumers in controlling the incurring of UOCs. It should be noted, however, that awareness by itself may not be enough to affect consumer behaviour. For grace periods to have a beneficial impact, consumers need to be aware that they have entered unarranged overdraft, and have sufficient time to transfer funds in order to avoid a charge being applied.
5.40 All PCA providers that committed to enable their customers to benefit from a small buffer zone have now done so. The level of buffer zones available varies by the type of account and provider. Most are around £10, although one is as low as £1, which may be of limited practical use.

5.41 Despite these developments, the OFT is concerned that charging structures for unarranged overdrafts remain complex and that increased transparency is not enough, by itself, to assist consumers in understanding these charges. In order to work out the cost of using an unarranged overdraft, consumers still need to be aware of the different types of charge that can be levied and the PCA provider’s charging policy. These factors, even when explained to consumers, make it difficult to understand and calculate the level of charge that they will incur at particular times. Chapter 7 considers consumers understanding of charges in more detail.

5.42 In light of these ongoing concerns over the clarity and predictability of UOCs, the OFT recommends that PCA providers should further consider ways to simplify their charging structures for overdrafts.

Responsibility

5.43 By September 2010, a number of providers had revised their responsibility policies. This included adopting a more pro-active approach to contacting customers incurring significant fees to establish whether more appropriate products were available and in order to discuss measures to reduce or avoid fees in future. The responsibility policies also introduced a cap on the level of fees that a customer could incur in a month. PCA providers have indicated that they are proactive in contacting customers if they detect irregularities with payments to their account, which could indicate they are experiencing financial difficulty,

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122 Including their use of buffers, waivers and caps on the total number of charges a customer can receive in any period.

123 Personal current accounts in the UK progress update, OFT, September 2010 (OFT1275) paragraph 4.12
and many providers also have specialised units for liaising with customers by email, by phone or in person.

5.44 In addition, the major PCA providers in Great Britain and most in Northern Ireland confirmed that they had published their existing responsibility policies on their websites. This was designed to ensure customers were aware of how they should be treated when in, or at significant risk of being in, financial difficulty and to enable them to ensure providers met their commitments in this regard.¹²⁴

5.45 The inclusion in the Lending Code of best practice guidance for PCA providers in dealing with customers facing financial difficulty and their responsibility policies might have been expected to lead to reductions in the level of charges incurred by consumers on low incomes. It is, however, difficult to attribute any direct impact from the responsibility policies as in general there has been a significant reduction in the level of overdraft charges.

5.46 The 2008 market study found that in 2006, 27 per cent of account holders who incurred UOCs paid no more than £50 and 52 per cent paid more than £100.¹²⁵ In 2011, it appears that a far higher proportion of those who incurred overdraft charges (61 per cent) paid less than £50 and just 19 per cent paid at least £100.¹²⁶

¹²⁴ Personal current accounts in the UK progress update, OFT, March 2011 (OFT1319) paragraph 3.13
¹²⁵ Personal Current Accounts in the UK, OFT, 2008, p.68
¹²⁶ Source: PCA providers’ responses to our request for information.
5.47 The 2008 market study also found that those consumers who incurred a charge were far more likely to incur a charge at least three times (62 per cent) than they were to incur just one (23 per cent) in 2006. In 2011 slightly fewer incurred at least three charges (52 per cent) and a slightly higher proportion incurred just one charge (31 per cent). In addition, of those accounts charged in 2006, more than 57 per cent had also been charged in 2005. The current situation has improved to a limited extent: of accounts charged in 2011, 51 per cent had also been charged in 2010.
The level of UOCs

5.48 There are several different types of unarranged overdraft charge (UOC):

- an unpaid item charge (UPIC)\(^{129}\) is levied upon the PCA provider declining a customer’s request to make a payment which, if it had been paid, would have created or extended an unarranged overdraft.
- a paid item charge (PIC) is incurred when a customer makes a request to make a payment which the PCA provider accedes to and in doing so provides or extends an unarranged overdraft.
- maintenance charges are levied in relation to time periods when accounts are in unarranged overdraft, whether months, weeks or days, and
- interest on unarranged overdraft balances.

\(^{129}\) Also referred to as returned item fees.
5.49  Figure 5.6 below shows how both arranged and unarranged overdraft revenues have evolved over time.\(^{130}\)

#### Figure 5.6 – Revenues for arranged and unarranged overdrafts

![Revenues for arranged and unarranged overdrafts](chart)

**Source:** OFT analysis of data from PCA providers  
**Note:** Figures are adjusted for inflation (expressed in 2011 prices).

5.50  As shown in the sections below, there has been a substantial reduction in UOCs since 2007. UPICs in particular have fallen by two-thirds. Charges for unarranged lending have also fallen substantially, by at least one-third. The amount of revenue PCA providers extracted from UOCs fell by £1047 million (in 2011 prices) in total. The OFT’s evaluation of the 2008 market study and test case has estimated the consumer benefits from this reduction in UOCs to be at least £928 million.\(^{131}\)

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\(^{130}\) As not all PCA providers were able to provide a split between arranged and unarranged interest, we have made an assumption for this split based on the providers that were able to provide this information.

\(^{131}\) This is not the same as the fall in UOCs revenues as the estimation of consumer benefits considers the volume of lending under the counterfactual multiplied by an estimate of the price change. This accounts for a) that not all of the decrease in revenues for UOCs will represent detriment to consumers where additional lending has been provided, and b) other factors may have caused the volume of unarranged lending demanded by consumers to change.
5.51 However, in the same period the amount of revenue extracted from interest (both unarranged and arranged) rose £107 million (in 2011 prices), while revenue from arranged overdraft charges rose £432 million (in 2011 prices). Thus, PCA providers' total revenue from arranged and unarranged lending has fallen by £507 million overall (in 2011 prices).

5.52 Given the substantial increase in arranged lending charges and interest, we have considered the extent to which this may be causally linked to the fall in UOCs. This discussed in more detail below.

5.53 The following sections discuss the changes to UPICs, unarranged lending charges and interest in more detail.

UPICs

5.54 As the 2008 market study reported, between 2000 and 2006 UOC levels had shown an increasing trend.\(^{132}\) This can be seen for UPICs, which typically exceeded £30 by 2006, in Figure 5.7 below. We extended the OFT’s original analysis of UOCs conducted in 2008.\(^{133}\) Figure 5.7 shows the start and end dates (March 2007 and November 2009) of the Test Case\(^ {134}\) and the publication date of the PCA market study (July 2008). As can be seen, average UPIC levels fell significantly around the time of the OFT’s market study and the test case, from over £30 to around £10. However, they have not fallen much since March 2011.\(^ {135}\)

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\(^{132}\) Personal Current Accounts in the UK, OFT, 2008, Chart 3.16. Note that the UPIC levels depicted there differ from those in figure [3] below as the latter are adjusted for inflation.

\(^{133}\) This was carried out with data we received from the PCA providers as part of their response to our information request in this review.

\(^{134}\) This is described in Chapter 1.

\(^{135}\) Personal current accounts in the UK progress update, OFT, March 2011 (OFT1319)
5.55 The extent to which UPICs have reduced varies significantly across PCA providers. This can be seen in Table 5.2 below covering the UPICs charged by the main providers in 2007 and 2011.

<table>
<thead>
<tr>
<th></th>
<th>RBS</th>
<th>Lloyds</th>
<th>HBOS</th>
<th>Barclays</th>
<th>HSBC</th>
<th>Nationwide</th>
<th>Santander</th>
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</thead>
<tbody>
<tr>
<td>2007</td>
<td>38</td>
<td>35</td>
<td>39</td>
<td>35</td>
<td>25</td>
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<td>25</td>
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<td>8</td>
<td>25</td>
<td>15</td>
<td>25</td>
<td>25</td>
</tr>
</tbody>
</table>

Source: PCA providers’ response to OFT information request (OFT analysis of each PCA provider’s account with largest number of account holders). Note: figures in this table are not adjusted for inflation.

5.56 Revenues derived from UPICs are shown in Table 5.3 below. Real UPIC revenues, across all PCA providers, fell by 61 per cent between 2007 and 2011, driven by the fall in charge levels. UPIC volumes

136 Inflation adjusted.
reported by individual PCA providers (not shown above) are approximately constant over time for most providers with the exception of a small increase in 2009.

Table 5.3 Total UPIC revenues, PCA providers, 2007-2011

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
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<tr>
<td>Revenues (£ million in 2011 prices)</td>
<td>1,064</td>
<td>929</td>
<td>835</td>
<td>509</td>
<td>413</td>
</tr>
<tr>
<td>% of 2007 revenues</td>
<td>100%</td>
<td>87%</td>
<td>78%</td>
<td>48%</td>
<td>39%</td>
</tr>
</tbody>
</table>

Source: PCA providers’ response to OFT (2012), OFT analysis. Covers PCA providers representing roughly 95 per cent of market, 2011 prices.

Unarranged lending charges

5.57 The costs to customers for unarranged lending are complex, consisting of transaction fees (PICs), periodic fees\(^{137}\) and interest payments. In addition, as discussed earlier in this chapter, some providers have charging policies that include buffers (for example where the first £10 of unarranged lending is free), waivers (for example for first charge incurred by a customer) and caps on the total number of charges a customer can incur in a given period.

5.58 Moreover some PCA providers have altered their charging structure over time. Overall there has been a shift by some providers away from PICs and monthly maintenance fees towards charging daily or weekly maintenance fees.

5.59 To analyse the evolution of unarranged lending charges in a way that accounts for the complexity of the charging structure and changes to it we have looked at the charges levied on a variety of possible unarranged lending scenarios. This scenario analysis, described in the following section, only considers unarranged overdraft charges and not interest, as

\(^{137}\) Maintenance fees can be daily, monthly or weekly.
the interest payments are negligible relative to the other charges for the short periods of time considered in the scenarios.\textsuperscript{138}

**Scenario analysis**

5.60 Each charging scenario describes a hypothetical situation in which unarranged lending has been provided to a PCA customer. These scenarios were agreed with the industry following the 2008 market study to help customers to understand better the costs of different ways in which unarranged overdrafts might be used.\textsuperscript{139}

5.61 For each scenario, we have calculated the total amount that would be payable by the customer for each PCA provider, taking into account the complexities of the charging structure. In order to take account of buffers, waivers and caps applied by the providers, we also introduced certain assumptions,\textsuperscript{140} where these were not specified in the original scenario, and considered the sensitivity of these assumptions.\textsuperscript{141}

\textsuperscript{138} *Review of the personal current account market*, January 2013, Chapter 4. We estimate that interest charges are approximately two per cent of total unarranged lending charges based on the PCA providers that provided this information.

\textsuperscript{139} See *Personal current accounts in the UK, A follow up report*, October 2009, OFT 1123, for a discussion of implementation and *Personal current accounts in the UK, Progress update*, March 2011, OFT 1319, for details on the agreed scenarios.

\textsuperscript{140} The assumptions used for the charging scenarios specify the total amount of unarranged lending, the timing and sequence of payments and whether it was the first time the customer had entered unarranged lending. The assumptions and details of the scenarios are set out in more detail in the evaluation report, available on the OFT website.

\textsuperscript{141} The scenarios we use are in principle similar to those published by PCA providers on their websites. However, the published scenarios reflect the PCA providers’ current charging structure and so do not allow us to analyse changes since 2007. Furthermore, in order to calculate total costs for consumers, PCA providers need to make certain assumptions. In order to ensure that the assumptions are consistent across PCA providers we have calculated the scenarios ourselves.
Figure 5.8 - Evolution of charging scenarios for unarranged lending across time

Figure 5.8 above shows the weighted average level of charges across providers for each scenario between 2007 and mid-2012.\(^{142}\) In each scenario, unarranged lending charges have fallen substantially since 2007. Unarranged lending charges have fallen by approximately 50 per cent on average across the scenarios. The smallest reduction in unarranged lending charges across any of the scenarios is 25 per cent. As we do not have information on the incidence of these scenarios in practice, it is not possible for us to estimate an accurate weighted average for the fall in prices arising from the different charging scenarios. However, given the consistency of the reduction in the amount of charges across the scenarios we consider that it is likely to be similar to the average across scenarios.

\(^{142}\) Scenario one has been excluded from this analysis as it refers to UPIC levels only.
Revenues from unarranged lending

5.63 Revenues from unarranged lending charges have fallen by 23 per cent from their 2007 level (in 2011 prices), as can be seen in Table 5.4 below. Revenues increased somewhat in 2008, before decreasing in the following years.

Table 5.4 Revenues from unarranged lending charges

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues (£ million in 2011 prices)</td>
<td>1,701</td>
<td>2,034</td>
<td>1,836</td>
<td>1,540</td>
<td>1,306</td>
</tr>
<tr>
<td>% of 2007</td>
<td>100%</td>
<td>120%</td>
<td>108%</td>
<td>91%</td>
<td>77%</td>
</tr>
</tbody>
</table>

Source: PCA providers submission to information request (2012), OFT analysis, 2011 prices.

5.64 Revenues from unarranged interest are very small compared to total revenues from unarranged lending.\(^{143}\) For this reason and as some PCA providers were not able to provide a split between arranged and unarranged interest revenues, revenues from interest on both arranged and unarranged overdrafts are considered together below.

Arranged lending

5.65 Revenues from arranged lending charges and interest have increased substantially. Given this, we have considered both the extent of this increase and the extent to which it may be causally linked to the fall in UOCs.

5.66 Revenues from arranged maintenance charges have increased substantially overall by £432 million (2011 prices), from £16 million in 2007 to £448 million in 2011. The increase in revenue is predominately due to the introduction of maintenance fees by some PCA providers, in

\(^{143}\) We estimate that interest charges are approximately two per cent of total unarranged lending charges based on the PCA providers that provided this information.
some cases in place of charging interest and in other cases in addition to charging interest. The revenues are shown in Figure 5.9 below.

