

Treasury Select Committee

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

Tuesday 1 November 2016

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Members present: Mr Andrew Tyrie (Chair); Mr Steve Baker; Helen Goodman; Steve Hammond; Kit Malthouse; Chris Philp; Mr Jacob Rees-Mogg; Rachel Reeves; Wes Streeting

Questions 142 - 296

Witnesses

I: Professor Alasdair Smith, Chair, Competition and Markets Authority Retail Banking Investigation Panel, Adam Land, Senior Director, and Bill Roberts, Assistant Director, Competition and Markets Authority

Examination of Witnesses

Witnesses: Professor Alasdair Smith, Adam Land and Bill Roberts.

Q142 **Chair:** Thank you very much for coming to see us. Of course, we saw you about a year ago and expressed considerable concern about the outline report that you had produced. I have to tell you that, on the basis of the evidence that we have received, we remain just as concerned, if not more concerned, now that we have seen your final report.

I would like to begin, though, by going to what I think is a summary of the report that has been produced in the form of a speech by you, Professor Smith. If I can take you to its final conclusions you are basically saying, as I understand it, that we should make progress by what you have described as spreading existing good practice. What good practice did you have in mind?

Professor Smith: What I had in mind there is that the very strong package of remedies that we are putting in place following our report draws very heavily on developments, many of which were already in train. As I may have said in that speech, that is first of all not surprising, because this is an area that lots of committees and authorities have



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looked at for very good reasons over the last 10 years and there have been a number of initiatives. It is natural that we have picked up a number of things that are already in place and pushed them forwards. That is a very strong feature and, I would argue, a very positive feature of our remedies package.

If we had come to an area that so many people have looked at, including you, Mr Chairman, and gone off in completely new directions and ignored what people had already done, ignored the problems for small business banking that the Treasury have been dealing with following the Small Business, Enterprise and Employment Act, you would be saying, "Why are you not taking account of all the good things that are already being done?" That is what we have done. I make absolutely no apology for it; I think it is the right thing to do.

Chair: To build on existing good practice. My question to you was which existing good practice you had in mind.

Professor Smith: The heart of our remedies programme, which I highlighted in that lecture that you have kindly picked up, is the open banking initiative. That picks up something that was already underway. John Fingleton, formerly of the OFT, did a very important piece of work for the Treasury that was then picked up by an Open Banking Working Group set up by the Treasury. It is very closely related to the work that the banking system has got to do for the second Payment Systems Directive, which needs to be implemented by 2018.

What we were able to do was to pick up that already-existing initiative that was in some danger of running into the sand and, putting some of our legal muscle behind it, make sure that open banking goes forward on a very demanding timetable and, in 2017, delivers changes to banking. These are changes that we think are going to tackle the fundamental problems that have bedevilled competition in banking for decades, are going to make a transformational change, open up new services to customers and make a difference to personal customers and business customers.

Chair: "Transformational change", "make a difference to millions of customers"—this is what we have heard about all the other initiatives that we have had in the past. I have asked you twice what the existing good practice is and, apart from a reference to some work by Mr Fingleton, I do not think I have yet had a reply. The major initiatives that I can think of are the Midata initiative, which does not seem to have made much progress, and Business Banking Insight. Did that do a good job? There were the annual statements that were demanded. They do not seem to have rectified the problem. There is then the marketing campaign for switching. Switching levels have remained stubbornly low. That is all on the back of very high concentration levels. In fact, they are up, are they not?

Professor Smith: It depends what the benchmark is.



Q143 **Chair:** What about concentration levels in SME lending by the big four?

Professor Smith: Concentration levels obviously went up very substantially with the bank mergers that took place in 2008. They have been drifting down a little bit since then but at a disappointingly low pace. I am not at all disagreeing with you on that, but if I go back to the initiatives that you mentioned as already being in place, obviously I am not here to defend past initiatives—

Q144 **Chair:** But you are saying that you want to build on existing good practice, so presumably that existing good practice is built on the base of past initiatives.

Professor Smith: Yes, and our proposals also build on what we have learned from things that have not worked. Let me pick up the Midata initiative as an example of that. We looked at Midata. We probably talked about Midata when I was here last year. In principle, Midata is a very good idea because it is an attempt to tackle what I described a moment ago as the fundamental problem in banking: that customers do not have the tools that they need to make the decisions that are in their interests.

Q145 **Chair:** Professor Smith, we are all agreed that these initiatives had good intentions and that they are all pointed in the right direction. It is the outcomes that we are concerned about.

