

Treasury Committee

Oral evidence: [Retail Banking Market Review](#),
HC 231

Tuesday 18 October 2016

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Members present: Mr Andrew Tyrie (Chair); Helen Goodman; Stephen Hammond; George Kerevan; Mr Jacob Rees-Mogg; Rachel Reeves.

Questions 74-141

Witnesses

I: Peter Vicary-Smith, Chief Executive Officer, Which?, Mark Mullen, Chief Executive Officer, Atom Bank, David McCreadie, Managing Director, Tesco Bank.

Examination of Witnesses

Peter Vicary-Smith, Mark Mullen and David McCreadie.

Q74 **Chair:** Thank you very much for coming to give evidence to us this morning. We have a leading consumer group and a couple of small banks, one of which, Atom Bank, is very small. Atom Bank is perhaps rightly named at the moment, having only just got going, but atoms can of course become very powerful. We will see whether you grow. Can I begin by asking you all a simple question? I do not know whether it has a simple answer, but we will have a go. In a nutshell, did the CMA get it right in their report? If not, why not? I will start with you, Mr Vicary-Smith, and then I will move across the panel.

Peter Vicary-Smith: Bluntly, their report was feeble. They spent a lot of time going over old ground and looking at the analyses of problems. The remedies that they have come up with, whilst perfectly reasonable things to do, will be utterly inadequate in changing the lamentable state of the banking market, particularly with regards to competition. C would be my rating.

Q75 **Chair:** In what ranking would you give it a C?

Peter Vicary-Smith: A to C.



HOUSE OF COMMONS

Q76 **Chair:** I was just checking. From A to Z, C is not too bad. You talked about remedies being perfectly reasonable in themselves. There are a couple of major remedies in the report, one of which is this open banking idea, which would hopefully create a new body in a couple of years, which will try to use new technology as a vehicle for giving customers more information to choose whether to switch. The other recommendation is on the unauthorised overdrafts. We are going to go over both of those points in more detail. In a nutshell, what is your concern with those two proposals?

Peter Vicary-Smith: You would expect an organisation like Which? to be in favour of greater information, transparency, and the ability to compare. However, that is a necessary but insufficient condition to actually get the market changing. When it comes to the issue of unauthorised overdrafts—I am sure we will go into a lot more detail—this is such a pernicious part of the banking system, preying on the most vulnerable consumers. We have made a number of suggestions, including the equalising of arranged overdraft fees, as some do already. It will have unintended consequences with no real analysis of that issue. It goes over old ground with throwaway remarks such as, “This will not work,” rather than actually looking at remedies, which is their job

Q77 **Chair:** I have just one further point on the open banking proposal. The central long-term proposal for triggering the proposal is adequate competition. Where would you rank that in a scale of 1 to 10?

Peter Vicary-Smith: In terms of some of the things they are talking about, maybe it is 3 out of 10. It is something that needs to happen, but there is a lot more that has to happen afterwards if it is going to have an effect on banking. Simply giving people information is not enough. You have to help them towards conclusions, and they also have to have the desire to switch between genuinely different propositions. There is nothing in the report that enhances that latter part, which is why it will fail unless something else happens.

Chair: Yes, we might come back to free-if-in-credit banking misnomer or fiction later on in questioning.

Mark Mullen: Good morning, Mr Chair. I lead a newly-authorised bank, to which you referred. We are offering products to both businesses and personal customers, but we are using technology to do it, with a telephone contact centre to provide support. In answer to the question, no; I agree with Peter.

I do not believe that the CMA’s findings are in any way adequate. It proposes remedies that do not go far enough, and you have mentioned overdraft caps. In terms of the things it refers to by way of open banking standards, it essentially intervenes in a way that is unhelpful. What was intended to be an independently governed process is now actually not going to be; it is going to be driven by the very banks that have been guilty of anti-competitive practices in the past. It is handing the keys to the



HOUSE OF COMMONS

city of the future to those banks and letting them steer the course for open standards.

It barely talks about free-if-in-credit banking, but it concludes that it really does not want to do anything about it, because it is almost in the “too difficult” pile. It essentially confines itself to a very limited amount of intervention, I suspect in some way due to the fact that its predecessor, the OFT, had got a bloody nose in the past when it fought the banks on overdraft charges and, if I recall, lost a test case.

It therefore leaves such a lot of things hanging. It does not talk about incentives. It does not talk about how much banks are willing to pay to get loss-leading current accounts, which is a real impediment to competition if you are going to create a current account bank. I find it very difficult to see the positives in the report.

Q78 Chair: Just picking up on one point that you made, you said that the open banking proposal is handing power to the very banks who are the cause of the problem, or words to that effect. I do not want to put words in your mouth, but are you saying that they are basically a vested interest, or cartel, and are very unlikely to want to sort the problem they are being asked to address? Is that your concern?

Mark Mullen: Yes, it has the appearance, as a colleague of mine described it, of a trade body. The permanent members of the steering group are the four biggest banks and Nationwide. There are facilities to allow other banks to be represented at the table, but that steering group then gets to decide who chairs the implementation group, which they have already done. The signal to the outside world is as concerning as whether the committee functions well in practice. The signal is that we can trust banks to set limits on how much they charge customers on overdrafts, and to determine how information will be shared with competitors, platforms, and other technology companies for the future. The signalling is really quite negative.

Q79 Chair: That is very clear. Mr McCreadie, you had better run to the rescue of the CMA; they are under attack at the moment. What do you feel about the report?

David McCreadie: Thank you, first of all, for asking us along today to participate in the hearing. Just for background, we actually do offer current accounts and mortgages, so we have been quite active in engaging with the CMA in terms of the inquiry they have been running. We do feel that more could have been done. The suggestions in there are not too unhelpful, but there is nothing that is going to really get to the heart of the matter around greater transparency for customers and understanding the value of different accounts and the cost to customers of different accounts. That would be specific to the current account market.



HOUSE OF COMMONS

With regard to mortgages, like other smaller and challenger banks we are trying to grow our business. We do not think that there is anything that addresses the capital and funding disadvantages, and the proportionality of regulation that would allow us to grow, particularly in low-risk residential mortgages.

Chair: I am going to move the questioning on to Rachel Reeves. You are all saying pretty much the same thing at the moment, although you are adding quite a lot of interesting colour to the initial conclusions. Do not all feel the need to chip in each time. However, if you do have a specific point, I am sure that colleagues will want to bring you in.

Q80 **Rachel Reeves:** Thank you, Chairman, and thank you all very much for coming along to give evidence today. I want to talk about unarranged overdraft charges. The CMA has recommended three things: an alert if you go into overdraft; a grace period for putting some money in; and a monthly maximum charge. I want to focus on the monthly maximum charge. My concern is that pretty much all banks at the moment have a monthly maximum charge, and so the CMA recommendation for a monthly maximum charge set by individual banks does not suggest to me that there is going to be any difference to what we have now. Mr Vicary-Smith, do you concur with that, or do you think that this will throw a spotlight on the issue, causing charges to come down?

Peter Vicary-Smith: No, I absolutely concur. As an illustration, we worked out in July that if you borrowed £100 for 28 days on an unarranged overdraft, you could pay £90 in fees. If you borrowed the same amount on a payday loan, you would only pay £22.40 on fees. The CMA, while not taking any action on the overall level, has actually made unarranged overdrafts up to four times as expensive as payday loans, and we all applauded the CMA for taking action on those.

The other thing is that there is a lot of confusion about what the monthly maximum charge is. Is it a consecutive period of 30 days, or is it a monthly period? If you went over during the middle of a month to another middle of the month, you could incur either one or two full months of fees. There is a lot of confusion in there. Fundamentally, the level of these charges is absolutely outrageous.