**Figure 5.9 Revenues from arranged maintenance charges (£m)**

![Graph showing revenues from arranged maintenance charges (£m) over years 2007 to 2011.]

**Source**: PCA providers’ response to OFT information request (OFT analysis): sum of revenues across all PCA providers that submitted data covering the whole period (HSBC including First Direct, Barclays, RBS Group, Nationwide, Bank of Ireland, Citibank, Islamic Bank, Lloyds Group, Norwich and Peterborough, Santander).

5.67 Debit interest rates for arranged lending have also increased from 17.7 per cent to 19.3 per cent on average across those providers that continue to charge interest.144 Most PCA providers now either set interest rates for unarranged lending at the same level as for arranged lending or no longer charge interest on unarranged lending, having introduced maintenance charges instead.

144 Bank of England, Monthly interest rate of UK monetary financial institutions (excl. Central Bank) sterling overdraft households (in percent) not seasonally adjusted; annual average calculated. Note that this average does not take into account PCA providers that have replaced interest with maintenance charges. The weighted average interest rate including all PCA providers has fallen.
5.68 Reported net debit interest revenues\textsuperscript{145} for both arranged and unarranged lending have increased by approximately £107 million. This increase may reflect in part the increase in debit interest rates and partly the change in accounting costs of capital. We consider that this increase in net interest revenues is likely to overstate economic revenues for PCA providers as we were told by some PCA providers that the cost of capital used in the calculation of net interest revenues is not an accurate reflection of the actual opportunity cost of these funds and increased costs of lending after the financial crises.

5.69 There is a potential for the increase in arranged lending charges to have been caused by the fall in UOCs. This issue is examined in detail in the separate report of the evaluation of the OFT’s 2008 market study and test case. This analysis considers whether arranged and unarranged lending may be complementary and the impact this may have on PCA providers’ incentives and ability to raise arranged lending prices when UOCs are lowered. It suggests a number of reasons why such incentives may be limited, and also argues that if the PCA providers would find it profitable to introduce additional charges for arranged lending then this would be the case irrespective of whether unarranged lending charges were reduced. It also considers the extent to which changes in UOCs and revenues from arranged lending varied across PCA providers, finding significant variations which further suggest that the extent to which the rise in arranged lending charges is linked to the fall in UOCs is limited. Overall, it concludes that establishing causality between these two changes, essentially whether a waterbed effect exists between these two charges, is a difficult issue to resolve, but it considers that the extent to which the increase in arranged lending charges and interest was caused by the fall in UOCs is likely to be limited.

\textsuperscript{145} Net debit interest revenues take into account the margin the bank makes on the lending. The margin is accounted for by the interest rate charged to the customer minus the providers’ internal transfer price for the cost of internal funding, which is typically based on a bank specific metric of costs of funds. See Inflation Report, August 2011, Bank of England, p.16 for a general discussion of credit spreads.
6 SWITCHING ACCOUNTS

6.1 Consumers who proactively seek better deals, on either price or quality, help drive competition in markets. Markets can be competitive when switching rates are low if customers are able to switch easily and providers respond to the threat of switching by offering better deals. However, without consumers being willing or able to switch easily between competitors, providers have little incentive to provide better offers.

6.2 This chapter reviews the OFT’s work to date in relation to consumers switching their PCA, and the future switching landscape. The OFT reached a number of findings in its 2008 market study in relation to switching and agreed a number of initiatives to improve the switching process. This chapter considers the impact of these initiatives, and provides information on the new switching service recommended by the 2011 ICB report and due to be implemented in September 2013.

6.3 The key findings from this review concerning switching are that, while there have been some marginal improvements in awareness of switching and satisfaction in the process, many consumers remain unwilling to switch. It is hoped that the new switching system to be implemented in September 2013 will further improve the effectiveness of switching and give consumers greater confidence in the process.

The OFT’s PCA market study and progress reports

6.4 The OFT’s 2008 market study found low levels of switching between PCAs. Contributory factors were both the actual and perceived problems that consumers can face. Specifically, the OFT identified three main areas of concern:

- Low consumer awareness of the switching process: The OFT’s 2008 market study found indicators of low consumer awareness of various aspects of the switching process, including a lack of knowledge of the existence of an automatic switching process and
how it worked. A low level of awareness of these issues can result in consumers being reluctant to even consider switching PCAs.

- **There were a number of ways in which the switching process could go wrong for a consumer:** The 2008 market study found that 28 per cent of switchers reported some problems with the process, such as misplaced Direct Debits, standing orders and balances.¹⁴⁶

- **The perceived risk and complexity of the switching process:** The 2008 market study found that consumers perceived the switching process to be risky and complex.

6.5 The 2008 market study found that nearly 60 per cent of consumers surveyed had never heard of switching services offered by PCA providers, or if they had, knew nothing about them.¹⁴⁷

6.6 Over a quarter of those who switched encountered problems with the process, and those consumers that used their PCA provider’s switching service were significantly more likely to report experiencing a problem than those consumers who switched without using a PCA provider’s switching service.¹⁴⁸ In addition, those consumers who used automated switching systems had no control over the process but faced a significant proportion of the risks should something go wrong, such as penalties for non-payment or adverse credit rating data due to misplaced Direct Debits or standing orders.¹⁴⁹

¹⁴⁶ *Personal Current Accounts in the UK*, paragraph 5.57.
¹⁴⁷ *Personal Current Accounts in the UK*, Table 5.9.
¹⁴⁸ *Personal Current accounts in the UK*, Table 5.13. Thirty-seven per cent of switchers who used their PCA provider’s switching service had some kind of problem, compared to 19 per cent who made their own arrangements.
¹⁴⁹ *Personal Current Accounts in the UK*, paragraphs 5.50 and 5.75.
These findings are consistent with a 2007 consumer survey by Bacs Payment Schemes Limited (Bacs)\textsuperscript{150} which identified four key problems in the switching process:

- moving direct debits
- length of time taken
- transferring their balance to the new PCA provider, and
- problems with paperwork.\textsuperscript{151}

In addition to the problems encountered when switching between PCAs, consumers perceived the switching process to be working poorly. The OFT found in its 2008 market study that nearly half of the consumers surveyed had not even considered switching\textsuperscript{152}, with a similar proportion not very or not at all confident about the switching process being smooth, with particular concerns over Direct Debits or standing orders not being paid.\textsuperscript{153}

The 2008 market study concluded that low levels of switching caused by barriers, or perceived barriers to switching, had reduced incentives for PCA providers to compete for customers. This creates a significant challenge for new PCA providers in attracting customers, which can

\textsuperscript{150} Bacs is the body that processes payments for a number of different payment schemes in the UK, including Direct Debit and Direct Credit.

\textsuperscript{151} Bacs PCA Switchers Survey 2007, see \textit{Personal Current Accounts in the UK: a follow up report} (2009 OFT1123) paragraph 5.8 \url{www.oft.gov.uk/shared_oft/personal-current-accounts/OFT1123.pdf}

\textsuperscript{152} \textit{Personal Current Accounts in the UK}, paragraph 5.70. Forty-seven per cent of consumers surveyed had not even considered switching.

\textsuperscript{153} \textit{Personal Current Accounts in the UK}, paragraphs 5.47-5.48 and Chart 5.10. Forty-five per cent of non-switchers were not very/not at all confident about the switching process being smooth.
make entry and expansion more difficult, and reduces the incentives on established providers to compete. \(^{154}\)

6.10 In addition, such inertia in the PCA market may have spill over effects into other retail banking products. The OFT’s *Review of barriers to entry, expansion and exit in retail banking* highlighted that PCAs often act as a gateway product for the sale of other retail banking products. If potential PCA providers are deterred from entering the PCA market, or established PCA providers are deterred from expanding, this may also limit their ability to compete in other markets. \(^{155}\)

**Switching initiatives**

6.11 The OFT considered that the switching problems identified could be reduced or removed by making the process of switching easier, and reducing or removing the negative perceptions of switching. This should have the effect of incentivising PCA providers to offer better PCA products, in the knowledge that consumers are not prevented from switching to them. The OFT hoped that in turn, consumers would take advantage of those better offers, by choosing PCAs with lower charges and debit interest rates, or higher credit interest rates.

6.12 Following publication of the 2008 market study, the OFT worked with the Bacs Switching Working Group to address the concerns identified. The objectives agreed were set out in a follow up report published in October 2009: \(^{156}\)

- **Increase levels of consumer awareness of the switching process:** Consumers should be aware that they can switch PCAs and that they can find information on switching easily and readily. When

\(^{154}\) The OFT’s 2010 review of *Barriers to entry, expansion and exit in retail banking* (OFT1282) found that low levels of switching across PCA customers was a significant component of consumer inertia in retail banking, and that this inertia was the key barrier to entry and expansion for new PCA provider entrants in retail banking. See [www.of.t.gov.uk/shared_of.t/personal-current-accounts/of.t1282](http://www.of.t.gov.uk/shared_of.t/personal-current-accounts/of.t1282)

\(^{155}\) *Barriers to entry, expansion and exit in retail banking* paragraph 1.22.

\(^{156}\) See *Personal Current Accounts in the UK: A follow up report* section 5.
switching PCA providers, consumers can either handle the change themselves, or they can utilise the switching service of their new PCA provider.

- **Reduce problems encountered by consumers when switching:**
  There should be a reduction in the number of problems encountered by consumers and those problems that are encountered should be resolved swiftly and satisfactorily. Consumers should not incur costs or inconvenience as a result of the mistakes or omissions of others.

- **Reduce the fear of the switching process:** It was considered that the success of the first two objectives would contribute to this.

6.13 To tackle the level of awareness of the switching process, Bacs set up a consumer website\(^{157}\) to provide helpful advice and tools for switching, including a timeline for the switching process, template letters for consumers to use to send to their old PCA provider, and a guide to switching between PCAs which could be downloaded. Bacs also established a direct debit help centre\(^{158}\) for questions regarding Direct Debits, including how to set them up and transfer them to a new PCA.\(^{159}\)

6.14 Bacs also introduced a number of initiatives to **reduce the numbers of Direct Debits being sent to the old account**.\(^{160}\) This included an originator education strategy which involved disseminating best practice, writing to direct debit originators that did not update their records, explaining the need for prompt action, and producing new forms to standardise interbank communication. Bacs also sought to update its Service User’s Guide & Rules to stipulate that consumers should not be adversely

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\(^{157}\) See [www.thesmartwaytopay.co.uk/directdebitexplained/pages/accountswitching.aspx](http://www.thesmartwaytopay.co.uk/directdebitexplained/pages/accountswitching.aspx)

\(^{158}\) See [www.thesmartwaytopay.co.uk/DirectDebitHelpCentre/Pages/DirectDebitHelpCentre.aspx](http://www.thesmartwaytopay.co.uk/DirectDebitHelpCentre/Pages/DirectDebitHelpCentre.aspx)

\(^{159}\) *Personal Current Accounts in the UK: A follow up report* paragraph 5.17

\(^{160}\) Consumers can switch their current account liabilities, such as Direct Debits and standing orders, either manually, taking responsibility for the transfer themselves, or through their bank’s automated system, known as ToDDaSO (Transfer of Direct Debits and standing orders). The OFT’s initiatives implemented with Bacs sought to improve the automated service.
affected by any problems caused by the switching process or a direct debit originator, by encouraging service users not to charge customers or register adverse credit data in the event of a problem occurring.

6.15 No specific policies were put in place to **reduce the fear of the switching process**. Both the OFT and the Bacs Switching Working Group considered that the perceived problems with switching were caused by low awareness and actual problems encountered when switching. By addressing these two issues, it was hoped that the improved consumer experience of the switching process would improve the perception of switching in the market in parallel.

**ICB recommendations**

6.16 The ICB report echoed the OFT’s view that ‘[l]ow levels of actual switching on their own would not be a concern if consumers were willing and able to switch quickly when differences between firm’s products or prices occurred.’\(^{161}\) However, the report noted that there was significant evidence to show that consumers were put off by the current process. For example, they found that the current switching system takes around 18 days on average to complete and required action by the customer, both the new and old PCA providers, direct debit originators and employers or other organisations that make payments to the customer, all of which was off-putting to potential switchers.\(^{162}\)

6.17 As a result of their findings, the ICB recommended the establishment of a current account redirection service in order to ‘smooth the process of switching current accounts’.\(^{163}\) This system is intended to ensure that a consumer’s PCA is switched within seven days and that any potential errors in the process are kept to a minimum.

\(^{161}\) *ICB report*, paragraph 7.38.
\(^{162}\) *ICB report*, paragraph 7.41.
\(^{163}\) *ICB report*, paragraph 8.57.
6.18 Following the Government’s acceptance\(^{164}\) of the ICB’s recommendations, the Payments Council took responsibility for implementing the new switching service by September 2013. The new Automated Switching System, incorporating the conditions set out in the ICB report,\(^{165}\) will have the following features:

- The service will be free to use and take seven working days for a full switch to complete.

- Payment arrangements (such as paying an electricity bill by direct debit or standing order) will be transferred automatically and all payments will be made from the new account as soon as the switch is complete.

- If payments are sent to the old account after the switch is complete, they will automatically be redirected to the new account for 13 months - the consumer will be advised if there are any exceptions to this.

- If there is a closing credit balance, it will automatically be transferred to the new account.

- Using the switching service will not affect the consumer’s credit rating no matter how many times they switch, providing they clear any overdrafts when requested by the old PCA provider.\(^{166}\)

6.19 The new switching system will automatically close the consumer’s old account. To date, many consumers when looking to switch have kept their old account open – a partial switch. Consumers wishing to keep their old account open will be able to use the new switching service, but

\(^{164}\) The Government published its response to the ICB report on 14 June 2012 supporting the ICB’s approach to PCA switching. See Banking reform: delivering stability and supporting a sustainable economy June 2012 CM8356, paragraphs 4.11-4.15. www.hm-treasury.gov.uk/d/whitepaper_banking_reform_140512.pdf

\(^{165}\) ICB report paragraph 8.57.