Professor Smith: I hoped to say why I think open banking both builds on Midata and learns from the essential failure of the Midata initiative itself. Midata has good intentions, taking consumers' banking data, and having someone else look at it to say, "You could do much better by switching banks or switching to a different kind of bank account". That is the kind of help that customers need. However, to use Midata you need, in a very clunky way, to download a chunk of data from your online banking website, which itself is a technical task that may well be beyond most people, and then to ship it off to a third party who will look at it. That raises obvious concerns, both about the technical difficulty and about security. The open banking initiative will do the same task for consumers but in a much simpler way and more importantly—I am sure we are going to talk about this—in a much more secure way.

Chair: We are going to come back to open banking later on in the hearing. I would really like to concentrate on the main themes of your speech. You can hear certainly my scepticism about whether there is enough existing good practice to build on. You also say that you favour behavioural remedies over structural remedies. I take it that when you talk about behavioural remedies you mean that we need higher quality behaviour from consumers.

Professor Smith: No. We need much better tools in the hands of consumers to make banking easy for consumers, because it is currently too difficult.



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Q146 **Chair:** Can you think of a major behavioural remedy that has worked in the past?

Professor Smith: Yes. A number of banks give overdraft alerts to customers who are going into unarranged overdraft and the work of the FCA on that has shown that giving customers overdraft alerts has a very big impact on the behaviour. Some of us might think it is surprising but it is a fact that the majority of customers can change their behaviour and can make some financial adjustments on receiving an overdraft alert. The experience of the one bank that the FCA looked at was that bank customers were, on average, able to reduce their unarranged overdraft charges by a quarter as a result of receiving alerts.

Q147 **Chair:** We are going to come on to this in a moment, but you would not suggest that the situation on overdraft charging was in a good place at the moment.

Professor Smith: No, not at all, but your question was not whether we were in a good place on overdraft charges. Your question was whether I could identify a remedy that has been effective, and that is a remedy that has been effective.

Chair: Something that has made it a bit better than it was.

Professor Smith: Yes. A 25% reduction in the uncomfortably high level of unarranged overdraft charges is a big impact.

Chair: Just unpack that: a 25% reduction in the uncomfortably high level of overdraft charges. We have 75% to deal with; is that right?

Professor Smith: I would suggest that it might be ambitious to say that customers on an unarranged overdraft should pay nothing.

Chair: However, this is a behavioural remedy that succeeded at 25%.

Professor Smith: Yes.

Q148 **Chair:** I would just like to come back to your speech, to a key passage that says, "The strong opposition may come ... from politicians, the media and consumer groups who think the remedies don't go far enough". We are the villains of the piece, are we not, in your speech?

Professor Smith: No, I do not regard critics as villains at all. Critics can be useful.

Q149 **Chair:** We are the people who are not going to accept your proposals from the tone of this. Is that not right?

Professor Smith: What I was attempting to do in that paragraph was to say that when a competition authority engages in what we could call supply-side remedies, for example requiring the owner of Heathrow Airport to get rid of Gatwick and Stansted and Edinburgh, then that is a set of measures that is fought through the courts by the parties involved.

Q150 **Chair:** We understand. You want demand-side remedies. That is what



your whole speech is about; it is about saying that the consumer has got to work harder.

Professor Smith: The point of that paragraph was not to say that politicians or the media are the enemy, and I would not dream of saying that. It is saying that when you are looking at demand-side remedies—customer-facing remedies—we as a competition authority need to think quite hard about selling the remedies as effective tools because we are influencing a wide range of parties and thinking about how this market is going to shape. The communication of what we are aiming to do is more important than it would be if what we were doing was attempting to break up the parties.

Chair: You are an academic, Professor Smith.

Professor Smith: A recovering academic, I would like to think.

Q151 **Chair:** Do you feel that academics are in this very critical camp, or do you think they have something to offer that might be more constructive than the politicians, the media and the consumer groups?

Professor Smith: Some of the academics who have a strong interest in the details of how the banking markets work have commented very positively on our report.

Q152 **Chair:** Diane Coyle is an academic, is she not?

Professor Smith: Yes.

Q153 **Chair:** She said, “I could actually weep with disappointment that this once-in-a-generation opportunity to fix a really important and dysfunctional market looks like it is being squandered. The situation has actually got worse since Cruickshank”—that is the key landmark report two decades ago—“not better”. I have other quotes of a similar ilk in front of it. She does not strike me as the academic equivalent of a rogue state. She strikes me as somebody who is a very reasonable, thoughtful, independently-minded academic. Do you agree?