One of the things we have talked about is moving to a system where unarranged overdrafts are at the same rate as arranged overdrafts. Tesco does that; I am not sure if Atom Bank does. There is not that great a cost in risk or administration procedures to a bank for unarranged overdraft facilities being the same as arranged, but there is an enormous cost to the consumer. One cannot help but look at it and think that it is just another way of making profits. I am fine with profits, but they should be made in transparent ways. Here, they are made from the most vulnerable people in society.

Q81 **Rachel Reeves:** I would like to explore two things that you said there, Mr Vicary-Smith, first of all around what a more effective cap would be,



HOUSE OF COMMONS

and, secondly, on vulnerable customers. You spoke there about the difference between a payday loan of £22.40 for £100 and an unarranged overdraft with charges of up to £90. You also talked about the difference between authorised and unauthorised charges. It seems to me that there are two solutions: you could either equalise authorised and unauthorised overdrafts, or you could have a cap, as currently exists for payday lenders. Would you have a preference between those two options?

Peter Vicary-Smith: I would prefer to start with the process of equalising between arranged and unarranged, because I would rather allow the forces of competition in the market to set a standard rate than intervene. However, it might be, if rates were not coming down in time, one would have to go further. At the moment, just getting those two sets of borrowing in the same space would be a considerable advance.

Q82 **Rachel Reeves:** Mr McCreadie, Tesco Bank, as Mr Vicary-Smith said, already has the same charges for authorised and unauthorised overdrafts. Why do you do that, and why do you think that other banks perhaps do not?

David McCreadie: I can only comment on what we do and why we do it. We actually determined, ahead of launching our current account back in June 2014, what we perceived to be the real costs of granting an agreed or unagreed overdraft facility. We essentially went through our calculations to determine what the charges should therefore be. There was minimal differentiation in our forecasts of what that charge should be for the two populations, and so we simplified it and kept single charging. That is where we are today.

As a starting point, we would not really favour the alternative of imposing a regulatory cap. We would be very mindful of understanding the unintended consequences of banks perhaps restricting access to credit for customers and of the risk of all banks moving to the cap and competition being removed from that element of our proposition. Those unintended consequences would have to be thought through before anyone would be comfortable.

I would prefer to see much more focus on transparency, consistent with the comments from Peter. We can do more to help customers understand the true cost of banking and the value that they see from their account. Too many customers today think that all banks are the same. Actually, our and other banks' propositions would save many customers a lot of money, as opposed to if they had banked with large incumbents.

Q83 **Rachel Reeves:** The Chairman has previously raised the issue of transparency around charges for authorised and unauthorised overdrafts. It is a big issue, but that exists for authorised and unauthorised overdrafts. Not many people know the charging structure or the interest rates for either. If you equalised the charges for authorised and unauthorised overdrafts, why do you think that would increase



HOUSE OF COMMONS

competition for customers?

David McCreadie: For us, it is really just part of one measure. There are a lot of things we do today that are referred to in the CMA report, around prompting and alerts, for example, that can allow customers to have greater control around the costs of their banking. Last month, in September, 65% of the customers we prompted ended up paying money in before the grace period we allow to avoid charges. There are some helpful things that are proposed.

We have consistently proposed to the CMA and others a very simple means for customers to understand the cost of arranged and unarranged overdraft charges on their account, how it compares to others, whether or not there is any monthly or annual charge, and the credit interest that may or may not be payable. We have proposed a very simple traffic-light labelling system to help customers understand their good, bad or indifferent options. As you say, it is very hard for customers to recall, prompted or unprompted, what the charge would be if they went into an agreed or unagreed overdraft situation. We would like to help customers and be more transparent around that.

Q84 Rachel Reeves: Mr McCreadie, to build on what you have said, a lot of the banks I have spoken to about this issue say that there is a different risk profile for authorised and unauthorised overdrafts, which is why they have the more punitive charges on unauthorised overdrafts. Do you think that is fair?

David McCreadie: We are only two years into our own business, and it is hard to see how that differentiation will evolve. It would not surprise me if, over time, there would be a difference, but it is hard to see in a business of our maturity. It would not be unexpected based on my knowledge of other products and businesses.

Q85 Rachel Reeves: One argument made by others who have given evidence to this Committee is that there is not really a difference between an authorised and unauthorised overdraft. If you allow a transaction to go through, a bank is, implicitly at least, authorising that overdraft; otherwise, they would decline the payment. Do you think that is fair assessment?

David McCreadie: I can understand if someone has that point of view. For the majority of transactions, you are correct: the bank will be making a decision whether to approve it or not. There are a minority of transactions where that is not the case—for example a contactless transaction, where there is no automatic checking of the availability of credit in an account. For the vast majority, however, it is the bank making a decision. We feel the reality is that banks need to make the appropriate decision between helping the customer and giving them the information they need, which is why, in our experience, prompts and alerts have proven to be quite successful.

Q86 Rachel Reeves: I would just like to revisit this issue of vulnerable



HOUSE OF COMMONS

customers and who are in these overdrafts. StepChange published some research last week that showed that many of their clients who come to them for debt advice are getting into unauthorised overdrafts, not one month but month after month, and are racking up overall yearly overdraft charges of over £200. You said, Mr McCreadie, that when you alert your customers to the fact that they are about to go into an unauthorised overdraft, 65% of them take action. I would assume that those who do not take action are those financially vulnerable customers not in a position to take action, because they do not have the money to put their account back into credit. Would that be your view?

David McCreadie: I suspect that there will be a segment of customers like that. There will also be a segment of customers who are time-poor or are comfortable that they understand the cost to an account of not taking action. There is no doubt that a segment of the customers you are describing will be in that population. However, today we also allow customers a free service, whereby if they are concerned are about their ability to go into an overdraft situation, they can elect to switch on what we call overdraft control. A number of banks are doing this, and we do it for free. It means that we allow no transactions, bar the contactless transactions I mentioned earlier where the customer can go into an overdrawn state. It is about giving the right tools and controls that banks have to customers. The technology is available for us to help customers make informed choices.

Q87 **Rachel Reeves:** Thank you, Mr McCreadie. Mr Vicary-Smith, you said earlier on that you do not mind banks making profit, but that you want greater transparency and information. I do not mind banks making profit, but I do have a problem when they are making profits on the backs of the most vulnerable customers. That was my concern about unauthorised overdrafts.

Allowing people grace periods and providing alerts is great for those who have simply not kept a grip on their finances and can move their money from one account to another, from a savings or joint account; they are able to rectify their overdraft problem. However, for many customers that is just not possible, because they do not have the money to put the situation right. To what extent do you think the more than £1 billion banks make in overdraft charges comes from the most vulnerable customers?

Peter Vicary-Smith: If you look across the spectrum through time of where banks have made money, it tends to be borne by the most vulnerable, be it because of financial illiteracy, poverty, mental health issues, or an inability to understand finance and how to manage their accounts. PPI and unauthorised overdraft charges are some examples. I agree entirely with you that the money being made out of unauthorised overdrafts is from people in that category; they are in debt constantly and they cannot manage their way out of it.



It seems pernicious to me that the banks are making so much money out of this group of people. There are plenty of ways to make money as an established bank. You do not need to be bleeding the very people who can afford it least, who are also, as the CMA recognise, the least likely to switch. They cannot get themselves out of that situation by going somewhere else.

Q88 Rachel Reeves: Many vulnerable customers have financial difficulties not just with their current accounts, but also other debts. As StepChange's research showed, on top of those other debts, they are accumulating £200 of additional charges every year in overdrafts. We have already said that the CMA has decided not to take stronger action on unauthorised overdraft charges.