\(^{166}\) Bacs submission to the OFT, setting out the key features of the new Automated Switching System.
will not benefit from the redirection element of the service so the potential for errors will remain. This means that the initiatives introduced by the Bacs Working Group to reduce the number of Direct Debits being sent to the old bank remain important for ensuring that all consumers are able to switch their accounts without error, whether they execute a full or partial switch.

**Impact of switching initiatives**

6.20 According to data from GfK’s Financial Research Survey\(^{167}\) the rate at which current account holders switched their main account in a 12-month period has gradually increased over time but remains at a low level. As illustrated in Figure 6.1 below, the switching rate\(^{168}\) has increased from 2.3 per cent in 2008 to 3.1 per cent in 2012.

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\(^{167}\) The GfK Financial Research Survey is a monitor of consumers’ financial behaviour based on 60,000 interviews a year with a representative sample of British adults.

\(^{168}\) Defined as the proportion of current account holders who reported opening an account within the last 12 months by switching their main account from another bank/building society.
The GfK research also showed that younger consumers were more likely to switch their PCAs compared to older consumers, as shown in Figure 6.2 below. Those in the 16-34 age group consistently had the highest rates of switching, with rates between around 3.5 and five per cent. Over the same period, the rate was typically 1.5 percentage points lower for those in the 35-54 age band and a further 1.5 percentage points lower for those aged 55 and over.
Figure 6.2: Percentage of account holders that have switched in a 12 month period: by age group

![Graph showing percentage of account holders that have switched in a 12 month period by age group from 2008 to 2012.]

Source: GfK Financial Research Survey (FRS).

Notes: The proportion of current account holders who have opened an account within the last 12 months by switching their main account from another PCA provider.

6.22 The OFT’s 2012 consumer survey assessed the impact of the OFT and Bacs initiatives on the problems identified in the switching process, and whether and how the switching landscape had changed since the 2008 market study. The findings from this are consistent with that from the GfK survey, in that the number of consumers switching remains low. Around four per cent of consumers surveyed reported they had switched

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169 Problems identified in the switching process were namely poor consumer knowledge of the switching process, problems experienced when switching, and the fear that the switching process will go wrong.
their main current account in the previous 12 months. Seventy five per cent said they had never switched their account.\textsuperscript{170}

**Increase levels of consumer awareness of the switching process**

6.23 Following the 2008 market study and 2009 follow-up report, the OFT continued to monitor developments with the switching process and published progress reports in 2010\textsuperscript{171} and 2011.\textsuperscript{172} These reports found that the website Bacs established to provide advice and tools to consumers for switching is being used, albeit in small numbers. Within 12 months of being set-up,\textsuperscript{173} the relevant pages of the Bacs website had been accessed over 7,000 times, and over 10,000 account switching documents had been downloaded from the website.\textsuperscript{174} These materials continue to be promoted, and the most recent Bacs review of the website in 2012 shows that the webpage is receiving more than 1,000 visits a month.\textsuperscript{175}

6.24 Furthermore, for PCA providers\textsuperscript{176} that were able to provide this information, the number of consumers viewing providers’ switching information on their websites has been increasing over the past two years, and in 2011 there were over one million unique views of this information.

6.25 Bacs data provided for this review, shows that requests to use the PCA providers’ switching services have nearly doubled since 2008, from 576,729 in 2008 to 1,042,515 in 2011 and 1,204,804 in 2012 showing that more consumers are opting for this system over time. The

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\textsuperscript{170} OFT consumer survey 2012.


\textsuperscript{173} September 2009 – September 2010.

\textsuperscript{174} *Personal Current Accounts in the UK: progress report* paragraph 2.11.

\textsuperscript{175} Bacs response submitted to the OFT.

\textsuperscript{176} These PCA providers hold just under 48 million PCAs between them, compared to over 76 million accounts in the UK.
2012 consumer survey also showed that 62 per cent of those who switched their current account in the last 12 months used the switching service of the PCA provider they were switching to, compared to 51 per cent in 2008. This increase in use of the automated switching system might suggest a greater awareness of the switching process.\footnote{177}

6.26 Despite evidence that consumers are accessing this information, and that there has been an increase in the use of the automated switching process by consumers, consumers’ overall knowledge of the switching process has not significantly improved. In 2008, the OFT’s consumer survey\footnote{178} found that 41 per cent of respondents knew at least a little about switching. In 2012, the OFT’s consumer survey found that this figure was 45 per cent.

Reduce problems encountered by consumers when switching

6.27 The Bacs Switching Working Group sought to reduce problems encountered by consumers when using the automated switching system. As mentioned above, consumers who used the automated switching system were more likely to report experiencing problems than those who managed the process themselves.

6.28 The OFT’s 2010 progress report indicated that Bacs had found evidence to suggest that there had been a reduction in misplaced Direct Debits, with the number of Direct Debits being send to the old PCA following a switch falling by 20 per cent between September 2009 and June 2010.\footnote{179} Furthermore, having repeated their consumer survey in 2010, Bacs reported a decline in the proportion of switchers experiencing problems from 32 per cent in 2007 to eight per cent in 2010, and an

\footnote{177} The increase in usage of this service may also be due to the improvements in the performance of the service following the 2009 switching initiatives.

\footnote{178} Carried out by Ipsos/MORI for the OFT.

\footnote{179} However there was a slight increase in the number of misplaced Direct Debits by the OFT’s 2011 progress update. See Personal Current Accounts in the UK: progress report paragraph 2.7 and Personal Current Accounts in the UK: progress update paragraph 1.7. In January 2011 8.5 per cent of Direct Debits were misplaced compared to 7.6 per cent in June 2010.
increase in satisfaction in the process from 78 per cent in 2007 to 85 per cent in 2010.\textsuperscript{180}

6.29 Updated figures from Bacs provide evidence of a further decrease in misplaced Direct Debits, with an annualised average of 7.2 per cent of Direct Debits sent to the old PCA provider in 2012 compared to 8.3 per cent in 2010, and 10.1 per cent in 2008.\textsuperscript{181} This improvement has been achieved alongside the reported increase in switching requests through the PCA provider’s automated switching system.

6.30 The OFT’s 2012 consumer survey asked all switchers\textsuperscript{182} whether they had experienced any problems with their switch. In contrast to the trend reported by Bacs, our survey indicated that the number of consumers encountering problems remained broadly unchanged when compared to our 2008 survey, although there was a significant reduction in the number of problems relating to standing orders, as can be seen in Table 6.1 below.\textsuperscript{183}

\textsuperscript{180} *Personal Current Accounts in the UK: progress report* paragraph 2.9. Bacs repeated research originally carried out in 2007 to measure the incidence of problems which switching accounts.

\textsuperscript{181} Bacs submission to the OFT. For the first seven months of 2012 the annualised average percentage stood at seven per cent.

\textsuperscript{182} ‘All switchers’ includes switchers who used the automated switching service and those who switched their PCA manually.

\textsuperscript{183} It is inherently difficult to compare surveys across time periods. The OFT used a different definition of switching a PCA for its 2012 consumer survey to ensure the information we report only covered consumers that had completed a switch of their main PCA. Therefore, some inconsistency in the data collected may be expected between the OFT’s 2008 and 2012 surveys. In addition, seeking to compare surveys carried out for the OFT and those carried out for Bacs is complex and we do not have sufficient information pertaining to the Bacs survey to be able to consider whether or not these surveys asked comparable questions in comparable ways of comparable groups of consumers. We also note that some data used by Bacs considers individual transactions being misplaced, rather than data per consumer. For these reasons, we do not consider it appropriate to draw clear conclusions in this area.
Table 6.1 – Problems in the switching process

<table>
<thead>
<tr>
<th>Did you experience problems when switching?</th>
<th>2008</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transferring/moving Direct Debits</td>
<td>27%</td>
<td>25%</td>
</tr>
<tr>
<td>Transferring/Moving Standing orders</td>
<td>15%</td>
<td>6%</td>
</tr>
<tr>
<td>No - didn’t have any problem</td>
<td>65%</td>
<td>63%</td>
</tr>
</tbody>
</table>

Source: OFT 2008 and 2012 consumer surveys

Note: Based on consumers that reported having switched their accounts in the last 12 months

6.31 While problems are still occurring, they were often resolved, at least partially, by their provider. According to the 2012 consumer survey, 66 per cent of respondents who said they had raised the problem(s) with their bank reported that they were all resolved to their satisfaction. A further 10 per cent reported some of the problems were resolved.184

6.32 In addition, 81 per cent of consumers who reported that they’d switched account in the previous 12 months found the process very or fairly easy,185 similar to 2008.186 While those who had experienced a problem were less likely to say the process had been easy, 66 per cent of switchers who had experienced a problem, still found the process to be very or fairly easy, as shown in Figure 6.3 below.

184 Further, research undertaken by the Payments Council indicated that in 2012 consumer satisfaction rates for consumers who had switched their PCAs through their banks’ automated system was 77 per cent.
185 Thirty-nine per cent said very easy; 43 per cent fairly easy.
186 OFT 2008 consumer survey; 75 per cent of consumers that said they had switched in the last 12 months.
Figure 6.3: How easy did consumers find the switching process?

Source: OFT consumer survey 2012.
Base: Those that said they had switched their account in the last 12 months.

Reduce the fear of the switching process

6.33 It was the OFT’s view that by seeking to increase awareness and reducing the occurrence of problems with the switching process, the perception of the switching process among consumers would improve. While there has been some increase in awareness of the switching process, in particular the current automated system, the perception that switching is problematic remains.

6.34 Our 2012 survey found that 41 per cent of consumers who had never switched were either not very or not at all confident that the switching process would go smoothly.\(^{187}\) This is similar to the 2008 market study where 45 per cent of non-switchers were not confident about the process.\(^{188}\) In addition, out of the respondents to the 2012 consumer

\(^{187}\) 25 per cent were not very confident and 16 per cent were not at all confident.

\(^{188}\) 32 per cent were not very confident and 13 per cent were not at all confident.
survey who had considered switching but had not switched, the most common reason for not switching was a concern that it would be too complicated (21 per cent).\textsuperscript{189}

6.35 The majority of consumers who have switched their PCA, however, would recommend switching to others, even when they have reported problems. The consumer survey found that 73 per cent of respondents who had switched their PCA were likely to recommend switching with only 16 per cent being unlikely or fairly unlikely to recommend switching to others.\textsuperscript{190} While those who did experience a problem were less likely to recommend switching than those who did not have any issues, the majority were still very or fairly likely to recommend it (see Figure 6.4 below).

\textsuperscript{189} OFT consumer survey 2012. Other reasons included no visible advantages/benefits, consumers being too busy/lazy to switch and a lack of confidence in the change.

\textsuperscript{190} OFT consumer survey 2012. Thirty-five per cent of switchers said they were ‘very likely’ to recommend switching, and 38 per cent said they would be ‘fairly likely’ to recommend switching to others.
Figure 6.4: Likelihood of recommending the switching process

Source: OFT consumer survey 2012.
Base: Those that said they had switched their account in the last 12 months.

6.36 This evidence indicates that the consumers who switch generally have a positive experience and find the process easy. However, the OFT and Bacs Switching Working Group initiatives have not succeeded in having an impact upon the general perception among consumers that the switching process is difficult and that problems will occur. It is hoped that the new switching service, recommended by the ICB, and due to start in September 2013, will have a greater impact in this area, particularly if the services is extensively promoted, as expected, by providers and the Payments Council.

What prompts consumers to switch?

6.37 Consumers still appear reluctant to switch their PCA. Indeed, we found that 75 per cent of respondents had never switched their PCA, and of
these, 75 per cent had not even considered switching. As illustrated by Figure 6.5 below, respondents cited a number of reasons for never switching. Although satisfaction with the current provider is the most commonly given reason for not switching, the responses suggest that a significant proportion of consumers are not satisfied with their current provider but do not switch.

**Figure 6.5: Top reasons cited for never switching current account provider**

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>I like my current provider/happy with current account</td>
<td>58%</td>
</tr>
<tr>
<td>Have never wanted to</td>
<td>16%</td>
</tr>
<tr>
<td>Never thought about it</td>
<td>10%</td>
</tr>
<tr>
<td>Too complicated</td>
<td>8%</td>
</tr>
<tr>
<td>No significant benefits to be gained by switching provider</td>
<td>7%</td>
</tr>
<tr>
<td>Too time consuming</td>
<td>6%</td>
</tr>
<tr>
<td>Too lazy / can’t be bothered</td>
<td>4%</td>
</tr>
<tr>
<td>Too much could go wrong</td>
<td>3%</td>
</tr>
<tr>
<td>I would have to rearrange other services</td>
<td>3%</td>
</tr>
</tbody>
</table>

**Source:** OFT consumer survey 2012.

**Note:** Base is those that said they have never switched account. Excludes ‘don’t know’, ‘other’ and any mentions with fewer than 30 counts. Data is based on a question to which multiple responses could be given.

6.38 Research by Quadrangle, a research agency commissioned by Lloyds Banking Group to understand how to encourage movement in the PCA

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191 The 2008 OFT consumer survey similarly found that 74 per cent of respondents had never considered switching.

192 See [www.quadrangle.com/flash.html](http://www.quadrangle.com/flash.html) for details.
market, found a similar reluctance to switch. Quadrangle’s report suggested that consumers have a different mindset in relation to switching PCAs compared to switching utilities: PCA customers have a higher brand attachment to their PCA provider, see little incentive to switch, and feel they cannot compare different products or benefits. The report characterised consumers in terms of their willingness to engage or switch their accounts, ranging from disengaged to high potentials, and suggested that different types of messaging were appropriate to these different groups.