Professor Smith: I agree. She is a very respected commentator, formally an economic journalist, now an academic and well worth listening to. I happen to disagree with her judgment on our report and I do not doubt we will talk through the issues that she discussed about unarranged overdraft charges and capital requirements. I am happy to talk about them in detail.

Q154 **Chair:** We will in a minute. There are then the challenger banks. I do not know whether you feel they are rogue companies but they have been pretty robust. Here is Mark Mullen of Atom Bank: “I do not believe that the CMA’s findings are in any way adequate. It proposes remedies that do not go far enough”. You have mentioned overdraft caps; that is the question. “In terms of the things it refers to by way of open banking standards, it essentially intervenes in a way that is unhelpful”. He has got it wrong as well, has he? He is a challenger bank.



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Professor Smith: Yes, I would, with respect, disagree with him on both of those of those fronts. Of course, a lot of the responses of the challenger banks to our report have been in respect of capital requirements. That is what they have written to you about primarily.

Q155 **Chair:** Why do you think it is that politicians, the media, the consumer groups, the challenger banks and many academics are all going in one direction and you are going in another?

Professor Smith: When people absorb fully the far-reaching implications of open banking and other things around—when they have had time to absorb it and look at what we are aiming to do and think of what the long term effects are—they will at least understand why we think that this is a very strong report of which we are proud.

Q156 **Chair:** If we keep calm and wait for the passage of time, are things going to improve decisively with these proposals?

Professor Smith: It is not waiting for the passage of time but ensuring that our remedies are implemented. When they are implemented and have their effects, then we will see transformational change.

Chair: If we are patient.

Professor Smith: Everything takes time.

Q157 **Chair:** It seems to me that there have been so many reports that we have had saying that this market is in fundamentally bad shape: the Cruickshank Report and about 15 OFT reports over the years of varying types. There was also the Independent Commission on Banking chaired by Vickers, which came to similar conclusions. He is a leading academic with world-class expertise in this field from All Souls. There is the Parliamentary Commission on Banking Standards, which came to a similar conclusion, which I chaired. There was the Treasury Select Committee Report of 2011. All of these have been moving in the same direction. We have finally got to the point where there was a consensus that we had to do something about it and had to do a fundamental rethink about the way we were providing banking services to retail customers.

Just to read your speech, frankly, it seems that either that group have been making a hullabaloo about not very much, or this speech has an air of greater complacency than any I have read from a regulator. It seems to say, "Do not worry. Let time go by. Let's build on existing practices. Let's use behavioural remedies of an incremental nature and we will be fine."

Professor Smith: No, I have to disagree with that. Let me just pick up two examples. The Vickers commission of course primarily was focusing on prudential security and has launched ring-fencing, an area that we, for obvious reasons, have not covered. However, it was the Vickers commission that also launched the Current Account Switch Service.



Q158 **Chair:** That has not worked, though, has it? There is a packet being spent on it and we are no better off, are we? The switching levels remain stubbornly low.

Professor Smith: The switching levels remain quite low but the Current Account Switch Service is itself a very good service. We have looked at current accounts—

Chair: Sorry to interrupt for the third time. The switching service has not provided what those who designed it hoped for it, has it?

Professor Smith: As I was trying to say, the switching service has provided what Vickers wanted to be provided. The issue is that it has not had sufficient take-up. We have not, with respect, said, “The switching service is all fine. Let’s just leave it to rumble on for another five years.” We have looked at what needs to be done to make the switch service work much better and we have a number of measures that we are getting Bacs to implement to make the switching service work better. Open banking, again, will be the thing that changes customer behaviour. We would expect it to push up the level of switching, not that the level of switching is an objective in itself. The switching service itself is good. Your concern about it is that it does not have enough take-up. That is exactly our concern and that is why we are doing things to improve the take-up of it.

Rachel Reeves: Professor Smith, a few weeks ago I did some call listening at StepChange, the debt charity, listening to people who are experiencing financial difficulties, and I do fear that the CMA and your evidence today has been somewhat complacent about the challenges in which people in financial difficulty find themselves. StepChange has recently looked at its customer base—the people who are phoning them every month—and they estimate that between 6,000 and 10,000 people contacting the debt charity every month have incurred unarranged overdraft fees and charges, and that those are adding, on average, about £225 a year to their already heavy debt burden.