Andrew Bailey from the FCA gave evidence to this Committee before the summer. He said that the FCA has a wider remit, and that he is interested in looking again at this. What process do you think should happen now? Obviously, some of the recommendations made by the CMA will come into effect over the next few months. Do you think it is now for the FCA to act, or for Parliament to act? What do you think should happen now, Mr Vicary-Smith?

Peter Vicary-Smith: It is for the FCA to act. The FCA has shown the willingness, in the evidence that it has given and in conversations, to act. However, to my mind, that is frankly a dereliction of the duty of the CMA. They have left the heavy lifting and the difficult choices to the FCA, and that is not what they are there for. If the FCA did not act, I would imagine Parliament would want to, because somebody has to stand up for these consumers and say to these banks that this is the wrong way to be making profits. If the CMA does not do it, hopefully the FCA will. If the FCA did not, it would be for Parliament to act.

David McCreadie: We obviously took the idea of labelling from what we have seen in food labelling. By giving customers information, we allow them to make more informed choices. The reality is that we have seen customers make healthier choices as a result of that labelling. We have actually also seen the product manufacturing processes change. Certain ingredients or features that may not be good for a customer's health have actually been reduced as a result of labelling, so there are demand and supply-side advantages to such simple labelling processes.

We have taken customer research and shared that with the CMA and others, and we are willing to share it with anyone who wants to hear it. We are getting very positive feedback from customers. Simplicity and transparency are really the key things to allowing comparability. My concern with some of the documentation that came out from the CMA on Friday is around how they will ask for the perception and reality of customer service to be ranked. It has 16 different metrics, which will end up being very, very complicated. It will suit the incumbents and does not get to the heart of the issue, on cost and value for the customer. That is something we will continue to try to promote to the CMA.



Q89 **Rachel Reeves:** Thank you, Mr McCreadie. Finally, Mr Mullen, you wrote a blog in August saying that the CMA decisions were underwhelming and uninspiring. Do you want to add anything to that?

Mark Mullen: In all of the years I have worked in the industry, the single biggest source of customer complaint in retail banking has been overdraft charges. It was only overtaken by PPI, which gives you an idea of the magnitude of the problem. The banking industry has been quite content to just see that as the cost of doing business. You cannot find any other explanation. That level of dissatisfaction is a plaque that you just live with, because, ultimately, that is just how the banking system works.

It tells you that, culturally, the banks do what they must and not what they should. It is a compliance and rules-driven industry. Because it does not obey the laws of physics or mechanics, there is no physical thing that defines how a bank should behave. It basically says, "This is the rule, and therefore I comply with the rule." Unless you move the rule, it essentially tries as little as possible to anticipate the direction of travel. They do as little as possible.

If you have a bank today that still believes it is legitimate to charge customers £90 for short-term borrowing of £100, that tells you something about the attitude of the industry. Equally, if you borrow money on a mortgage and charge a fee for that mortgage, you have to include the fee in the effective interest rate that you report to the customer. Why is it not obligatory for overdraft fees to be included in the effective rate that you report to the customer? They are still getting away with saying that an overdraft costs 19%, but that is only the interest element and not the fee element. On the point that you have just made, there is not the comparability to say X is equal to X.

Q90 **Chair:** Are you saying that, without that, there cannot be competition?

Mark Mullen: Yes, correct, because the banks are sophisticated in how they price-structure.

Q91 **Chair:** That is what this Committee has been saying for six years, as you probably know. Earlier reports had a big hand in triggering what has become the CMA report. Mr McCreadie, you made an interesting point a moment ago, drawing an analogy with the food industry. Of course, you have a particular interest in the food industry. It is certainly the case that if a person of very modest means goes to Tesco, does not like the offer and thinks that they are being ripped off, they go to Aldi or Asda. They feel they have enough information to be able to do that. Do you realistically think, as a bank that operates very much in this market, that we can get to a position where that level of information is available to customers? Are we asking too much of the CMA?

David McCreadie: No, I do actually believe that we could get there. It clearly requires not just one bank promoting such a labelling system; it would be required to operate across the industry. We have proposed what we think is a good start. It has had a positive reaction from



HOUSE OF COMMONS

customers. It does not mean that it is necessarily at its endpoint, and other stakeholders will have the opportunity to comment on it.

A representative example of other credit products with a simple labelling system based on overdraft charges, credit interest and fees would be something that would become recognised by customers. As a result of food labelling, people do have a clear example of what red, amber and green generally mean to them. We could get there, but it would need to be a concerted effort across the industry.

Q92 Helen Goodman: Obviously it is not a very competitive market and switching levels are very low. As you have been describing, there is a lack of transparency. One of the areas in which there is a lack of transparency is the so-called free-if-in-credit account. Mr McCreadie and Mr Mullen, do you provide free-if-in-credit accounts, or do you make it clear to your customers what the cost of having a bank account is?

David McCreadie: There are different elements to that question. The reality is that I would agree with the comment at the start of the hearing, that there is this misnomer of free-if-in-credit banking. There are certainly a lot of accounts that do not charge a monthly or annual fee just for the privilege of having the account. Our own account does not charge a monthly or annual fee for the account.

However, we are very clear to customers about what charges may apply in certain circumstances; we are very clear to customers that we will give them benefits for using their account through Clubcard reward points; and we are very clear to customers about the credit interest they will pay for the privilege of having their deposit with us. As I mentioned earlier, we then have a number of other things, such as alerts. We have also gone as far to become the only bank in the country that demonstrates in our monthly statements, based on their exact balances held in the month, how much customers could have earned if they had their money sitting in a savings account with us.

The whole element of forgone interest is where banks generally make most money from current accounts; I think the total income generated from current accounts was £8.4 billion two years ago. That will clearly reduce in a low interest rate environment, but it confirms the point that free-if-in-credit, as described, is a misnomer.

Q93 Helen Goodman: But you are not actually telling people the costs of running their free-if-in-credit bank account.

David McCreadie: No, we are. There are really two elements. There are the charges you may incur, and we are very clear what those charges are. There is a very clear interest rate if there is any borrowing, it is clear what other charges might apply for transactions going through the account and we are actually the only bank that demonstrates to customers how much they could have earned on the interest forgone by having the money sitting in our current account rather than our savings



HOUSE OF COMMONS

account. We are required to be very clear, and we are very clear, what the charges are. We feel that they are fair and competitive charges.

Q94 **Helen Goodman:** Is telling people what they have paid if they have had an overdraft, and what they might have earned on another account, not different from what the costs are of having the current account?

David McCreadie: There is no cost. There is no charge to the customer.

Q95 **Helen Goodman:** There is no charge, but there is a cost.

David McCreadie: The only cost is if you go into an overdraft situation, which is described. We are very clear about what the costs are, and they are fair charges. We also give you lots of ability to avoid charges. There is also the interest forgone that you would have earned if you had had the money sitting in a savings account, rather than any element of your balance that did not earn interest.

Q96 **Helen Goodman:** Are you saying that you do not cross-subsidise between the people who have overdrafts and the people who are in credit?

David McCreadie: No. What we do is describe to each customer, based on their circumstances and their use of the account, what the charges would be, but there is no monthly or annual cost, or any fee for having an account.

Q97 **Helen Goodman:** Mr Mullen, how is it at Atom Bank?

Mark Mullen: I am not dodging the question; we do not have a current account yet, but I can answer it in the following—

Q98 **Helen Goodman:** What do you have?

Mark Mullen: At the moment we are only offering savings and lending, and in a couple of weeks' time we will start offering mortgages, and we are looking to introduce a current account in quarter 1 of 2017. I have run current accounts—

Q99 **Helen Goodman:** So you are in a great position to have lots of views on current accounts and the way they are run?