6.39 The 2012 consumer survey showed that among consumers who had switched their PCAs, they were incentivised on a relatively even basis between the positive benefits of moving to a new provider and problems with the old supplier. These are referred to as pull and push factors respectively in Table 6.2 below. Those who had never switched, however, believed that they would be more incentivised by push factors such as receiving poor service/returns from their current PCA provider.

\(^{193}\) See Quadrangle research available from [www.quadrangle.com/flash.html](http://www.quadrangle.com/flash.html) and chapter 6 of this report.
### Table 6.2 – Factors that would prompt non-switchers to switch/factors that prompted switchers to switch

<table>
<thead>
<tr>
<th>Switching incentives</th>
<th>Never switched</th>
<th>Have switched</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PULL FACTORS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Better interest rate at different bank</td>
<td>23%</td>
<td>8%</td>
</tr>
<tr>
<td>Lower overdraft charges and fees at different bank</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>Cash incentives to join/switch to new account</td>
<td>3%</td>
<td>20%</td>
</tr>
<tr>
<td>Easy access to a local branch</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td><strong>PUSH FACTORS</strong></td>
<td>34%</td>
<td>38%</td>
</tr>
<tr>
<td>Errors/problems with operation of present current account</td>
<td>13%</td>
<td>14%</td>
</tr>
<tr>
<td>Overdraft charges and fees at current bank account are too high</td>
<td>8%</td>
<td>12%</td>
</tr>
<tr>
<td>Poor branch opening hours/service at your current bank</td>
<td>7%</td>
<td>5%</td>
</tr>
<tr>
<td>Poor interest rate on your main current account</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>Negative comment/recommendation about present current account</td>
<td>1%</td>
<td>5%</td>
</tr>
</tbody>
</table>

**Source:** OFT consumer survey 2012.

**Base:** All switchers in past 12 months, covering the first reason given by respondents.

### Potential impact of the new switching service

6.40 All major PCA providers \(^{194}\) have signed up to the new switching service. Despite this wide take up, for the new system to have a tangible affect on the PCA market, the funding of the new switching service should not impose any disproportionate costs on new entrants or smaller providers. Consumers will also need to be made aware of its existence and trust that it will significantly improve the switching process.

6.41 The new switching service was designed to overcome one of the significant barriers to entry and expansion in this market - the difficulty

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\(^{194}\) Some smaller PCA providers will review implementation of the new switching service before deciding to sign up at a later date
in overcoming consumer inertia and concerns around switching provider. It would be a significant concern to the OFT if the responsibility for contributing to the fees in the new switching service, as determined by the Payments Council and the existing PCA providers, were to act as a further barrier to entry and expansion.

6.42 The OFT is aware that Tesco Bank has raised concerns with the Parliamentary Commission on Banking Standards concerning this issue. In its submission to the Commission it noted that:

‘The ICB and government have been clear that CASS [the new switching service] must be 'be [sic] designed and implemented in such a way that does not impose disproportionate costs on new entrant banks, smaller players or direct debit originators’ and that the service should be free for customers. It is our view that current switching fee proposals jeopardise these objectives by creating an additional barrier to success for new entrants, which threatens to undermine the consumer benefits of CASS.’

6.43 To that end, the OFT would have concerns over fees from this service being borne wholly by the new bank unless a very clear justification for this approach can be provided that takes into account the impact of this approach on competition in the market and barriers to entry. This is because such fees may represent a disproportionate burden on new firms entering the PCA market, or small existing providers seeking to expand significantly through the use of the new switching service. It is possible that the level of the proposed switching fee may impact on the business case for new firms to enter the market using the new switching service. This may lead to potential entrants seeking to enter without using the new switching service, or finding that entry is too costly and challenging.

6.44 In relation to advertising the new switching service, the Payments Council will be working with participating PCA providers to plan a

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significant advertising campaign in 2013 and 2014, so that the existence of the new service and what is offered will be widely advertised to consumers. Further, Bacs will be working with PCA providers to develop best practice guidelines for managing the consumer experience and ensure customer-facing staff are trained to promote the service.

6.45 Our consumer survey also looked to assess the potential impact of the new service. We found that out of those consumers who have never changed their PCA, 28 per cent\textsuperscript{196} agreed that the description of the new system would make them more likely to consider switching, with only four per cent\textsuperscript{197} saying that the new system would make them less likely to switch. Further, out of those who have switched in the past, 36 per cent\textsuperscript{198} said that they would be more likely to switch following the introduction of the new switching service. The Quadrangle survey also found that half of the consumers that it had asked viewed the introduction of the new switching service positively, and believed it would improve consumer confidence in the switching process.\textsuperscript{199}

6.46 The OFT, therefore, considers that the new switching service could have a significant impact on the number of problems being encountered and it is possible that this may also affect consumers’ propensity to switch, as well as improve the wider perception of the switching process.

6.47 In addition to ongoing monitoring to ensure that any problems are dealt with promptly, the OFT recommends that the Financial Conduct Authority or the Competition and Markets Authority carry out a review of the effectiveness of the new switching service once this has been in place for at least 15 months. As well as establishing that the system

\textsuperscript{196} Ten per cent of consumers said that they would be much more likely to switch under the new system, with 18 per cent stating that they would be ‘somewhat more likely’.

\textsuperscript{197} Comprising two per cent said they would be ‘much less likely’ to switch and two per cent ‘somewhat less likely’.

\textsuperscript{198} Twenty per cent of consumers who have switched said that they would be ‘much more likely’ to switch under the new system, with 16 per cent stating that they would be ‘somewhat more likely’.

\textsuperscript{199} Quadrangle research, page 41.
functions as expected, we anticipate that such a review would consider consumer interest and confidence in the system, and whether it results in consumers being more willing to switch when they are dissatisfied with their existing bank.

**Portable account numbers**

6.48 The ICB report noted that some consumer groups were keen to see the introduction of account number portability. The ICB stated that the new switching service would be a cost-effective first step but recommended that if it does not deliver enough of an increase in willingness to switch to lead to effective competitive tension, that account number portability should be actively considered. 200 The Government’s response to the ICB’s report supported this stance, making clear that if the new system does not deliver the expected consumer benefits the Government will consider more radical alternatives, including full account number portability. 201

6.49 The OFT notes that there has been little consideration of the feasibility of the introduction of account number portability and the benefits it might bring to consumers, beyond those which may be gained from the new switching service. Similarly, there has been no consideration of whether the potential cost would be proportionate to the potential benefits. The Payments Council stated in its submission to the OFT that while at a superficial level account number portability is appealing, the implementation would be complex, carry an unreasonable degree of risk and would come at a significant cost – which would be ultimately passed on to consumers. 202

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200 *ICB report*, paragraphs 8.48, 8.60.

201 See *Banking reform: delivering stability and supporting a sustainable economy* paragraph 4.15.

202 The Payments Council has said full account number portability could take up to a decade to implement, would require a complete redesign of UK payment systems, and risks rendering the UK system incompatible with some international payment systems. See [www.paymentscouncil.org.uk/current_projects/account_switching/account_number_portability](http://www.paymentscouncil.org.uk/current_projects/account_switching/account_number_portability)
6.50 Despite the recommendation from the ICB report and the Government response, and progress towards the start of the new switching service, a number of consumer organisations and other commentators have continued to call for portable account numbers to be introduced. The OFT does not believe that the case for this is clear, and we agree with the ICB and the Government that it is more appropriate to first consider the impact of the new switching service.

6.51 The OFT expects that arguments concerning the viability of portable account numbers will continue at least until a clear indication of the cost of this measure can be determined and the success of the new switching service can be seen. Consequently, the OFT considers that by the time that results of the FCA/CMA review of the new switching service is available, there should also be results of research into the cost of account number portability. Therefore, the OFT recommends that the Payments Council undertake research into the costs of bank account number portability. This would allow the impact of the new switching service to be evaluated together with any additional options to further develop the switching process.
7 TRANSPARENCY OF COST

7.1 A competitive PCA market is one in which consumers make informed choices about which provider and product is best for them, use those products efficiently and switch to better providers when they identify them. In order to do so consumers need to understand the costs of using their PCAs and how these compare with products offered by other providers.

7.2 This chapter reviews the OFT’s work aimed at improving the transparency of pricing information available to consumers. Following the findings in its 2008 market study, the major PCA providers\(^{203}\) agreed to provide their customers with enhanced information on their monthly statements, introduce annual summaries and provide illustrative charging scenarios on their websites. This chapter surveys the implementation and impact of these initiatives and reviews consumers’ general awareness of their PCA’s costs.

7.3 The key findings from this review concerning transparency are that, while the majority of PCA providers have been providing their customers with enhanced information on monthly statements and illustrative charging scenarios, the roll-out of annual summaries has been disappointingly slow. While it is too early to fully assess the impact of these initiatives, early indications are that consumers find this information helpful. However, there is more that could be done to increase the impact of these measures. In light of this, the OFT makes a number of recommendations to increase the impact of the existing transparency initiatives.

\(^{203}\) The major PCA providers in Great Britain refers to Barclays, HSBC, Lloyds Banking Group, National Australia Group Europe (which includes Clydesdale Bank and Yorkshire Bank), Nationwide Building Society, Royal Bank of Scotland Group (excluding Ulster Bank) and Santander UK.
Findings from OFT’s 2008 market study

7.4 The OFT’s 2008 market study found that consumers had low levels of awareness and understanding of the costs associated with their current account, often seeing it as a free product. As a result, consumers were poorly placed to make informed choices as to the type of account most suited to them, determine how to make efficient use of their account and assess whether it was in their interest to switch to a different provider.

7.5 The 2008 market study found a particular lack of awareness of charges for unarranged overdrafts. For example,204

- 25 per cent of respondents that had been charged in the past 12 months said they did not know what their bank charges were
- 67 per cent of all respondents to the survey said they did not know what their bank charged for entering unarranged overdraft
- 22 per cent of respondents who had been charged in the last 12 months said they did not know about unarranged overdraft charges before they incurred one.

7.6 Another key cost to consumers is interest foregone. This is the difference between what a consumer earns in credit interest from their current account and what they could earn holding the same money in a savings account or a current account with a higher interest rate. It is the opportunity cost of holding credit balances in a PCA.205

7.7 While many consumers appeared to understand the concept of interest foregone, the 2008 market study found that they lacked the information they needed to assess this cost. Research conducted for the OFT revealed that the majority of the sample of customers surveyed under-

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204 ‘Personal current accounts in the UK - an OFT market study’, July 2008 (paragraph 4.75).

205 PCAs also have additional functionality over that offered by savings accounts.
estimated their average balance, some by 40 per cent or more.\(^{206}\) In addition, the survey found that 80 per cent of all respondents did not know their credit interest rate.\(^{207}\) The 2008 market study also found that nearly 90 per cent of accounts in 2006 received an annual rate of interest of less than 0.5 per cent at a time when the average Bank of England base rate was around 4.5 per cent.\(^{208}\)

7.8 The 2008 market study concluded that this lack of awareness and understanding of the cost elements associated with PCAs, together with consumers' reluctance to switch, resulted in consumers not actively searching for a new PCA provider as often as they should. This reduced incentives for PCA providers to be more efficient and to offer more competitive and innovative products.

Initiatives to improve transparency

7.9 In October 2009 the major PCA providers in Great Britain\(^{209}\) voluntarily agreed to implement a number of initiatives to increase the transparency of costs associated with PCAs. These were intended to help consumers:

- better understand the costs of their PCA, enabling them to make informed choices about how to use their existing PCA more efficiently
- better understand the potential costs of other competing PCAs against the benefits offered, allowing them to assess which provider is the best one for them.

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\(^{206}\) This research was conducted by IPSOS MORI for the OFT, and asked 19 consumers to estimate their average monthly balance. This was then compared to their actual average monthly balance.

\(^{207}\) ‘Personal current accounts in the UK - an OFT market study’, July 2008 (paragraph 4.27).

\(^{208}\) ‘Personal current accounts in the UK - an OFT market study’, July 2008 (paragraph 4.16).

\(^{209}\) The major PCA providers in Great Britain refers to Barclays, HSBC, Lloyds Banking Group, National Australia Group Europe (which includes Clydesdale Bank and Yorkshire Bank), Nationwide Building Society, Royal Bank of Scotland Group (excluding Ulster Bank) and Santander UK.
Enhanced monthly information

7.10 The OFT recognised that much of the information that consumers need in order to make informed decisions about their PCAs was already available to them via their monthly statements. However, this information was often provided with other information, making it difficult to distinguish. For example, unarranged overdraft charges were usually recorded in the body of a statement where they could get lost among other transactions.

7.11 The OFT therefore considered that key information on PCA costs should be summarised and/or highlighted where possible. In response, PCA providers agreed to make the key costs of the PCA more prominent (for example in a summary box). This information would include: 210

- **unarranged overdraft charges**: the total value and number of charges incurred by the consumer in that period, together with a breakdown by the type of charge (for example, whether it is an unpaid item charge, a paid item charge, a guaranteed paid item charge or any other similar charges incurred in that period)

- **monthly/periodic management fees**: the total value of any regular fees associated with the normal running of an account, for example fees for operating a packaged or premium account

- **value of debit interest**: the total amount of interest that has been deducted from the consumer’s account (at each of the applicable rates for arranged and unarranged overdrafts) in the relevant period

- **value of credit interest**: the total amount of interest that has been added to the consumer’s account in the relevant period

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• information on debit and credit interest rates and the consumer’s average credit and debit balances: these are discussed separately below.

7.12 The OFT intended that the enhanced monthly statements would prompt consumers to manage their accounts better. For example, a clear total and breakdown of charges in summary form would bring account costs to the fore and might result in some consumers taking action to avoid unarranged overdraft charges in the future. Likewise better information on average credit balances might prompt consumers to transfer excess balances into a savings account.