The people whose calls I listened to—the people whom these charities help—do not have the luxury of time to wait for these remedies to come into effect, if indeed they do come into effect, which I, and I think the Chairman as well, would very much doubt. I want to ask you some questions specifically around overdraft charges today.

The heaviest overdraft users are the least likely to switch. That is evidence from the CMA. Are banks taking advantage of these customers?

Professor Smith: It is inevitably the case that if a bank or any other commercial firm feels that it has got a captive group of customers those customers are not going to get the best deal. The fact that a lot of overdraft users feel that they have no alternative but to continue with their existing bank is one of the reasons why overdraft charges remain stubbornly high. Yes, I agree with you. Just to make it clear, I also, incidentally, agree with you in more general terms that overdraft



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charges, especially unarranged overdraft charges, are the biggest single problem in the professional banking market, and the cost of unarranged overdraft charges for vulnerable consumers with debt problems is a particularly important issue.

Q159 Rachel Reeves: I would argue that while the remedies that you are proposing might help some overdraft charge users, they will not help the most financially vulnerable. You say that some of the actions that you have taken in terms of the grace periods and the alerts given to customers will reduce the charges on overdrafts by a quarter. Do you believe that those charges will reduce for financially vulnerable customers or just for customers who have made a mistake and misestimated when money is coming out of their account?

Professor Smith: Would it be helpful if Adam said a few words about the overall package about unarranged overdrafts?

Rachel Reeves: I know about the package of measures. I am aware of those. My concern particularly is about whether your measures help financially vulnerable customers or just customers who have made mistakes about when direct debits are going to come out or have failed to put money in their account when they were supposed to?

Professor Smith: It is fair to say that our measures about unarranged overdraft users are measures that have looked at unarranged overdraft users in general. We recognise that financially vulnerable customers are a particularly important group of customers but our measures are geared at everybody.

Adam Land: If you look at the total base of people who use overdrafts, it is about 45% of all customers, which is about 20 million people. Unarranged overdrafts is about 10 million people. There are a lot of people with quite diverse experience and quite diverse usage of overdrafts. We are looking for remedies that help all of those people.

Q160 Rachel Reeves: You say that, Mr Land, but giving people an alert that they are just about to go into an unarranged overdraft is fine if you have the money, then, to move into that account to avoid the overdraft. The grace period is useful to those customers as well. However, I do not see how either of those remedies are at all useful to financially vulnerable customers who, at that moment, presumably are not able to put money in their account to avoid going into an unarranged overdraft. Would you agree with me on that?

Adam Land: I totally understand what you are saying. When we look at the package of remedies that we have, there are really three components. The first is around alerts and grace periods. The second is around the maximum monthly charge, which we will talk about in a moment. The third area is actually open banking, which is an important aspect of that. We have probably not made the connection with overdrafts and open banking as strongly as we could; there are a number of ways in which open banking and our remedies help overdraft



customers.

I would probably highlight three things. The first challenge for overdraft customers is that customers quite often feel captive to their bank; they feel like they cannot switch to another provider because they are in debt to their current provider. Paul Pester, who is the Chief Executive of TSB, came up with this brilliant idea of a credit passport, where essentially you can use your current account information to demonstrate how you are managing your money and send it to potential lenders. That is one area where people are able to demonstrate their financial position.

The second area that is really relevant to the most vulnerable is around money management tools. This is an area where open banking will really help customers. For example, at the moment, we will help customers manage their own money and avoid getting into positions. For example, at the moment if you go to a debt advice centre, one of the things you will want to do is work out how much money is coming in, how much is going out, set a budget and work within that budget. Open banking will enable people to use their own banking history to work out that budget and to track their progress against that budget. We see that as putting a really important tool in the hands of the most vulnerable. I do take your point about overdraft alerts. What we have found is that a lot of customers are able—not necessarily on the day—to manage their money and avoid at least some of the charges.

Q161 Rachel Reeves: Let's come back to this issue of the financially vulnerable and how they are treated by the banks. Professor Smith, the charges in 2014 on overdrafts made by banks was £1 billion. What proportion of banks' revenues from personal current accounts comes from overdrafts?

Professor Smith: From overdraft charges altogether, it is about a third of the revenue that banks make.

Rachel Reeves: In your report, it says it is 60% of net revenue per main account in 2014.

Professor Smith: I think that 60% does not include the revenue that banks make from lending out customers' money.