Mark Mullen: No, no, not at all. Absolutely not. An invidious position.

Helen Goodman: A blank sheet of paper.

Mark Mullen: Absolutely, but an invidious position, because I can tell you from previous experience with the former bank that I ran, which introduced a £10 fee: uproar was the answer from customers. It was absolute uproar. They were not willing to pay a fee for banking, since the 1980s when the Midland essentially introduced free-if-in-credit as an idea and, lemming-like, all the banks followed. Now they are in a situation where they cannot get themselves out of that mess, so they provide various different packaged accounts and try to dress up some benefits and attach a fee to that.



HOUSE OF COMMONS

Usually the fee is quite small, in the order of £2.50 to £5 per month, to keep it below a psychological threshold, because once you get above £10 people begin to get annoyed. There is just not an acceptance among customers that they should have to pay for banking on a fee basis.

Q100 Helen Goodman: Mr Vicary-Smith, what do you think that we should do in this situation? Do you think we should change the rules of the game, so that everybody is required to charge for their current accounts, or do you think that transparency, in the way that Tesco is running their accounts, is sufficient?

Peter Vicary-Smith: What I want to see is diversity in the market. I am very relaxed if some institutions want to charge a fee and others do not want to charge a fee, but I want to see a lot of people doing different types of thing to create a truly competitive environment. I go back, as was mentioned earlier, to Cruickshank. Two things, I think, were interesting, looking back at Cruickshank the other day. One, of course, was his comments upon how much money is made from funds sitting in an account. The other comment was that something like 68% or 70% of the market was held by the major players, and today the number is something like 70%. In other words, it has not budged over that entire period. To my mind, competition is not working in the industry. Everybody has followed by going to fee-free banking. I am trying to find a neutral way of putting it, because it is not free, and often fees are charged, but let us call it fee-free for the moment.

However, the banks are still making money. I think I am right in saying this, but forgive me and I will correct it later if I am wrong, but through the financial crisis, the retail side of all the major banks continued to make money through the financial crisis. Therefore, an established bank can make money out of current accounts; it does not need to introduce fees to do so. The other dimension here is that people put in fees as an alternative to unauthorised overdrafts: they would not have to make all this money out of unauthorised overdrafts if only they could introduce fees.

First, the same argument was used about PPI: we only do it because we cannot charge people fees. However, I have seen no evidence that the introduction of fees would lead to a reduction in unauthorised overdraft charges. It is seen as just another way of making money. My overall view is that I do not want to see a regulation that everybody has to introduce a fee—I think there would be uproar from consumers if that happened—but I do want to see some having fees, some not having fees, some having packaged accounts, some having other types of basic account that are cheaper to run and so on, because that is what a competitive marketplace should offer people.

Q101 Helen Goodman: That does, if I might say so, sound a little bit complicated. If I could come back to the example of the food labelling, of course we had long negotiations, via the Food Standards Authority, with the retailers about standardising the food labelling. Mr Vicary-Smith,



HOUSE OF COMMONS

learning from that experience, is it not then necessary that the way in which the banks describe the costs and charges be standardised? Otherwise people will not be able to understand what is going on.

Peter Vicary-Smith: There should absolutely be standardisation of how it is described, and Which? was a strong proponent of that food labelling legislation, as you know. There should absolutely be standardisation of how it is described, but what the basic features of an account are, what is charged for and what is not charged for, I am very relaxed for that to differ by bank, providing they are up front about what they are doing and what they are charging for, and how they are making their money.

Mark Mullen: Can I make another comment? The clue is in the title, "free-if-in-credit". In other words, it is all right to offer free banking for customers who are in credit, but clearly not everyone is in credit, and therefore there is a substantial section of the population for whom banking is not free. They are the ones who are subsidising the customers who have the credit to avail themselves of free banking.

Q102 **Helen Goodman:** Absolutely.

Mark Mullen: We should not forget that. The second point is that lots of the free-if-in-credit offers also add interest-rate incentives on top of that. Here is the truth, however: lots of the pricing models that underpin those offers are predicated on the fact that customers will not always manage their accounts to take best advantage of the offer. Banks are under no obligation to tell a customer when essentially they are not taking full advantage of the way that the account has been designed. They make money from people forgetting. I think free-if-in-credit is a major competition problem, because it does not allow you to launch a current account and make an honest profit against a competitive establishment. We have to lose money on a current account if you are going to introduce a new one, in order to have any credibility as a provider. Ultimately, that requires that you recover the cost somewhere else. The trouble is that nobody knows where.

Q103 **Helen Goodman:** Another question is about whether or not switching is influenced by quality of service. An important aspect of quality of service is obviously the branch network. Mr Mullen, you do not have a branch network, because you operate entirely on the phone and online, and you have just said that you do not yet have a current account, so you might want to tweak my question, as it were. Do you have any sense of the demographic of people who are using the Atom Bank? Is it primarily young people with above-average incomes, or is it a true, straightforward cross-section of the community?

Mark Mullen: There is a very direct answer to that: given the type of savings products that we are offering—we are only offering fixed-term savings at the moment—they tend to appeal to older people, so the average age is likely to be closer to 50 than it is to 25 or 30. To that extent, the appeal of Atom will change as we offer different products. If



HOUSE OF COMMONS

we were offering mortgages to personal customers, you would have an average age of mid to late 30s. For current accounts, the average age is likely to be younger, as much as anything else because young people are willing to try new things and have less complex financial needs at that point in their life. Therefore, their ability to move from one bank to another is slightly less onerous than if you are trying to drag a whole bunch of products and service with you.

Regarding the point about whether to offer branch service or not, we are in a different position, because we are not making a promise. We have never made a promise to a customer to say, "We will offer you branch banking." That is quite different from a bank that has been offering branch banking for the last 250 years, and has decided that it is going to start to retreat.

Q104 **Helen Goodman:** I will come on to what they do in a minute, but can I repeat part of my question? What about the income distribution of the people who are using Atom Bank? Are they, by and large, people with above-average incomes?

Mark Mullen: I would imagine so. I genuinely do not know.

Q105 **Helen Goodman:** But you have not done that piece of work?

Mark Mullen: No.

Q106 **Helen Goodman:** Mr McCreadie, I do not really understand how Tesco Bank works, because I bank with the Co-op. Does the fact that you have a branch network of shops mean that people can go to their local Tesco and have a conversation about their banking as well as buy their potatoes?

David McCreadie: No. The answer is no to that specific question. I will just describe very quickly what we do. We are predominantly a digital business, online: nine out of 10 of all our customers who open an account with us do so through a digital channel, and 96% of all servicing of our accounts and policies is on mobile, iPad or desktop as well. Where we do leverage and provide convenience to customers is just over 300 stores where we allow you to make a physical deposit of a cheque or cash, or a withdrawal from the customer service desk. However, it is just a money transaction, like paying for any good in the shop; there is no facility to discuss financial services beyond that.

Q107 **Helen Goodman:** I suppose I have the same question for you. Your banking is online. What is the skew in the population that you serve by age and income? Do you know?

David McCreadie: I do. Obviously, we have a broad range of products. We would have similar experience where we are talking about something like a fixed-rate saver; it would skew to an older demographic. The reality is that because we have a breadth of products, including current accounts, we have quite a broad diversity in our customer base.



That will include, which I think is probably part of your question, within the first day of launching a mobile banking app, in June 2014, an 85-year-old customer calling up to ask a question about the app they had just downloaded. I think this is probably quite consistent across the industry; we are seeing customers of all ages becoming more comfortable engaging with modern technology.