7.13 Additionally, it was intended that some consumers (such as those who had incurred high unarranged overdraft charges) would see this as a prompt to consider switching to a more appropriate PCA. Highlighting the various charges was expected to help consumers identify the information they needed to obtain on different accounts in order to make comparisons.

Annual summaries

7.14 Annual summaries were designed to provide an easy to understand outline of the charges and interest rates that had been applied to a consumer’s PCA in the previous 12 months. This information was intended to help consumers focus their attention on the costs they were incurring and provide customer specific information that could assist with making comparisons with other PCAs. The OFT also hoped that the receipt of the summary would provide something akin to a natural break point for a PCA contract, which is currently not available.211

7.15 Annual summaries were also envisaged to be complementary to the enhanced monthly statements, by allowing the consumer to take a

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211 With some other financial products like car and house insurance, contracts usually last a finite period, for example a year, prompting consumers to search annually for a better product.
longer term view on the costs incurred in using their PCA. In particular, the annual summary would contain a total cost figure for the year, which we believed would be more likely to prompt consumers into taking action than the smaller, regular monthly figures on the enhanced monthly statements.

7.16 The annual summaries include the following information:\textsuperscript{212}

- any regular account charge (for example, monthly charge for maintaining the PCA) payable when the PCA is in credit

- any transaction charges (for example, for setting up a standing order) payable when the PCA is in credit

- credit interest

- arranged overdraft:
  - debit interest
  - annual or monthly maintenance charges, and other relevant charges

- unarranged overdraft:
  - debit interest
  - maintenance charges

\textsuperscript{212} Two options for providing annual summaries were discussed with PCA providers. The first was to provide the same information as was required by the Competition Commission for the Northern Ireland PCA providers. The second was an alternative version which contained some additional information on the number of charges incurred and a breakdown of charges by type. Having listened to concerns from some the PCA providers about providing a different summary for consumers in Great Britain from the one that had already been required for Northern Ireland, we considered that either version of the summary would be acceptable, and the version selected is consistent with that provided in Northern Ireland.
transaction charges (for example, referral or unpaid charges),
and other relevant associated charges (for example, letters to
consumers).

7.17 The summary was also to include an explanation of the level and
application of all those charges included on the statement.

**Average credit and debit balances**

7.18 The 2008 market study found that only seven per cent of consumers
saw interest rates as important when choosing a PCA.\(^{213}\) Furthermore,
35 per cent of active accounts (nearly 20 million accounts) had an
average daily balance when in credit of over £1,000, with nearly eight
per cent (four million accounts) holding an average balance of more than
£5,000.\(^{214}\) This suggested that consumers were under-estimating the
benefits of moving to a PCA with a better credit interest rate or
transferring excess funds into a savings account that paid a higher rate
of interest.

7.19 As discussed earlier in this chapter, consumers holding a positive
balance in a PCA may be able to earn a higher rate of interest by moving
some funds to a savings account or switching their current account. An
understanding of and ability to assess this interest foregone as a cost of
a PCA might help consumers understand the potential benefits of
switching providers or to manage their credit balances more efficiently.

7.20 At the time of the 2008 market study the OFT did not look to include
information on interest foregone in the enhanced monthly statements or
annual summaries. This was due to uncertainty over how interest
foregone would be calculated and whether consumers would understand
and utilise this information. In addition, it was not considered a priority
given the low interest rates prevailing at that time.

\(^{213}\) ‘Personal current accounts in the UK - an OFT market study’, July 2008 (Chart 4.1).
\(^{214}\) ‘Personal current accounts in the UK - an OFT market study’, July 2008 (paragraph 4.14).
7.21 The OFT considered instead that it was more appropriate to provide information on both the consumer’s credit interest rate and their average credit balance on the annual summaries and/or enhanced monthly statements. This would enable consumers to estimate how much extra interest they would receive by moving to a PCA which offered a higher credit interest rate, or by moving some of their money into a savings account. An on-line calculator for credit interest was also provided to help consumers.

7.22 Similarly, the OFT considered it appropriate to provide information on average debit balances. This would allow consumers to judge how much less interest they would be charged if they switched to a PCA with a more competitive debit interest rate.

7.23 All major PCA providers\textsuperscript{215} volunteered to provide each consumer with their average credit balance or average debit balance, or both if some time was spent in both credit and debit. The average credit balance is the sum of the closing balances for those days that the consumer was in credit divided by the total number of days in the statement period. Average debit balances are calculated in the same way for those days in debit.

7.24 Major PCA providers also agreed to provide information on debit and credit interest rates. These include any rates which are currently, or could be, applied to the account (so, for example, the overdraft interest rates would be provided even if a consumer had not gone into overdraft). The OFT considered this information to be key to providing a comprehensive picture of the costs and benefits of operating a PCA. Although information on interest rates was available on websites and leaflets, including this information on regular statements was expected to encourage consumers to consider switching by making it quicker and easier to assess costs.

\textsuperscript{215} Except Barclays who do not provide information on credit interest rate where there is no credit interest payable.
7.25 It was agreed that information on average balances and interest rates would be provided as part of either the annual summary, or the enhanced monthly statements.

Charging scenarios

7.26 As highlighted, the 2008 market study found that consumers were not familiar with key charges associated with their account. For those customers who pay unarranged overdraft charges (around 23 per cent of all account holders in 2006),\textsuperscript{216} this lack of knowledge of costs might have led to them being poorly placed to assess their PCA’s value for money and the potential gains from switching. Furthermore, consumers’ ability to act as a competitive constraint on the level of unarranged overdraft charges was diminished by the difficulty of making comparisons across PCA providers.

7.27 The PCA providers agreed to provide information on how much their PCAs would cost in each of a series of scenarios involving transactions that result in consumers using unarranged overdrafts. The scenarios differed according to the number of days overdrawn and the number and value of transactions. While some of these were designed to be reasonably representative of common ways that consumers might use an unarranged overdraft, others showed more extreme examples to illustrate how differing behaviour affected the level of charges.

7.28 The scenarios\textsuperscript{217} are as follows:

- **Scenario 1**: provider refuses a payment from your account because there is not enough money in your account.

- **Scenario 2**: a payment from your account takes you into an unarranged overdraft by less than £10. You are overdrawn for one day during the month.

\textsuperscript{216} ‘Personal current accounts in the UK - an OFT market study’, July 2008 (Chart 4.7).

\textsuperscript{217} The scenarios were made available on PCA providers’ websites from June 2010. These scenarios were finalised following the publication of the 2009 report.
• **Scenario 3**: a payment from your account takes you into an unarranged overdraft and you make another payment from the account while you are overdrawn. You are overdrawn for two days in a row during the month.

• **Scenario 4**: a payment from your account takes you into an unarranged overdraft, and you make nine more payments from the account while you are overdrawn. You are overdrawn for 10 days in a row during the month.

• **Scenario 5**: a payment from your account takes you into an unarranged overdraft. You are overdrawn for one day. However, on three more occasions during the month, a payment takes you into an unarranged overdraft. On each of these occasions you are overdrawn for three days in a row.

• **Scenario 6**: a payment from your account takes you into an unarranged overdraft. You are overdrawn for 21 days in a row during the month and you make 12 more payments from the account while you are overdrawn.

7.29 The scenarios were intended to illustrate to consumers how different patterns of usage affected the level of charges in each PCAs. While these scenarios were not intended to enable consumers directly to identify the PCA that was the best for them (given the sensitivity of charges to specific patterns of usage), the aim was to provide some initial comparisons that were likely to be helpful to consumers.
Information to help consumers choose PCAs

7.30 Research\textsuperscript{218} conducted for the OFT’s 2009 report found that some consumers had little knowledge of what information they needed in order for them to take full advantage of greater transparency in the PCA market. With this in mind the OFT made the following tools available on the Consumer Direct website:

- A page of advice on PCAs covering what they are, what they do, and what to look out for.\textsuperscript{219}

- A list of key questions that consumers should ask of PCA providers before taking out a PCA including questions on the benefits that a PCA offers and the key costs of the PCA.\textsuperscript{220}

- A comparison sheet\textsuperscript{221} of key PCA features to help consumers choose the right PCA for their needs.

- An on-line calculator\textsuperscript{222} of credit interest which allows consumers to compare the amount of interest they are currently earning with the amount of interest they would be earning with a different account.

\textsuperscript{218} This research was carried out for the OFT by Carol Goldstone Associates. A small sample of consumers were asked about the information needed to understand and compare the services offered by PCA providers, and how they would like such information to be provided.


\textsuperscript{220} See: \url{http://webarchive.nationalarchives.gov.uk/20120117142610} and \url{http://moneyadviceservice.org.uk/yourmoney/free_printed_guides/default.aspx} for details.

\textsuperscript{221} See \url{http://webarchive.nationalarchives.gov.uk/20120117142610/http://moneyadviceservice.org.uk/yourmoney/everyday_money/default.aspx} for details.

Impartial price comparison website for PCAs

7.31 OFT research in 2009 also showed that existing price comparison sites that covered PCAs did not allow consumers to sort by important features such as the total cost. This research also provided support for an impartial price comparison website run by an organisation with no financial interest in the consumer's choice.

7.32 The OFT considered that a practical way of achieving this would be for the FSA to introduce a price comparison website for PCAs as part of its Money Made Clear website. The OFT considered that there were a number of benefits associated with an FSA-run price comparison website:

- consumers would recognise and trust the FSA brand
- an FSA site would allow consumers to list products in order of cost, taking into account factors like arranged overdraft charges.

7.33 In its October 2009 report, the OFT indicated that the FSA would conduct a feasibility study on the introduction of a PCA comparison section on its Money Made Clear website to help consumers understand and compare PCAs. In April 2010, responsibility for helping consumers understand their finances better was passed to the Consumer Financial Education Body (CFEB). In April 2011 CFEB was renamed the Money Advice Service.

ICB recommendations

7.34 The ICB report,\(^\text{223}\) published in September 2011, found that transparency and comparability of PCAs are crucial counterparts to improving the switching process. Improving the technicalities of switching alone would not lead to an increase in competition unless customers could identify the best provider to switch to.

\(^{223}\) See [www.hm-treasury.gov.uk/fin_stability_regreform_icb.htm](http://www.hm-treasury.gov.uk/fin_stability_regreform_icb.htm) for details.
7.35 The ICB recommended that the OFT and the Financial Conduct Authority (FCA)\textsuperscript{224} work with PCA providers to improve transparency across all retail banking products. In particular, the ICB recommended that:

- Interest foregone relative to the Bank of England base rate should be incorporated into the annual statements as soon as possible, and no later than January 2013. Furthermore, the FCA should carry out customer research to identify the best way to present interest foregone on bank statements, and should require PCA providers to provide this information in the standardised way it identified.\textsuperscript{225}

7.36 In addition, once the OFT’s transparency remedies have been implemented, the ICB recommended that the FCA consider the following options for improving transparency further:\textsuperscript{226}

- PCA providers should provide full account usage information from at least the previous 12 months in electronic form. This would allow the development of price comparison models that could identify the optimal current account based on the customer’s actual transaction history.

- Create a price comparison tool to assess the key features of current accounts and show which had the lowest annual cost for a customer with a particular set of characteristics. This could provide a template for private sector providers to improve their service in this area. As price comparison sites gain prominence in consumer decision making in financial areas, the FCA should consider a code of practice or a kite-mark scheme to ensure that these sites are providing independent objective advice to consumers.

- Develop comparison tools to take into account non-price characteristics of banking products. The FCA could develop a

\textsuperscript{224} The FCA was not in existence at the time of this recommendation. The FCA will replace some of the functions of the FSA from April 2013.

\textsuperscript{225} ICB Final report, September 2011 (Paragraph 8.72 and 8.73)

\textsuperscript{226} ICB Final report, September 2011 (paragraph 8.74)
standard questionnaire addressing non-price attributes of current account providers.  

Midata

7.37 The Midata project is part of the Government’s Consumer Empowerment Strategy. It is a voluntary programme between the Government, UK businesses and industry groups to give consumers increased access to their personal data in a portable, electronic format. The aim is for individuals to be able to use this data to make more informed choices about products and services, and to manage their financial lives more efficiently.

7.38 Following a consultation in 2012, the Government announced that it would put in law a reserve power to regulate Midata in the future, if the current voluntary approach failed to deliver the envisaged changes.

Simplified overdraft terminology

7.39 In light of concerns over the transparency and comparability of overdraft fees, a number of the largest PCA providers have agreed to introduce standardised wording to describe different types of overdraft charges.

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227 One tool in this area is being developed by Fair Banking, who provided evidence to the Commission on their research to develop a kite-mark indicator for banking products that contribute to ‘financial well-being’.

228 See www.bis.gov.uk/policies/consumer-issues/consumer-empowerment for details.

229 This regulation would compel businesses to provide personal transaction data to individual consumers, in an electronic machine readable format, upon request. The regulation would be focused on three ‘core’ sectors (PCAs and credit cards, mobile phones and energy) with a view to extending to others if appropriate.

230 Lloyds Banking Group, RBS, HSBC, Barclays, Santander, Nationwide and Northern Bank.

231 The revised terms will be:

- overdraft interest (also described as arranged overdraft interest and unarranged overdraft interest where a firm sets different rates for arranged and unarranged overdrafts)
- overdraft set up fee
- overdraft renewal fee
- overdraft usage fee (also described as arranged overdraft usage fee and unarranged overdraft usage fee where a firm sets different fees for arranged and unarranged overdrafts), and
These revised terms were defined to increase clarity for consumers and make it easier for them to compare costs across different PCA providers’ products. This terminology is due to be used from September 2013.