Chair: We are talking about the forgone interest. Just to clarify the difference between these numbers, that is a number looking at total revenue, including the forgone interest. Rachel is right to be quoting the figure that she is giving, excluding the forgone interest.

Rachel Reeves: From your report, it says that revenue from charges and overdraft interest accounted for around 60% of net revenue per main accounts.

Professor Smith: That is right. That is leaving aside forgone interest, which is about half the revenue. I am sorry; the number I had in my head was 30%. It is 30% of 50%. Apart from the interest that banks make on customer balances, overdraft charges account for 60% and



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unarranged overdraft charges for just a little bit under half of that. It is a lot of money.

Adam Land: £2.9 billion is the total for overdrafts. £1.2 billion is the total for unarranged overdrafts.

Q162 **Rachel Reeves:** It is a huge amount of money. What impact do you think your proposals will have on that £1 billion charge. When they are implemented next year, what would you expect to happen to those charges?

Professor Smith: I would expect, at a minimum, that the 24% reduction in charges that we have seen in those banks that have alerts will be reproduced across the board.

Rachel Reeves: You would expect it to fall by 24%.

Professor Smith: I would not expect it to fall by 24% because some banks already give overdraft alerts.

Rachel Reeves: Where would you expect that £1 billion to be next year?

Professor Smith: Very significantly lower.

Q163 **Rachel Reeves:** How much lower? You say that these measures are going to have an impact, Professor Smith. Great; what is that impact going to be?

Professor Smith: It is not sensible to try to forecast that.

Rachel Reeves: You have told us, Professor Smith that you think these are going to have an impact but now cannot tell us what that impact is.

Professor Smith: You are asking me to put a number on it. I am not going to be so bold as to put a number on it.

Rachel Reeves: A range.

Professor Smith: It will have a very substantial impact but, if I could finish, it is not just overdraft alerts that are going to have the impact; it is also the fact that banks will have to announce a maximum monthly charge, publicise that and it is also, as Adam was talking about, that when open banking gets underway, customers will have a much stronger range of tools available to them that will enable them to manage their use of unarranged overdrafts much more effectively than they can do at the moment. I am not going to say the £1.2 billion is going to go down by a half. Personally I would regard a reduction of a half as a reasonable target; it might take us some time to get there.

Q164 **Rachel Reeves:** I come back to the point at the beginning, that the customers at the moment who are racking up charges of £200, £300 or £400 a year on charges cannot wait years and years for your changes to have an impact, if indeed they have an impact at all. I find it hard for you to be able to substantiate this claim that it is going to have a large impact when you cannot even give us any type of figure.



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Let's move on, though, to the monthly maximum charge that Mr Land and you, Professor Smith, have spoken about. Most of the banks have already set a monthly maximum charge, and there is some awareness of what those charges are. It has been publicised a lot recently. When I have spoken to the banks it does not seem that any of them have any intention of reducing their monthly maximum charge as a result of your recommendations. In fact they are under no obligation whatsoever to do so. Would you expect any of those monthly maximum charges to fall, Professor Smith?

Professor Smith: Yes, I would. It is true that many of the banks already have maximum monthly charges but overdraft charges are a very complex set of charges. Different banks have different definitions of things. The current maximum monthly charges are not on a consistent basis between banks, so they are not numbers that you can confidently compare different banks with. They are also not numbers that banks have got to publicise to their customers. What we are requiring is that all banks have a maximum monthly charge, that they all calculate it on the same basis, taking into account things like unpaid item fees, other fees and interest charges, so they are all doing it in the same way, and that they publicise it as prominently to their customers as all their other charges.

We think that the maximum monthly charge will have a very significant impact in raising the profile of overdraft charges in consumers' minds when they are thinking, "Am I getting a good deal from my bank?" and in enabling them to compare different banks. If they are bothered about their overdraft charges, and they have been hit by unwelcome and unfair overdraft charges, as they see it, they can say, "Hold on. Hold on. Are my bank's overdraft charges too high? What's the bank down the street able to offer me? Could I switch?"

We are taking measures to ensure that consumers who see that another bank has got lower overdraft charges will find it easier to switch than they currently find it, so yes, we expect that to affect banks' behaviour, and I would expect that even the banks that currently have maximum monthly charges will be having a very hard look at this and saying, "Given that this is now going to be publicised so prominently and there are going to be comparisons with our rivals, have we got this in the right place?" It is going to have a significant impact on banking behaviour.