Q108 Helen Goodman: Mr McCreddie, every time I discuss digital exclusion with the banks, they always have one customer who is 85, and I am sorry, but that is not typical. I am going to ask Mr Vicary-Smith a question now. There is a big overlap between financial and digital exclusion, and bank branch closures are clearly going to impact badly on those sectors of the community who are digitally excluded. Given this, do you think that we ought to look again at the possibility of the banks sharing infrastructure, so that they can continue to provide face-to-face services across the community?

Peter Vicary-Smith: I have a couple of points to make. Our customer satisfaction scores show that First Direct, the Co-op and Nationwide do very well—three organisations with very different inherent structures, and First Direct, of course, with no branches. The crucial thing, to my mind, is that I am not going to tell a bank that they should keep a branch open in a place and lose money, because then I cannot criticise where they make money elsewhere in the process.

To my mind, a decision on whether or not a branch is viable has to be one that is left for the bank to decide, but if they are going to close the branch then there should be alternative facilities provided. The conversations I have been having with banks have been about how they will get services into that community. Will they use other types of outlet—church halls, post offices, whatever it may be? Will they share infrastructure to enable a service to continue to be held? What else are they looking for?

That will in part be driven by the local community. Some of the more interesting stuff as a result of the banking protocol has been the conversations happening with banks and the local community, before they close a branch. For example, when Barclays were planning to close what I think was the Richmond branch, there was uproar. When they started talking to the local community about why there was uproar, it was largely around the fact that there was a local florist and everyone took cash out to pay the florist. A cashpoint facility removed a great deal of the antagonism towards the closure of that particular Barclays branch; there were other branches still in the area.

There are many reasons why people want to use branches. They can be very parochial reasons or very broad ones, but particularly with those groups who cannot easily access information online, and do not comprehend it as well online, there has to be some other form of facility. It is incumbent upon banks to provide that, and to go that extra mile in looking at infrastructure possibilities and where else they might have



HOUSE OF COMMONS

pop-up banks and so on, to provide facilities for that community. They are social enterprises as well as profit-making enterprises.

Q109 **Helen Goodman:** This is a particular problem, of course, for micro-businesses and very small SMEs. I do not know if you have looked in to that issue at all, at Which?.

Peter Vicary-Smith: We have not looked into that specific issue, no.

Q110 **Stephen Hammond:** Good morning. We have been speaking a little bit about the cost of products. In the study that the CMA undertook, they failed to ask the banks to reveal the profitability of individual products. Indeed, they failed to take an overall view on whether current accounts are profitable, or an overall profitability study, saying it was too difficult to estimate. That tends to imply that the banks do not themselves know whether current accounts are profitable enough. Is that a view you agree with?

David McCreadie: Again, I will comment for our own bank: we have a very clear view of the individual product profitability and income we generate on different products, and also where there is a need to maybe allocate costs across a different product range. I would be surprised if other banks do not have a view.

There will be a recognition that, in particular, the deposits in current accounts, where eight out of 10 customers in the UK get zero reward for that money sitting in the current account, are then an advantage to incumbents to lend out to customers on a more affordable, competitive basis. I would be very surprised if banks do not have a clear understanding.

Q111 **Stephen Hammond:** You will be as surprised as this Committee was, then, that the "Too difficult to estimate" answer was a proper defence?

David McCreadie: Yes. There may be a need to make some assumptions and judgments, but that is what banking is.

Mark Mullen: I do not know how you can calculate how much you are willing to pay a customer to come and open an account unless you have some idea of how much you are going to make from the customer over the life of that relationship. You cannot. They may not have perfect knowledge; I understand that, because they are very complex organisations. There are lots of cost allocation and transfer pricing models that they use. I worked in one for many, many years. However, I have also run pricing models, so I can assure you that there is a sense of how much money each customer and/or each product line makes. There has to be.

Q112 **Stephen Hammond:** If we had that analysis, do you not think we would have been much clearer about how competition in the retail market would work?

Mark Mullen: Yes, I am sure that—



Q113 **Stephen Hammond:** So is it not clear that if the CMA had pressed for that analysis, we would have been able to be much clearer about how retail competition could work, and indeed how we could take away some of those barriers to entry for smaller competitors, or new entrants like yourselves?

Mark Mullen: More understanding of even gross profitability, without necessarily getting into the complexities of the various different cost allocation models—even that gives you some insight into how much gross revenue they are making out of a given customer, over a given period of time. That information is available; you cannot run a bank without it.

David McCreadie: Even without submitting that information—from what you are describing, the banks have not been asked to provide that—I think there was an explicit comment from the CMA report that they do recognise the incumbent advantage that scale in current accounts provides the large banks across other products.

Q114 **Stephen Hammond:** They did. A lot of us were particularly surprised at their inability, in this study, to force the banks to reveal at least gross profitability, or some indication. Equally, and my colleague Helen Goodman has already started on this point, they have decided to take no action on free-if-in-credit accounts. Again, they had two defences to this. First, the CMA in its study said that if you look at other countries without free accounts, they still had relatively low levels of switching in the personal banking or personal customer market. It also said that they are very popular with customers, and therefore why should you interfere in the market, if that was what was popular with customers? I wonder if you would agree with either of those defences.

David McCreadie: Again, for me, I think they have recognised where the issue is, but they have not proposed remedies that will get us to the heart of dealing with those issues. Some of the service level prompts that are being proposed, the customer service responses, and some of the alerts that we mentioned earlier will be positive. However, they do not get to the heart of engaging more consumers in understanding the alternatives that are available.

I will tell you: there is lots of competition and competitive offers for your current account and your relationship, but no customer has a very clear view of how to compare the true cost of what they are paying today, or missing out on today, by staying with their incumbent bank. We and others are continually focused on improving the offers for customers and being competitive. However, it is quite hard when we have no easy way for a consumer to engage and make a true comparison, to make a more informed decision.

Q115 **Stephen Hammond:** But as a result of this CMA report, Mr Vicary-Smith, it is not any easier for any customer to make the analysis that Mr McCreadie was describing, is it?



Peter Vicary-Smith: No. I always struggle to see why banking should be such a different industry from everything else. With other industries, you compare the products; you have good information and the likes of us can provide you with better information on the product you might be wanting to buy. You look at what other people say about that particular provider and that product, you then go and find the best price you can for it, and then if you are not happy, you have a way of getting out of that easily.

Retail banking, to my mind, should be very similar. People should be able to understand the offering in front of them, by comparing information that is provided in a transparent way, and then they should be encouraged to switch to something more akin to their needs, with truly differentiated offerings. The CMA inquiry is not driving us towards that nirvana.

Q116 **Stephen Hammond:** And it is true, is it not, that there is no such thing as free banking? It is a dangerous myth.

Peter Vicary-Smith: Yes.

Q117 **Stephen Hammond:** Mr Mullen, in your response to Helen Goodman a moment ago, you also said—I think I got it right—that nobody knows the products that recovery of the costs of personal customer accounts comes from. Can we look at the level of cross-subsidy? We have obviously spoken about overdraft customers, but presumably we are expecting that, in order to provide the free-if-in-credit model, cross-subsidies are extended across all the product ranges?

Mark Mullen: The banks have significant resources that they can allocate to looking at behavioural economics, portfolio behaviour over long periods of time. Take, for example, a bank that decides to pay cashback on recurring payments. You set up your standing orders and direct debits, and it gives you a percentage of cashback on your council tax or bill payments, or what-not. Why does it do that? It does that not because it makes money out of it, because the revenue from the payment does not cover the cost of the cashback. It is knowingly losing money on that individual transaction. It is doing it because its analysis will tell them that if a customer sets up standing orders and direct debits on a current account, they are less likely to move. It is quite a lot of hassle, in the mind of the customer, to have to unpick your standing orders and direct debits and move them to another account. It creates quite a lot of stress, especially if you miss a mortgage payment or something goes wrong. This is ultimately what CASS is meant to address, but it also needs to address the worry about it.