Implementation and impact of transparency initiatives

7.40 This section provides an update on implementation of the transparency measures agreed with PCA providers, and an assessment of their impact on consumers to date. To understand the impact of these measures, the OFT carried out a survey of 1,752 current account users across the UK. A key aim of the survey was to gather evidence on the levels of awareness of PCA costs and how useful consumers found the additional information. Further details of this survey can be found in Annexes A, B and C to this report. PCA providers also supplied the OFT with information on the roll out of transparency measures and, where appropriate, feedback provided by consumers.

Enhanced monthly information

7.41 Major PCA providers committed to provide enhanced information to all their customers on monthly statements by the end of 2011. The OFT is pleased that all major PCA providers now provide enhanced information to their PCA customers. The OFT is also pleased that several PCA providers that were not part of the original initiative have also provided their customers with enhanced information on their monthly statements.

7.42 The OFT sought to assess the impact of the enhanced monthly statements through its consumer survey. As the survey was carried out over the telephone we were unable to show respondents examples of a standard statement and one with enhanced information. Instead, we asked respondents if their most recent statement contained any of the following information: the total value of any unarranged charges in the

- transaction fee also described as paid transaction fee and unpaid transaction fee where a firm sets different fees for paid and unpaid transactions.
last month; the total value of any regular fees associated with their account; total amount of interest added to the account in the last month; the total amount of interest deducted from the account in the last month; and the debit\textsuperscript{232} and credit interest rates.\textsuperscript{233} Indications that any of this information had been provided was used as a proxy for respondents having received an enhanced monthly statement.

7.43 Despite roll-out having been completed by PCA providers in 2011, the OFT’s consumer survey found that only 61 per cent of respondents said that their monthly statement included information on total charges and interest. This may be explained by the significant number of consumers that fail to engage with and read their statements in detail. In our survey, 21 per cent of respondents said they don’t check the details of their monthly statements on a regular basis.\textsuperscript{234}

7.44 Encouragingly, there are indications that receiving statements with additional information may increase knowledge or awareness of charges among certain groups of consumers. For example, among consumers that are usually or permanently overdrawn we found that 54 per cent of those that said their most recent statement contained information on total charges and interest knew how much they were charged (in terms of a fixed fee) for their arranged overdraft. In comparison however, a lower proportion, 32 per cent of those who said their most recent statement did not contain this additional information knew how much they were charged for their arranged overdraft. A similar pattern can be observed for unarranged overdrafts. Further information in relation to this issue is provided in Figure 7.1 below.

\textsuperscript{232} For example packaged or premium account fees.
\textsuperscript{233} This is the information that the enhanced monthly statements were intended to make more prominent. As noted in paragraph Annexe(s) 7.10 much of this information was previously provided but difficult to distinguish in the body of the statement. Values for the total amount of charges, fees and interest, and details of interest rates, are less likely to have been provided previously.
\textsuperscript{234} Of these, 17 per cent indicated they only read or check their statements occasionally and four per cent said they never read or check them.
Figure 7.1: Knowledge of account costs – those that are usually or permanently overdrawn

Source: 2012 PCA consumer survey.
Base: Respondents that are permanently or usually overdrawn with an overdraft that charges.

7.45 The OFT’s 2012 consumer survey also showed that receiving statements with additional information might be enabling customers to avoid charges, encourage comparisons and consider switching. Twenty four per cent of those who said they had received the information on total charges and interest on their most recent statement said that it was likely that they would do something different as a result. Of this, 59 per cent said they may consider managing their finances differently to avoid charges, 17 per cent might compare interest rates to see where they could gain more interest, and 13 per cent said that they might consider switching to another provider. Details of how consumers may act as a result of this information is shown in Figure 7.2 below.
Figure 7.2 – What consumers said they may do differently having seen the enhanced statements

【图形内容】

<table>
<thead>
<tr>
<th>Action</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>may consider managing my finances differently to avoid charges</td>
<td>59%</td>
</tr>
<tr>
<td>may compare interest rates to see where I could gain more interest</td>
<td>17%</td>
</tr>
<tr>
<td>may consider switching to another bank</td>
<td>13%</td>
</tr>
<tr>
<td>may consider switching to another type of PCA offered by my bank</td>
<td>6%</td>
</tr>
<tr>
<td>may compare how going overdrawn compares with other ways of borrowing</td>
<td>2%</td>
</tr>
</tbody>
</table>

Source: 2012 PCA consumer survey  
Base: All who are likely to do something different as a result of seeing additional information.

Annual summaries

7.46 In its September 2010 report, the OFT noted that major PCA providers had agreed to roll-out annual summaries to their customers by the end of 2011. Some providers did not achieve this timescale, and by the end of 2012, less than 60 per cent of consumers had received their annual summary. At the time of writing, the vast majority of major PCA providers had completed roll-out with the remaining consumers due to receive an annual summary by the middle of 2013. The OFT expected

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235 The OFT estimates, based on data submitted by PCA providers, that around 64 million annual summaries had been provided to consumers. This figure also includes annual summaries provided voluntarily by PCA providers that were not party to the original OFT initiatives. The OFT estimates (based on the total number of accounts in 2011) that annual summaries had been sent for around 83 per cent of all PCAs in the UK. Given the increasing trend in account numbers, this is likely to be an upper bound.

236 Santander has completed implementation of the annual summaries with customers due to receive the annual summaries on the anniversary of their account opening. By July 2013 all customers will have received their first annual summary.
information on average credit and debit balances to be included in either the annual summaries or enhanced monthly statements at the PCA provider’s discretion. This information has been provided in the annual summaries by all major PCA providers, with the exception of Nationwide.

7.47 The slow implementation of this initiative is disappointing. The OFT calls on PCA providers to be more customer focused in future and to deliver on agreed commitments within the time specified. The OFT is pleased, however, that (as with enhanced monthly statements) several PCA providers237 not subject to the original OFT initiative have started providing their customers with annual summaries.

7.48 While the OFT’s estimates suggest that around 58 per cent of PCA holders had received their annual summary, the OFT’s consumer survey showed that only 26 per cent of all respondents said they had received one. This discrepancy may be explained by the difficulty of getting some consumers to engage in detail with the information supplied by PCA providers, with some consumers not reading either statements or other materials from their bank as discussed in paragraphs 7.43 and 7.62 respectively.

7.49 Given the incomplete roll-out, the OFT is unable to assess the full impact of these summaries. However, results from the consumer survey suggest that annual summaries may help consumers. We found that 15 per cent of those that received an annual summary felt it helped a great deal in understanding the costs and benefits of their current account and 48 per cent felt it helped somewhat. However, 35 per cent found the summaries not to be helpful at all.

7.50 The OFT asked PCA providers if they had received feedback on annual summaries. Almost all major PCA providers stated that they considered it too early to assess feedback from customers. However, Lloyds Banking Group provided information from a consumer omnibus survey

237 Bank of Ireland, Allied Irish Bank (First Trust Bank), Northern Bank, Norwich & Peterborough Building Society, Cumberland Building Society, Citibank, Ulster Bank.
which indicated that two-thirds of respondents found the annual summary to be useful, and more than two thirds found it very or quite helpful in understanding the costs and benefits of their PCA.

7.51 The OFT has concerns over how the annual summaries are being made available to consumers in many cases. The majority of PCA providers send the annual summaries by post, and the OFT is aware that a number of consumers do not look at statements or other material sent by their PCA provider (as discussed in paragraphs 7.43 and 7.62). Therefore, some of these summaries could be missed or mistaken for promotional material. At present, few providers give consumers electronic access to annual summaries.

7.52 Given the encouraging feedback from customers that have seen annual summaries, and in order to maximise their potential to affect consumer behaviour, we believe these summaries should be available all year round. Consequently, the OFT recommends that PCA providers make annual summaries easily accessible throughout the year in both electronic and paper form.

7.53 The OFT has considered the different approaches to the annual summary taken by various PCA providers, with different levels of information on the summary, different presentation, formatting and length, as well as different explanations, with some providing detailed terms and conditions and others with much less information. Given the slow speed of roll-out of the annual summaries, the OFT is unable to assess the impact of these differences from the consumer survey. Therefore, the OFT will consider information provided in annual summaries and the impact of differences in the presentation of this information as part of its research on consumer decision making.

Illustrative charging scenarios

7.54 By the end of June 2010, the major PCA providers in Great Britain had published illustrative charging scenarios on their websites. Furthermore,
several PCA providers\textsuperscript{238} that were not part of the original commitment have also included charging scenarios on their websites.

7.55 In its September 2010 report, the OFT found that the charging scenarios were not always easy to locate. The OFT encouraged PCA providers to make the charging scenarios easier to find. Subsequently, the OFT has found an improvement, with the majority of PCA providers including a link to the charging scenarios under the interest and fees for current accounts section of their websites.

7.56 Data from the PCA providers indicated that there were 1.4 million unique\textsuperscript{239} views of the charging scenarios in 2011. While this is a small proportion of PCA customers, the OFT considers these scenarios are a valuable addition to the transparency of PCAs. It is possible that if interest in switching accounts increases over time they will be used more by consumers.

**Information to help consumers choose PCAs**

7.57 Information on PCAs was made available via the Consumer Direct website, including general advice on shopping around for a PCA\textsuperscript{240}. This information remained there until the Consumer Direct functions were taken over by Direct Gov in April 2011\textsuperscript{241}. At that point Direct Gov removed this material as it did not consider the information compatible with its remit of providing details of government services and information. The OFT has not sought an alternative site to host this material as it considers that it is more appropriate for the Money Advice Service to design and provide this type of consumer education material.

\textsuperscript{238} Co-operative Bank, Bank of Ireland, AIB (First Trust Bank), Metrobank, Northern Bank, Norwich & Peterborough, Leeds, Cumberland, Coventry, Citibank, Ulster.

\textsuperscript{239} The number of first time views of the page containing the scenarios. Where these pages contain additional information, it is possible that the charging scenarios were not read in detail.

\textsuperscript{240} See paragraph Annexe(s)7.30.

\textsuperscript{241} Direct Gov has subsequently been replaced by gov.uk.
Impartial price comparison website for PCAs

7.58 The OFT considers that price comparison websites can play a role in reducing the risk of people buying over-priced products and can help consumers get better deals. The OFT published a report in November 2012 to highlight how consumers can make the best use of price comparison websites. This follows an OFT review which found that while PCWs can help people get better deals, use of these sites can be held back by a lack of understanding, trust and confidence among some groups of consumers.

Current price comparison sites offer a service to consumers considering the costs of their PCA, but do not always allow consumers to list products in order of the total cost of the PCA. In addition, they do not present consumers with full and relevant information on the costs of PCAs or allow the use of personalised data to search for the most appropriate account for a consumer based on their previous or expected usage patterns.

7.59 The OFT considers that to be more useful, price comparison websites could evolve to allow consumers to list PCAs in order of the total cost, taking into account factors like interest rates and overdraft charges. In addition, they could do more to offer consumers the ability to insert personalised information from annual summaries.

7.60 One way of achieving this would be for the Money Advice Service to increase the functionality of its price comparison website and, if feasible, make it compatible with the Government’s midata project. The Money Advice Service is currently in the process of updating its price comparison website for PCAs. The OFT recommends that the Money Advice Service enhances its PCA price comparison website to enable more accurate and detailed comparisons across PCAs and providers based on a consumer’s own specific needs, and the OFT will assist the Money Advice Service with this.
General awareness of PCA costs

7.61 The OFT’s 2012 consumer survey found that consumers still have low levels of awareness when it comes to the cost of operating their PCA. For example:

- 71 per cent of respondents did not know how much they are charged (in terms of a fixed fee) for using their arranged overdraft
- 88 per cent did not know the debit interest rate for arranged overdrafts that is applied to their account
- 78 per cent of respondents did not know how much they are charged for using their unarranged overdraft
- 46 per cent did not know the debit interest rate for unarranged overdrafts.

7.62 Levels of awareness of overdraft costs were significantly higher for those who frequently used an overdraft, compared to those who never use one. Of greater concern is that knowledge levels among consumers who frequently use their overdraft are still low. For example, 45 per cent of respondents who reported being permanently overdrawn did not know how much they are charged in terms of a fixed fee for going into arranged overdraft\textsuperscript{243} and 48 per cent did not know how much they are charged for going into unarranged overdraft.\textsuperscript{244} In general, of those who did not know what the charges were, the majority said that they had most likely been provided with the information.

7.63 While OFT’s transparency initiatives have improved the availability of information on the key costs of using PCAs, there remains a significant challenge in getting consumers to take account of this information. According to the consumer survey, 47 per cent of respondents said they

\textsuperscript{243}2012 PCA Consumer Survey. Base: all those with an arranged overdraft.
\textsuperscript{244} 2012 PCA Consumer Survey. Base: all respondents.
only rarely or sometimes regularly read banking material, and 21 per cent of respondents said they do not check the details of their monthly statements on a regular basis.\textsuperscript{246}

7.64 The OFT’s 2012 consumer survey also showed that that those consumers whose accounts were usually overdrawn were less likely to check their account balances on a regular basis. As shown in Figure 7.3 below, 67 per cent of those who were never overdrawn read the statements they receive thoroughly compared to 39 per cent of those who said they were permanently overdrawn.

**Figure 7.3 – What consumers generally do with their bank statements**

![Bar chart showing percentage of consumers by account status and their actions with statements]

**Source:** 2012 PCA consumer survey.

\textsuperscript{245} 29 per cent rarely and 19 per cent never read material such as product information, interest rate change leaflets etc. Figures may not match due to rounding errors.

\textsuperscript{246} 17 per cent only read or check them occasionally and four per cent never read or check them.
7.65 There is a continuing lack of consumer engagement in the PCA market generally, which means that a significant number of consumers are still unaware of the key costs of running their account. We consider that there is scope to build on the existing transparency initiatives to help address this. In particular, as stated above, we intend to consider the information provided in annual summaries, and the impact of differences in the way it is presented, as part of research on consumer decision making through behavioural economics.