The actions of the banks in terms of structuring their incentives are very precise. They are not random; they are based upon the performance of millions of customers over many, many years. It is learned and modelled, and they plug that into their pricing models. My view, when it comes to the, if you like, cross-subsidy discussion is you cannot sell



HOUSE OF COMMONS

alcohol in the UK as a loss-lead. You cannot do it, because it is bad for your health, but you can sell a financial product to a customer as a loss-lead, because it is not? Our experience over the last 20 years tells us that there are plenty of financial products that have been sold to customers that have turned out to be very bad for their health.

Q118 Stephen Hammond: You are one of the newest competitors in the market, and you are considering introducing personal customer accounts. One of your competitors says that a move away from the free-if-in-credit banking market would leave them unable to show transparent pricing of personal current accounts. Do you think that you will be able to offer more transparent pricing to your new customers?

Mark Mullen: The choice of offering transparency has nothing to do with competition; it has to do with whether you choose to do it or not. You can report how much you lose, just as much as you can report how much you make. Transparency is an entity choice. You do not need to look at Lloyds or RBS or anyone else to determine to be truthful and transparent. That is something any business gets to decide.

It would help the customer understand what value they were getting from their bank, whether negative or positive, and that is a good thing. Ultimately, to Peter's point, relatively straightforward, simple ways of comparing products should not be that difficult in banking. There is a bunch of legislation around mortgage and banking conduct of business rules to legislate about how interest rates are calculated. It is not beyond the wit of man to be able to say, "On an average seven-year current account, or five-year current account, whatever it will be, here is what you will likely pay."

Q119 Stephen Hammond: Mr Vicary-Smith, in the past, Which? has flagged up the substantial complaint level about packaged accounts. Can you give us some sense of the balance between complaints on packaged accounts and free-if-in-credit models, if at all? Do you think that some people are over-worrying about the free-if-in-credit model, and there are other things we should be looking at first?

Peter Vicary-Smith: The problem with a number of packaged accounts has been that they either have offered facilities that consumers do not want or value, or the consumers have not then taken them up and used them. The classic is people having a packaged account with some form of travel insurance, but then going and buying travel insurance for their holiday as well. The question always is, how much are you paying for this packaged account, and are you going to get the benefit out of all the various services that are up there?

Typically, people have not been getting the benefit that they thought they would get, hence the objections. If you look at the things I have seen on withdrawal of free-if-in-credit banking, they suggest that the complaints from people would be massively greater if free-if-in-credit—or fee-free, or whatever you want to call it—banking were withdrawn. People need to



HOUSE OF COMMONS

recognise that they are paying for their banking services through forgone interest and so forth.

You are absolutely right that it is a myth to say there is free banking, but let us have an honest discussion about where people are paying for it. It is very difficult to have that discussion without the CMA getting to the heart of where profits are being made.

Q120 **Stephen Hammond:** Not only where people are paying for it, but who is paying for it.

Peter Vicary-Smith: Who is paying for it, absolutely, yes.

Q121 **Stephen Hammond:** The extent of cross-subsidy should be worrying for your magazine.

Peter Vicary-Smith: Indeed.

Q122 **Mr Rees-Mogg:** Good morning, gentlemen. Coming back, Mr Vicary-Smith, you gave a C grade at the very beginning of the meeting to the barriers to entry within the CMA report: capital requirements, cost of funding and information asymmetries. Do you think that the CMA managed to address those questions, particularly the capital requirements?

Peter Vicary-Smith: The capital requirements I know less about as a subject, so I would rather defer on the specifics to my colleagues here. My point would be that the CMA identified some of the things that needed to happen, but had assumed that they would be sufficient, if they happened on their own, to create competition. That is where I and, I think, the others would drastically disagree with them.

Q123 **Mr Rees-Mogg:** Mr Mullen and Mr McCreadie, I wonder if you could give your thoughts on the capital requirements, which seem to me to be some of the biggest barriers to entry to challenger banks, how you found this, and what you think the solutions might be.

Mark Mullen: I certainly agree with that. It is up to 10 times less efficient for a new bank that does not, if you like, have an internal ratings-based regime in place to lend money. That can have a number of effects. It can encourage new entrants to take higher risks, because they have to in order to make big capital allocation work. Of course, it then places the big banks right smack in the heart of the low loan to value mortgage lending businesses, and lending businesses in general in the UK.

You could argue that that is quite a good thing, because they are really big banks and they are systemically important, and you do not want them taking very big risks, but it is bad for competition. If you look at any analysis of how banks make money in the current economic climate, in a low interest rate environment, they have to be lending. Any lending incurs capital charges, as it were, and therefore the capital charges are a massive driver of profitability in the industry.



HOUSE OF COMMONS

Those come from either European or global capital requirements regulations and regimes, as translated into law here in the UK, and they are not easy to change, and nobody is suggesting they are. However, it does seem to me that there should be an interim solution that says, "Okay, you do not have a huge amount of data to build very sophisticated models yet, but that is not quite the same as saying you are novices, or that you should be penalised to the tune of 10 times less efficiency for certain types of lending."

If we persist with that regime, it will be very difficult to introduce new entrants to the market. It is just economically difficult to make it work.

David McCreadie: I would echo Mark's points on that. I know you have heard this from colleagues from other challenger banks over the course of various hearings. It is most acute for low-risk residential mortgages, where, as Mark says, if my bank lends you a 50% loan-to-value mortgage, with the same affordability and equity in the house, I have to hold 10 times more capital than one of the larger incumbent banks with advanced internal models. It is clearly a barrier; there are other capital barriers as well, and the risk of further capital barriers that would be disproportionate to small, non-systemic banks is potentially coming along.

The CMA itself, just reading here from its summary of its inquiry, says "two members of the inquiry group are of the view that the evidence is sufficient to support a finding that the capital requirements regime for mortgages has sufficiently large effects on the costs and returns of banks to be a barrier to entry and/or expansion, not just in mortgages but across retail banking more generally." It looks like it was a split view, and that further evidence would be required to convince all members of the inquiry.

Our disappointment is that that has just been left to other bodies, rightly—PRA, Treasury and other regulators at UK and global level—to deal with. It just feels too open-ended, with no endpoint of where we may see some real relaxing to more appropriate capital requirements for smaller banks.

Q124 **Mr Rees-Mogg:** Do you think that there must be something wrong with the underlying principles being applied to capital requirements, if you see differences that are quite so wide? If an internal model provides a capital requirement that is one-tenth of the base model, then either the internal models are wrong, or the base model is wrong. Is that a fair assumption?

David McCreadie: It is actually a different starting point. The reality is that we will hear consistently as a smaller bank, over time, you will be able to gather the evidence and the data to reach a similar position. However, if you take a step back and look at the underlying risk, it does not seem appropriate to have that 10 times differential.



HOUSE OF COMMONS

Our recommendation has been, why not allow smaller banks to be able to access even the average risk weights of the advanced banks, or even for the banks, on an anonymised basis, to share their modelling and their data? That might allow us to get some of that disadvantage taken away from us.

Mark Mullen: I concur that the data is obviously key to this. If the calculation of capital adequacy is based on robust modelling, a new bank, almost by definition, has lots of things, but it does not have that. It is a Catch-22 situation that we cannot get out of.

Q125 **Mr Rees-Mogg:** Moving on to the Government's actions with the bank tax surcharges, and the move to a corporation tax surcharge, how do you feel that is working for challenger banks?

David McCreadie: As part of our own views as a bank on this, but also as part of the community of smaller challenger banks, we felt that in some ways the previous approach, where there was the levy applied to larger systemic banks, which were much more of a risk to society and the wider economy, was to reflect that concern. All that happened is that the big banks have been successful in having that slight disadvantage they had reduced over time. It takes four years to unwind completely the levy.

To be fair, we are not arguing that we should have favourable taxation treatment; we will deal with whatever the taxation regulations are that apply to our industry. However, it was the one area where there was at least something the other way. With all the incumbency advantages, this was something that was more helpful, when the levy was applying to larger systemic banks. If it is unwound, as is now proposed, it levels the playing field. All we want across capital, funding and taxation is a level playing field, and this is going in the opposite direction.

Mark Mullen: The new rules are a blunter instrument. We have a £25 million profit threshold, above which essentially everyone is trapped. My argument would be slightly different. What do you want a new bank to be doing with its profits? I would have thought you wanted them to invest in growing the fundamental enterprise and driving competition—£25 million is a lot of money, but in the context of building a bank, it is a fairly modest amount.

I would prefer that the threshold was higher. For all the criticisms of the levy, it was more nuanced. It was aligned to rewarding the right types of behaviour, whereas the new one is essentially saying, "That is a break point and we will apply the same rule to all."

Mr Rees-Mogg: And for a challenger bank, it reduces its long-term ability to lend, because every £1 you pay in tax is roughly £10 that you cannot lend, in broad terms. The bank levy and the corporation tax excess are very much domestic policy matters, whereas bank capital is much more international, including European. On the glorious day of



HOUSE OF COMMONS

23 June, we voted to leave the European Union. Do you see any chance of the international regulations being applied differently in the UK with the new freedoms that may come, or do you think that because they are set mainly above the European level, there will be little progress in changing the capital requirements?

David McCreadie: In the discussions we have had with Treasury, the PRA and others, there is a recognition of the barrier to expansion for us on the capital front. The only thing I could comment on, thinking it through as you asked the question: I am assuming that if you are required to get a number of bodies in one domestic entity to make a decision on something, it must be less complex than the situation we are in today.

Q126 **Mr Rees-Mogg:** So it could get better.

David McCreadie: The direction of travel has always been that it will get better; it is just that there is never any endpoint where that will come.

Q127 **Mr Rees-Mogg:** There are lots of bodies doing all this: CMA review, FCA, PRA—on and on it goes. They are all wanting to improve banking competition and promising to make it easier for new banks to set up. Mr Mullen, you have just been through this process. How have you found the behaviour of regulators, the ease of setting up and getting a banking licence? Are they delivering on their public pronouncements that they wish to make it an easier and smoother process, or did you find it quite onerous?

Mark Mullen: The regulatory oversight has been a strong point, to be direct about the journey. We were well supported by the PRA and FCA, and have been throughout. We remain well supported by them, to be fair. There are other challenges, but I cannot assign those other challenges to the regulatory relationship. That has been pretty good.

Q128 **Mr Rees-Mogg:** Mr McCreadie, you looked as though you wanted to add something.

David McCreadie: Only to back that up. I do not think there is any concern that we have about barriers to entry. There has been a lot done, and that is recognised by regulators, Treasury and so on. There is a clear empathy that there has not been enough done to remove barriers to expansion, and that is where we think most of the focus should continue to be.

Q129 **George Kerevan:** Good morning. Mr Mullen and Mr McCreadie, I wanted to look a little at the market for financial services to small businesses. One interesting element in the CMA report is an indication that small businesses below a turnover of £2 million find themselves facing an even more monopolised banking market than ordinary consumers. That, of course, impacts on their ability to raise finance. How are the new challenger banks able to alter that situation?



Mark Mullen: I can certainly give you an answer. First, the best description I heard of banks from small businesses is that they are used to paying for banking, unlike the conversation we have had about consumer banking, but they do not understand what it is, so they treat it as a form of tax. They do not necessarily assign the bills to a value experience. It is a form of tax. I can also tell you that the market for data management, as it relates to small businesses, is less well developed than it is for consumers.

Therefore, there is less well advanced bureau data; there is less well advanced company accounts data and management accounts data. It is, essentially, a more disaggregated industry when it comes to information. More lending is judgmental, so therefore it is more labour intensive, and a lot of the bigger players will have centralised their decision-making processes. They will essentially have extracted it away from the frontline customer relationship and pulled it into the centre. There is a general perception that it takes an awfully long time for a bank to make a decision—not necessarily that they will not make a positive decision, but that it will take an awfully long time to do it.

Our experience has been that portability of information from one bank to another is incredibly important for small businesses. Comparability of charging, again, comes up: “No idea what the actual rate card is or what my actual costs are with this bank, and how would I make a choice about that bank being better?” Speed is another factor. It is not a question of making a bad decision or saying no; it is a question of getting to it within less than six weeks, and that is not untypical. I think there are huge improvements that can be brought to the experience that small businesses have with banks.

I would not underestimate that post-banking crisis a lot of the big banks adjusted their risk appetites, de-leveraged, and essentially closed their doors to small businesses for a period of time. They focused on their bigger clients, and you have seen that translated into how they have then restructured the way they service those clients. They have pulled relationship managers away from them and essentially made them self-service. I can understand why that has happened, but it has never been sold or explained to the business community, which has been cut adrift and underserved.

Q130 **George Kerevan:** Can you give us any cause for optimism?

Mark Mullen: I can give you a cause for optimism by telling you that we know very viscerally what it is like to start a business, for example, at Atom. Consequently, we have a natural affinity for small businesses that comes from the last two and a half years of building this bank, and how difficult it is, and how closely associated the founder/owners are to the enterprises that they run. For them, it is their entire lives. It is not a profit opportunity; it is rather more than that.



I can tell you that investment in technology, where you are using the technology to make things speedier or more accurate, so that you do not continue to have to go back to customers, is a worthwhile exercise. I can also tell you that, certainly from our early experience, there is a real appetite for competition in the banking sector from small businesses.

We do not have to be as good as we want to be, because it is a journey for us, but they welcome having a different conversation with a different face. There is a visceral sense of, "I do not want to have to deal with the five that I have been dealing with over the last 20 years. Bring new, please." So yes, I think there is a cause for optimism.

Q131 **George Kerevan:** Mr McCreadie?

David McCreadie: We purely focus on retail banking, so we do not have any plans at this point in time to look at the SME market or expanding beyond retail banking. However, I think the comments Mark has made are consistent with what I have heard from other of the challenger banks, who tend to be more focused on SME lending, asset finance and residential mortgage lending. There is clearly still a prevalence of going to your incumbent core small business bank account for your lending; I think a figure of 90% was quoted in the CMA's report.

However, there are lots of less mature processes around data management that allow for that to move very quickly in the short term. The incumbency advantages around capital that can influence the ability to lend at competitive rates exist in small business as they do in retail.

Q132 **George Kerevan:** For any of the three of you, should the CMA have gone further in looking at the structure of the banking industry? It remains highly oligopolistic at the top, with relatively little in the way of the small regional banks that we find in Germany or Italy that service small businesses. Should we be looking at a more radical restructuring of the entire industry in order to solve this problem?

Peter Vicary-Smith: As I look across different markets in which we operate, the concentration of market share is not the most important factor in determining whether markets can act competitively. If I look at the grocery market, for example, I see intense competition between a small number of very large players, but that does not seem to translate into this market. I would not automatically treat breaking up the banks as being the solution to it. I would say there are many things to get them behaving differently. It is then also crucial to have lots of other players coming in, offering something different within the marketplace, to give consumers choice and keep the bigger guys on their toes. Those dimensions have not been looked at very much at all within this report.