**Interest foregone**

7.66 As detailed in paragraph 7.35, the ICB recommended that interest foregone should be included as part of the annual summaries. In June 2012, HM Treasury published a White Paper\(^{247}\) on banking reform, in response to the ICB. In this, HM Treasury confirmed that the OFT would take forward the ICB’s recommendations on the inclusion of interest foregone in annual summaries.

7.67 The OFT and FSA held two joint roundtable discussions, one with consumer representative groups on 22 October 2012, and one with industry groups and PCA providers on 23 October 2012. The issues explored included whether consumers would find information on interest foregone useful, the practicalities of calculating interest foregone and the most effective way of presenting this information to consumers.

7.68 The roundtables highlighted that there are different measures of interest foregone that could be provided. One option would be to base the calculation on what a customer could have earned from switching to another PCA. This could provide an incentive to switch to a PCA with a higher credit interest rate. Another option would be to base the calculation on what a customer could have earned if they had instead deposited their funds in a savings product. This could give consumers an indication of the cost of the functionality of a PCA and, in some circumstances may prompt consumers to move unused positive balances.

\(^{247}\) See [www.hm-treasury.gov.uk/fin_stability_regreform_icb.htm](http://www.hm-treasury.gov.uk/fin_stability_regreform_icb.htm) for details.
into savings accounts. Another option would be to base the calculation on the revenue earned by PCA providers from the positive balances held in PCAs.

7.69 The type of information that is most useful may vary for different types of consumers. For example, customers with high balances to which they do not need ready access may be more interested in finding out how much interest they could gain by moving funds into a savings account, whereas for consumers with lower balances may benefit more from a comparison with other current accounts.

7.70 The roundtables also considered, as recommended by the ICB, using the Bank of England base rate to calculate interest foregone. However, the base rate can vary significantly from the interest rate offered on PCAs or savings accounts and may not be representative of what the consumer could earn elsewhere. In addition to considering the type of interest rate chosen (for example, based on savings account rates or credit interest rate on an alternative current accounts), a consideration is also needed of whether the rate chosen should be the highest available in the market, an industry average, a PCA provider-specific rate or an alternative measure.

7.71 Attendees at the roundtables had mixed views on whether consumers would understand interest foregone, noting that it would need to be presented with a clear explanation of its meaning. For example, there was a concern that it would be viewed as a fee levied by the bank, or an amount that would be credited to them. Consequently, there may be a need to provide a detailed explanation to consumers on the meaning of the measure in accompanying materials. This could include details of the methodology used, the nature of the comparison and what particular results might mean and how consumers may benefit from the information.

7.72 Another question raised was whether the provision of this information would be sufficient to prompt consumers into taking any action or to change behaviour. Providers noted that consumers keep funds in their PCA to meet short terms banking needs, and therefore may not be able
or willing to move these funds to a savings account. PCA providers were also concerned that the information could lead to unintended consequences. For example, if consumers did not leave sufficient funds in their current account to meet all their payment obligations, then they could incur overdraft charges. Additionally, consumers could be worse off if they were to transfer their money into a savings account which requires a notice period which restricts access to their funds or an alternative PCA with reduced functionality or a different charging structure.

7.73  The OFT considers that there may be benefits from providing consumers with information on interest foregone. However, due to the lack of consensus on this issue we consider that it would be helpful to get feedback directly from consumers on the options for presenting this information and the value of providing it. We consider that the best way of obtaining this feedback would be a small scale field trial as this would enable real-world response data to be gathered and compared with consumers who have not received this information.

7.74  We will also work with the industry to trial the provision of information to customers on interest foregone. Three providers have agreed, in principle, to participate in this trial, and we expect to carry out the trial later this year.
8 TRAVEL MONEY AND CARD USE ABROAD

8.1 The OFT received a super-complaint from Consumer Focus in September 2011 concerning the costs of obtaining foreign currency in the UK and the overseas use of credit and debit cards.\textsuperscript{248} The OFT published its response to this super-complaint in December 2011.\textsuperscript{249}

8.2 This chapter outlines the OFT’s work in relation to travel money and card use abroad. Before publishing its response to the super-complaint, the OFT agreed with PCA and travel money providers a number of initiatives to improve the market. The OFT also committed to monitor progress on implementing these initiatives during 2012. This chapter provides an update on the implementation of the various initiatives agreed and the outcomes of this monitoring.

8.3 We are pleased to report that there has been clear progress, with the majority of initiatives now implemented. While some remain outstanding, the OFT expects the majority of these to be implemented during 2013. We expect these initiatives to lead to significant benefits for consumers in the overseas use of credit and debit cards and in purchasing foreign currency in the UK.

The super-complaint and OFT’s response

8.4 In its super-complaint, Consumer Focus identified three features which it called on the OFT to investigate:

- The charges applied when using credit or debit cards abroad which it considered were complex, unclear and confusing and may prevent consumers from making well informed choices.


\textsuperscript{249} See \url{www.of.t.gov.uk/OFTwork/markets-work/super-complaints/travel-money} for details.
• The charges applied by some banks and credit card providers for purchases of foreign currency within the UK which it considered were unfair and may restrict competition and consumer choice.

• The use by some UK foreign currency retailers of phrases promising zero per cent commission and competitive exchange rates which it considered may mislead consumers and prevent them from shopping around.

8.5 Our analysis of the available evidence supported the first two of the three concerns set out above. The key findings from this analysis were as follows:

• Most consumers did not think (or were unaware) that a fee included in the exchange rate was applied to their card when using it abroad. Card providers typically used an exchange rate that had been adjusted to include an exchange rate fee which was in addition to other foreign use charges that may apply.

• Most card purchases of foreign currency in the UK were by debit card. We found that consumers were in general unaware of the practice by some banks of charging for use of debit cards to purchase foreign currency in the UK.

• On the marketing of foreign currency in the UK, we found that claims such as zero per cent commission and competitive exchange rates may in some cases be misleading. However, we considered that consumers were able to shop around effectively on the exchange rates offered.

8.6 In advance of publication of its response to the super-complaint, the OFT engaged closely with the industry and agreed a number of initiatives concerning the above three areas of concern. In relation to charges for the use of debit and credit cards abroad, the OFT secured the following:

• Consistent terminology for foreign use charges to be agreed across the industry.
- Improved presentation of foreign use charges in credit card and (to the extent they are already provided) personal current account summary boxes, making it clear where charges are cumulative.

- Changes to call centre processes, so that where the payment card provider requires or encourages them to do so, customers telephoning payment card providers in advance of travel\(^{250}\) will be asked whether they want an explanation of foreign use charges.

- Improvements to website travel pages, such as accessible links to foreign use charges, worked examples of how foreign use charges apply, and links to historic exchange rate information.

- All major payment card providers to break out and show the £sterling amount of the exchange rate fee on monthly statements.

- Annual statements to show the GBP amount of foreign use charges that have been applied, where these are shown on monthly statements.

8.7 In relation to charges for using a debit card to purchase foreign currency in the UK, the OFT secured voluntary agreements from all five banks that charge for debit card purchases of foreign currency in the UK to drop the charge entirely.\(^{251}\)

8.8 In relation to foreign currency bought in the UK, the OFT received agreements from most large foreign currency vendors in the UK to review and amend their advertising in light of the OFT’s concerns. Foreign currency vendors also agreed to improve the availability of exchange rate information on websites and provide greater clarity on the sales channels to which particular interest rates apply.

\(^{250}\) Some providers ask card holders to contact them before travelling so they know to expect foreign transactions on the account.

\(^{251}\) Visa has reminded its members of their obligations not to treat foreign currency sales by non-banks in a way that results in a charge to the card provider. Furthermore, Visa consulted its members on changes to the scheme rules such that foreign currency sales in the UK by banks may not be treated in a way that results in a charge to the issuing bank.
8.9 We found less evidence to support Consumer Focus’ argument that use of the phrase zero per cent commission misleads consumers into thinking that they cannot get a better deal elsewhere. Consumer Focus suggested that the phrase may mislead consumers because, ‘the difference between the buy and sell prices of foreign exchange is what we understand to be commission.’ We consider that the majority of consumers understand that the cost of purchasing foreign currency in the UK depends on the exchange rate offered and that the phrase zero per cent commission does not imply that the exchange rate is as favourable as it could be.

8.10 We also considered that there was scope for the Department for Business, Innovation and Skills (BIS) to consider expanding its Pricing Practices Guide to include specific advice in relation to sales of foreign currency.

**Progress to date**

8.11 The OFT expected many of these initiatives to be implemented during 2012, with the exception of initiatives aimed at providing greater information on statements, including a breakdown of charges, summary boxes and annual statements, which were intended to be implemented during 2012 and 2013.

8.12 At the time of writing, not all the agreed initiatives have been implemented, therefore this section presents the current picture on implementation and highlights when the remaining initiatives are likely to be implemented.

**Card use abroad**

8.13 Table 8.1 below shows the progress made by members of the British Banking Association and the UK Cards Association concerning the implementation of the six initiatives relating to using payment cards abroad.
Table 8.1 Progress on card use abroad initiatives

<table>
<thead>
<tr>
<th>Initiatives agreed</th>
<th>Progress to date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consistent terminology</td>
<td>Following work by the British Bankers Association and UK Cards during 2012 to agree consistent terminology, most providers were aiming to implement this by the end of 2012 in line with the OFT’s deadline for implementation. A small number of providers failed to meet the deadline and will be implementing this and updating terms and conditions during early 2013.</td>
</tr>
<tr>
<td>Call centre information on charges</td>
<td>Swift action by many of the key providers meant they implemented new scripts during 2012, with customers being offered an explanation of applicable charges when telephoning their bank as well as in branch. This is in line with the OFT’s deadline for implementation.</td>
</tr>
<tr>
<td>Travel websites and leaflets</td>
<td>Many providers have already improved their printed materials and travel page(s) on their websites, giving clearer and more accessible information regarding charges for using payment cards abroad. Examples of changes include illustrative scenarios, worked examples, cost illustrations for example transactions, as well as tabular information on costs and exchange rates. The remaining two providers have updated their websites and will be updating their printed materials in early 2013.</td>
</tr>
<tr>
<td>Breakdown of foreign charges</td>
<td>Providers are in the process of implementing this initiative. This is expected to be completed by the end of 2013 in line with the OFT’s expectation for this to be implemented during 2012 and 2013.</td>
</tr>
<tr>
<td>Summary boxes</td>
<td>Some providers have already made amendments to their summary boxes but the majority are aiming to complete this by end 2013, in line with the OFT’s expectation for this to be implemented during 2012 and 2013.</td>
</tr>
<tr>
<td>Annual statements</td>
<td>Providers that have already implemented summary boxes are aiming to roll out information on annual statements by 2013. Others are implementing summary boxes first and then amending statements, and consequently, aim to complete this by the end of 2013, in line with the OFT’s expectation for this to be implemented during 2012 and 2013.</td>
</tr>
</tbody>
</table>

Source: OFT questionnaire and stakeholder engagement during the review of the PCA market 2012

Debit card charges for purchasing foreign currency in the UK

8.14 All five banks\(^{252}\) that previously charged consumers for using a debit card to purchase foreign currency in the UK have ceased to apply this

\(^{252}\) Barclays, Co-operative Bank, Lloyds Banking Group, RBS and Santander.
charge in line with the OFT’s expectations for these charges to be phased out in 2012.

Advertising concerning purchases of foreign currency

8.15 All the foreign currency vendors that agreed with the OFT to amend their advertising materials to address concerns raised by the OFT have now done so. Some have stopped using the phrase zero per cent commission. Others have made amendments to provide more clarity surrounding particular phrases used, including conditions that apply to them. There have been useful improvements to the advertising of exchange rates, with greater upfront information on conditions relating to particular exchange rates. This has taken place in line with the OFT’s anticipated implementation period during 2012.

Pricing Practices Guide

8.16 The BIS pricing practices guide provides a set of good practice guidelines for traders in giving information about price, particularly in the context of the provisions of the Consumer Protection from Unfair Trading Regulations 2008.

8.17 In September 2012, BIS updated the guide\(^{253}\) to provide revised and additional information to providers of foreign exchange services to consumers. This included additional and updated material concerning the display of exchange rate information and information to provide on receipts, guidance relating to pricing indications in the Consumer Protection from Unfair Trading Regulations 2008 and on money laundering regulations, and sources of further information and guidance.

\(^{253}\) Further information on this can be found on the BIS website at the following address: www.bis.gov.uk/assets/biscore/consumer-issues/docs/b/12-1129-bis-guidance-for-foreign-exchange-providers
9 MARKET INVESTIGATION REFERENCE AND NEXT STEPS

9.1 In light of our finding that significant competition concerns remain in this market, the OFT has considered whether a market investigation reference (MIR) of the PCA market to the Competition Commission (CC) would be appropriate at this point. This question was also raised by the ICB, which recommended that the OFT should consider an MIR by 2015, if one had not already been made following this review, and if one or more of the following conditions had not been achieved:

- a strong and effective challenger has resulted from the Lloyds Banking Group divestiture
- ease of switching has been transformed by the early establishment of a robust and risk-free redirection service
- a strongly pro-competitive FCA has been established and is demonstrating progress to improve transparency and reduce barriers to entry and expansion for rivals to incumbent banks.\(^{254}\)

9.2 The OFT has provisionally decided not to make a market investigation reference at this time. This is due to a number of developments affecting the PCA market in the coming months that may have a significant impact on competition in this market and which would, should the Section 131 Enterprise Act 2002 threshold be met, lead the OFT to not exercise its discretion to make an MIR.\(^{255}\)

9.3 However, the OFT is clear that further improvements in the way the PCA market functions are needed before this market can work well for consumers. This chapter provides a summary of the recommendations

\(^{254}\) Independent Commission on Banking, Final Report Recommendations; September 2011.