Q133 **George Kerevan:** It was interesting that in the evidence given to the CMA, relatively few people suggested a radical restructuring of the entire industry and the break-up of the main players.



David McCreadie: My view would be, if I take current accounts, which is at the core of a lot of what we have been discussing this morning, there are probably just over 20 personal current account providers in the market. If that was to become 23 or 27 or 30 by breaking up the existing larger incumbents, we do not necessarily think that would lead to a great change in competition. What will change is about behaviours and how you treat customers, and the transparency and communication of your product offerings.

Unlike the example that has been used by Peter, on grocery, the difference here is that in grocery you are fighting to retain and win new business, not just a focus on new customers and taking existing customers for granted. It is very easy to compare the offerings and to make a decision to move somewhere else. Our fundamental issue remains that the inquiry has not gone far enough in describing how the different options are available and making it more transparent to compare the true cost and the value that you are missing out on by staying with an incumbent bank. There are slight differences from grocery that make it quite hard to make as many inroads as you would want to as a competitor.

Mark Mullen: The CMA appears to have concluded that breaking up the banks is essentially penalising success. Why should we penalise organisations because they have grown by acquisition? They mopped up the building societies in the 1990s, if you recall; they have mopped up the regional banks, and they have become these conglomerate enterprises. Then, of course, they have done it globally, too. You can make an argument that that is competition and that is what successful businesses do. Why should they be punished for it?

The CMA has pivoted towards the Open Banking Initiative, to say, "I will tell you what we will do: Open Banking will introduce new types of competitors—not just other banks, but data providers, analysers and aggregators. That will provide the customer with a platform that enables them to choose, not just from their own bank's products, but potentially to be able to compare against a much wider set, and to use their data from their existing banks to help them make better financial decisions." I think that is the pivot that has happened. Do not break them up because it is a very expensive and difficult thing to do—and to David's point, it probably will not make a big enough difference.

On the other hand, introduce potentially many, many more new types of competitor by using technology and giving the customer empowerment to make their data available to those providers, and use it to optimise the decision making as it relates to their money. That is how I view it.

Q134 **George Kerevan:** Mr Vicary-Smith, pursuing that line of questioning, one obvious new element in the market is the rise of peer-to-peer lending. As a consumer champion, is that being properly regulated—positively or negatively?



HOUSE OF COMMONS

Peter Vicary-Smith: I do not know enough about the regulatory regime around peer-to-peer to give a precise answer. What I can say is that it comes back to this point I keep making about the variety of needs that people have and the variety of different types of access to credit they need at different stages. The job of a well-functioning market is to provide those to people at fair and reasonable prices, with a degree of security. If it can do that in a way that is safe, great; the more diversity we can have, the better. I do not see things in here that will create a great deal more diversity.

Q135 **George Kerevan:** What would you put in?

Peter Vicary-Smith: There are a couple of things. Switching is great as a mechanic, giving people information to switch, but alongside that, there needs to be the incentive to switch. This comes down, in large measure, to my mind, to the behaviour of individual banks. I keep going back to when we did the Future of Banking Commission report all those years ago. The big thing we talked about there was the culture of the banking system and the ways banks choose to behave. There is still inadequate progress being made on that.

As you have said a number of times, a lot of this stuff can be done tomorrow if banks choose to do it. They do not need a regulator or a report to tell them to do so, but there is not enough change happening about the way banks are behaving, how they are treating their customers, treating complaints and listening to consumers. Our recommendation of consumer challenging groups was batted aside by the CMA in their inquiry, without a great deal of analysis of why. I am quite hopeful, looking at the Prime Minister's intervention around consumers on boards. That may be another way of causing the banks to focus more on their customers.

If I may, one of the things I keep going on about to people in the comparison to the grocery market is that there you have a market where there is a lot of competition, people fighting for attention and fighting for new customers. If there is a problem with a product being unsafe, nobody waits for the regulator to take it off the shelves; it is off the shelves the same morning. There is relentless focus on the needs of the customer and the end customer's desires, product and store innovation constantly happening to deliver that, and yet still decent profits being made. What is so different in that marketplace? It is about the culture of the businesses and how they are choosing to operate.

Q136 **George Kerevan:** If the culture of the businesses, after all these years, is not changing, does that not indicate that the regulator or competition authority has to do something more dramatic?

Peter Vicary-Smith: There are many things that can happen; for example, the new body that has been set up looking at the issue of culture in banks. Why is that not publishing reports naming banks that are doing well and saying why they are doing well, and naming what is



HOUSE OF COMMONS

not being done well? Greater transparency around good and bad initiatives that are happening across banks would keep that slow, gradual drip-drip-drip on the stone that will ultimately change things.

Q137 Chair: Thank you very much for that piece of evidence. I just have two points of clarification I want to raise. First of all, Mr Mullen, you said much earlier that banks know how much they make from each customer. If they know that, then they know how much they are charging each customer. Why are they refusing to publish it?

Mark Mullen: That I cannot answer. There is no perfect pricing model that I have ever seen. All organisations, whether a complex bank or a small, simple organisation, have to make assumptions about cost allocations. There are lots of different models and theories about transfer pricing and costs. Perfection is not possible, I accept that, but pursuit of perfection is not required. You have 250 years of data in this industry. It is very difficult for me to accept that you do not know how much money you are making from a customer.

Q138 Chair: I have just one last point to Mr Vicary-Smith. Right at the beginning you made clear that you thought that the CMA had dropped a catch, and that the FCA might need to pick it up. Why do you think that the CMA has failed? Is it because this new body that has been created, as an amalgam of two other competition bodies, is flawed in some way? There has been criticism of the only other major report that they have produced, as well, on energy. Or is it that, in this case in particular, they have been dealing with an industry that are past masters at lobbying, and who hold a near-monopoly of the information that the CMA need in order to try to work out the answer? In the latter case, dealing with this would be enough to elude almost any investigative body, however determined.

Peter Vicary-Smith: I would be very disappointed to conclude the latter. It is a difficult body to get information out of, but the CMA should be able to do so; otherwise, if it cannot do it on this or on energy, what is it there for? One of the concerns that we had when the CMA was formed was whether it was going to be too dominated by economic theory modelling, if you like, of how certain markets should operate in theory, without a lot of what the OFT—

Chair: They have moved over to the panel system, with a much heavier emphasis on input from academics, as I understand it.

Peter Vicary-Smith: Exactly. One of the things the OFT could do was to bring in much more of what the reality is like for people on the ground, and did in a number of its latter studies. To my mind, this is too theoretical a paper. It sets up the models of: "This is to give people information, and the market will sort itself out without any other guidance and help." In theory, that may be true, but it is not in practice how real consumers behave. They have not taken enough account, in



HOUSE OF COMMONS

this, and in other work, of the reality of people's situation on the ground in Britain today.

Q139 **Chair:** I have given you two possible reasons why they dropped the catch, and you have reduced it to one rather than saying, "Neither of the above."

Peter Vicary-Smith: Indeed.

Q140 **Chair:** You are really saying that Parliament, in one way or another, needs to keep an eye on the behaviour of the CMA?

Peter Vicary-Smith: I am.

Q141 **Chair:** That is what you are saying, I think. Is that conclusion inconsistent with what others on this panel think?

David McCreadie: I would not have a broad enough understanding of other reviews to make a similar comment, but I would concur with the view that the reliance on academics and economists in the inquiry panel could have been aided by having more practitioners or experience from the industry.

Chair: We always operate on this Committee as a lobbying group for economists. They are a beleaguered group; they need a lot of defence. We know what you say. Thank you very much, all three of you, for giving evidence this morning. This has been extremely enlightening, and we have learned a lot. Thank you.