\(^{255}\) The OFT considers that it is appropriate, in this case, to base its provisional decision on the question of the exercise of its discretion without the need first to consider whether or not the legal threshold in Section 131 is met. If the OFT were to eventually conclude that it would be appropriate to exercise its discretion to make an MIR it would, of course, need to be satisfied that the Section 131 test was met.
for action to address the OFT’s ongoing concerns and the forthcoming action in the OFT’s programme of work.

**Power to make a market investigation reference**

9.4 Under Section 131 of the Enterprise Act 2002, the OFT may make a market investigation reference to the CC where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK.

9.5 Section 131(2) states that a feature of the market is to be construed as a reference to:

- the structure of the market concerned or any aspect of that structure
- any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned
- any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

9.6 This does not mean the OFT is obliged to make a reference in relation to every market which it believes meets the threshold set out in Section 131. Rather, the OFT has discretion as to whether or not to make a reference. The OFT’s guidance on market investigation references sets out four criteria, which must be met before the OFT would exercise its discretion to make a reference to the CC. These are:

- **Alternative powers**: it would not be more appropriate to deal with the competition issues identified by applying the Competition Act

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1998 or using other powers available to the OFT, or where appropriate, to sectoral regulators.

- **The scale of the suspected problem:** the adverse effect on competition is significant, such that a reference would be an appropriate response to it. The OFT’s guidance notes that while it is not possible to make a definitive statement about the circumstances in which adverse effects on competition will be regarded as significant, factors that are taken into account in assessing the scale of the suspected problem include:
  - the size of the market
  - the proportion of the market affected by the feature giving rise to adverse effects on competition
  - the persistence of the feature giving rise to adverse effects on competition.

- **Availability of remedies:** there is a reasonable chance that appropriate remedies will be available.

- **Undertakings in lieu of a reference:** it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference. This criteria is only relevant where OFT is minded to exercise its discretion to make an MIR.

9.7 The OFT would normally only exercise its discretion to make an MIR where the four guidance criteria above are met. However, it is open to the OFT to not exercise its discretion to make a reference where these criteria are met, but where, for other reasons, the OFT does not consider an MIR to be appropriate.257

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257 The OFT considers that it is appropriate, in this case, to base its provisional decision on the exercise of its discretion without the need first to consider whether or not the legal threshold in Section 131 is met. If the OFT were to eventually conclude that it would be appropriate to
The OFT's provisional decision on an MIR

9.8 The OFT has provisionally decided not to make a market investigation reference at this time. This is due to a number of developments affecting the PCA market in the coming months that may have a significant impact on competition in this market and which would lead the OFT not to exercise its discretion to make an MIR. The reasoning for this decision, including the competition concerns and market developments are set out below.

Competition concerns in the PCA market

9.9 The conclusion from this review is that longstanding competition concerns remain in the PCA market. Our concerns have been set out in more detail in Chapters 3 to 7 of this report and are summarised here.

- The market has become even more highly concentrated since 2008. The four large providers now have around 75 per cent of the market, and the financial crisis and recession have weakened the competitive constraint from the smaller providers. While there have been two new entrants in recent years – Metro Bank in 2010 and M&S Bank in 2012 - neither is yet in a position to significantly challenge the established providers.

- There has been a significant reduction in the level of overdraft charges. Overall the OFT estimates that there have been consumer savings of between £388 million and £928 million since the 2008 market study. During this period, unarranged overdraft revenues fell substantially, and despite increased revenues from arranged overdrafts and debit interest, there is a substantial saving for consumers. While the overall reduction is significant and welcome, this appears to be largely the result of pressure from OFT and others, rather than competition between providers. While the OFT welcomes the shift away from hidden and unexpected charges to exercise its discretion to make an MIR it would, of course, need to be satisfied that the Section 131 test was met.
charges that are clearer and more predictable, overdraft charging structures remain complex and there is more providers could do to simplify charges and make it easier to compare the costs of different accounts.

- Providers have made progress in helping consumers control when they use unarranged overdraft facilities and the charges they incur. Mobile technology along with balance alerts mean it is easier for consumers to manage their account and avoid incurring charges. However, awareness of text message alert services is low. Furthermore, opt-outs from unarranged overdraft facilities are not offered across the board – providers typically offer opt-outs on a limited range of accounts which often attract a monthly fee.

- Providers have begun rolling out the transparency initiatives previously agreed with the OFT. However, providers have been slow to make progress – three years after these initiatives were agreed, not all customers have received an annual summary. Early indications are that this information will improve consumers’ understanding of the costs of their account and therefore aid decision-making but the slow progress in roll-out means the impact to date has been limited.

- There have been improvements in the functioning of the current automated switching process. However problems still arise, and there remains a perception among consumers that the process is risky and complex. The rate of switching remains low.

9.10 The OFT considers that these concerns represent a significant source of consumer detriment. The market is large, with over 61 million PCAs in the UK being used regularly by 94 per cent of the UK adult population. Given the size of this market and its significance to the functioning of the wider economy, we consider that even small improvements in competition in this market could generate substantial benefits for customers. In principle, therefore, we consider that an MIR could be a proportionate response to the concerns raised. However, for the reasons
Discretion to make a reference

9.11 There are three significant developments happening or expected in the PCA market in the coming months. These could potentially have a significant impact on the effectiveness of competition in the PCA market, but this outcome is by no means guaranteed and it is not possible to determine their impact at this stage. These developments are the following:

- divestments by Lloyds Banking Group and RBS
- the new account switching service
- completion of the roll out of transparency initiatives.

9.12 First, significant structural change is expected by the end of 2013, with divestments from both Lloyds Banking Group and RBS as a result of State Aid requirements from the EC in approving capital injections for both businesses. Lloyds Banking Group is expected to divest around 600 branches with associated customers, representing a share of 4.6 per cent in the PCA market in the UK. RBS is expected to divest over 300 branches and associated customers, representing a share of two per cent in retail banking in the UK. Further details on these transactions and their implications can be found in Chapter 4.

9.13 Collectively, these two divestments are expected to increase significantly the size of one or two smaller providers in the market, or facilitate new entry. The extent to which these divestments will allow current or new providers to challenge significantly the existing large providers and start a process of moving the market towards a more competitive equilibrium cannot be determined at this time. This will depend on which organisation purchases the divested businesses, and how they seek to compete with the remaining providers in the market. In addition, it is not possible to assess at this stage whether these divestments will act as a springboard allowing the purchasers to further
gain market share on an ongoing basis from a greater willingness among consumers to consider switching to alternative providers.

9.14 Second, the new account switching service is due to become available from September 2013. As set out in Chapter 6, this service should represent a significant improvement to the switching process. As such, it has the potential to increase consumers’ willingness to switch accounts, in particular because it may address the perception that switching accounts is difficult. Any increase in consumers’ willingness to consider switching is likely to be more significant if the launch of the new account switching service is accompanied by significant publicity.

9.15 The scale of the impact from this measure is unclear in advance of its launch. We note that research indicates that some consumers do not perceive significant value from switching, and that it is difficult currently for consumers to compare accounts and assess for themselves the benefits of switching provider. Many of the recommendations in this report are designed to address these issues, and therefore increase the likelihood that the new switching service will lead to increased willingness among consumers to consider switching PCA provider.

9.16 Third, the initiatives to promote transparency in the market have not been rolled-out completely, with roll-out of some initiatives continuing in the first half of 2013. While the early indications are that some consumers find these initiatives helpful, we cannot assess the full impact of these initiatives on consumer understanding and decision-making until they have been implemented in full and consumers have had time to see and consider them.

9.17 In addition to these developments, the creation of the FCA in April 2013 may also play a role in stimulating effective competition. While the FSA has not had a strong competition remit, the new FCA will have an operational objective of promoting effective competition in the interests of consumers in the markets for regulated financial services and services provided by recognised investment exchanges. It will also have an accompanying duty to discharge its general functions in a way which promotes competition in the interests of consumers (where that is
compatible with its other operational objectives). This stronger competition remit will mean that the FCA will take a different approach to regulation\textsuperscript{258} from that taken by the FSA, which is likely to provide a further stimulus towards effective competition.

9.18 Collectively, these changes and the resulting flux in the market and uncertainty over their effects, mean it would be difficult at this time for the CC to reach robust judgements about how competition is likely to evolve in the short term, and how to design appropriate, effective and proportionate remedies to any adverse effects on competition. As a result of those developments, the OFT considers that it is questionable whether all four of the discretionary criteria set out in our guidance are satisfied at this time, even if they are satisfied, the OFT does not consider that it is appropriate to make an MIR to the CC at this point in time. In addition, the OFT’s programme of work on retail banking will allow us to consider whether the scope of any potential MIR should be restricted to the PCA market or cover number of retail banking markets or the retail banking sector as a whole.

Consultation on the provisional decision

9.19 Under Section 169 of the Enterprise Act 2002, when the OFT is considering whether to make a decision on a reference to the CC it must first consult, so far as practicable, any person on whose interests the decision is likely to have a substantial impact.

9.20 This report sets out the reasons for the OFT’s provisional decision not to refer to the CC the market for PCAs in the UK. We invite comments on this provisional decision by 8 March 2013.

9.21 Comments can be sent by email to retailbanking@of.gsi.gov.uk or by post to:

\textsuperscript{258} The intended approach of the FCA to its regulatory objectives, how it intends to achieve a fair deal in financial services for consumers and where it is on this journey were set out in 'Journey to the Financial Conduct Authority'. See www.fsa.gov.uk/about/what/reg_reform/fca for details.
9.22 While the OFT has provisionally decided not to make an MIR at this time, we have significant concerns about this market, and expect to return to this question – in line with the ICB’s recommendation – in 2015 if not before. With that in mind, the OFT makes a number of recommendations which build on previous initiatives to make PCA costs more transparent, the switching process more reliable and improve the way unarranged overdrafts are provided.

- In relation to **switching**, the OFT recommends that, in addition to ongoing monitoring to ensure that any problems are dealt with promptly, the **Financial Conduct Authority or the Competition and Markets Authority carry out a review of the effectiveness of the new switching service** once this has been in place for at least 15 months. As well as establishing that the system functions as expected, we anticipate that such a review would consider consumer interest and confidence in the system, and whether it results in consumers being more willing to switch when they are dissatisfied with their existing provider. In addition, the OFT recommends that the **Payments Council undertake research into the costs of bank account number portability**. This would allow the impact of the new automated account switching service to be evaluated alongside other options to further develop the switching process.

- In relation to **transparency**, the OFT has seen encouraging feedback from customers that have seen annual summaries and believe they could be of greater value if consumers had more consistent access to them. Consequently, the OFT recommends that **PCA providers**
make annual summaries easily accessible throughout the year in both electronic and paper form. The OFT also recommends that the Money Advice Service enhances its PCA price comparison website to enable more accurate and detailed comparisons across PCAs and providers based on a consumer’s own specific needs, and the OFT will assist the Money Advice Service with this.

- In relation to control and overdrafts, text alerts appear to have a positive impact on consumers’ ability to avoid incurring unauthorised overdraft charges, but there is currently a lack of awareness of this service among consumers. The OFT therefore recommends that PCA providers do more to offer their text alert service to all their customers proactively. It also recommends that PCA providers make opt-out of unarranged overdraft facilities available on a much wider range of PCAs. While it is recognised that this feature is likely to appeal only to some customers, the OFT considers that the limited way in which this option is currently offered is inhibiting take-up. In light of ongoing concerns over the clarify and predictability of overdraft charges, the OFT recommends that PCA providers further simplify their overdraft charging structures so that PCA pricing becomes less complex and easier for consumers to understand.

9.23 We will also work with the industry to trial the provision of information to customers on interest foregone. Three providers have agreed to participate in this trial, and we expect to carry out the trial later this year.

9.24 In the meantime, as part of our programme of work on retail banking, the OFT intends to:

- Carry out behavioural economic research on the way consumers make decisions and engage with retail banking services. This will build on existing transparency initiatives by improving our understanding of the information consumers need to make choices and how it can best be presented.
• Study the operation of payment systems, in the light of innovations since earlier competition analyses and the recent HM Treasury consultation on setting the strategy for UK payments.

• Study the market for banking services to small and medium sized enterprises (SMEs), looking at the effectiveness of competition in these markets and the extent to which they meet the needs of SMEs.

9.25 Much of the progress in the PCA market has come about as a result of intervention by the OFT, Government and the Financial Services Authority. Going forward we want to see improvements in this market driven to a much greater extent by competition. The OFT has previously set out, in the context of its programme of work on retail banking, five outcomes it expects to see in the retail banking sector, namely:

• The banking sector is more customer focused. Providers’ products are well-suited to their customers’ needs and are provided in a way that makes it easy for customers to make well-informed decisions about how and when they are used.

• Consumers are sufficiently engaged with their banking services to drive competition. Banks equip their customers to make better decisions about which products they use, and how they use them. This will stimulate banks to compete for customers’ business on things that matter to them.

• Competition between banks (and from non-banks) is driving providers to operate more efficiently and to innovate. Effective competition between banks encourages them to perform more efficiently, meaning that lower costs are passed on to consumers and businesses, potentially in innovative new ways.

• Consumers have a broad choice of provider. The sector is less concentrated, with greater competition from ‘challenger’ banks and/or new technology providing scope for increased competition from outside the traditional banking model.
• **Barriers to entry and expansion are lower.** Credible new providers are able to join the market and have reasonable prospects for attracting the scale of customer base needed to achieve the economies of scale required to operate effectively.

9.26 Empowered consumers drive competition, which puts pressure on providers to reduce the price and increase the quality of services offered. This forces providers to operate efficiently and stimulates innovation for the benefit of consumers and the UK economy. We want to see this dynamic process operating well across retail banking markets in the UK. Current account providers need to demonstrate a step-change in their approach to consumers for this to become a reality, and before regulators can step away from their scrutiny of competition in this market.