Q165 **Rachel Reeves:** Let me just come back to this point, because again you have claimed there is going to be a significant impact. That is great, although your definition of "significant" has been a bit vague so far. Let us have a look at what the banks do currently. RBS allows customers a £10 a day buffer and then charges a monthly maximum charge of £90 in any 30-day period. Lloyds and HSBC both charge up to £80 in a month. Customers of some Halifax accounts pay £5 a day up to a maximum of £100. You have there the big banks—RBS, Lloyds, HSBC and Halifax—charging between £80 and £100 a day.



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Professor Smith: A month.

Rachel Reeves: A month. If I was a customer at RBS being charged £90, I could indeed switch to Lloyds or HSBC and be charged a mere £80 a month. How much do you think that these monthly maximum charges are going to come down by? What is your definition of “significant”, Professor Smith?

Professor Smith: I am going to disappoint you by giving you the same kind of answer that I gave to the effect of alerts: it is very hard, realistically, to predict the size of effects but what we do know and what we can be confident about is that when customers’ attention is drawn much more vigorously than it is done at the moment to the potential scale of these charges, they will look at whether other banks can offer them a better deal and they can ask themselves the question. The vast majority of customers do not reach the £90 or £100 limit. Their behaviour will change as a result of these charges, along with all of the other things that we are putting in place.

Q166 **Rachel Reeves:** Professor Smith, you say people’s behaviours will change as a result of these charges. These charges exist now and it is possible to find out what the monthly charge is. In fact, if you go on the websites and look at the account details for these accounts, you can see all of this information. What changes as a result of the CMA recommendation or the CMA directive that you have to have a monthly maximum charge? These banks already have monthly maximum charges. What changes?

Professor Smith: As I said earlier, they all have to calculate them on the same basis and they all have to announce them very prominently, so it is not a matter of digging through your bank’s website and finding out what the charge is. It will be very prominently displayed to all of the customers.

Q167 **Rachel Reeves:** You have no view about what these charges will come down to. Do you think that these charges are fair, Professor Smith?

Professor Smith: As I said earlier in response to one of the questions from the Chairman or in response to your opening question, high overdraft charges are an indication that competition in this part of the banking market is not working well. Our analysis of the overall economics of personal current account banking shows that there are two areas in which the banks make most of their money from their personal current account customers. One is forgone interest and the other is overdraft charges. We have seen competition growing in the area of forgone interest because banks are offering more and more reward accounts—essentially interest-bearing accounts—and that is driving down the returns from forgone interest and giving customers with substantial current account balances a much better deal than they got in the past, so competition is working a bit in that area.



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In the area of overdrafts, where customers feel that they do not have the possibility of switching, competition is not working and charges are higher than they would be in a market with healthier competition. I am completely agreeing with you there.

Q168 **Rachel Reeves:** If I borrowed £100 for one month with a payday loan company, what charges would I incur, Professor Smith?

Professor Smith: I do not know, because I do not know much about the payday loan market, but fortunately Adam, on my left, has said quite a lot on payday loans.

Rachel Reeves: Mr Land, what charges would I incur if I took a payday loan for £100 on 1 November? How much would I be charged at the end of the month for that?

Adam Land: There is a cap on payday loans.

Q169 **Rachel Reeves:** What would the charge be?

Adam Land: In terms of payday loans, if you paid it back on time then the number is about £22.50. It is approximately £20 to £25. If you are late then there are additional charges, but those themselves are capped up to the value of the loan. Depending on when you paid it back, it would range between £22 and £100; that would be the interest that you paid back.

Q170 **Rachel Reeves:** If I went overdrawn with a high street bank today, 1 November, and was overdrawn until 30 November—just one of those high street banks that I have mentioned before—what would I be charged during the course of that month?

Adam Land: It varies according to the bank and it varies according to—

Chair: Not that much.

Adam Land: It varies quite a lot according to the bank. When we looked at the gains that customers could make by switching from their current provider to other providers, we found that on average a customer could save £92 a year by switching to the best account in the market. For an overdraft customer who is overdrawn for one or two weeks, they could save double that. If you are heavily overdrawn you could save five or six times as much.

Rachel Reeves: My question was quite a specific one

Adam Land: Yes, I was just responding to the Chair on that point.

Q171 **Rachel Reeves:** If I was overdrawn for £100 from now until the end of this month, at one of the main high street banks that I have just referred to, I would be charged between £80 and £100 for that. However, if I took a payday loan I would be charged £22.40 for borrowing £100 for a month. Do you think that that cap on payday loans is right, or do you think that that is not the right policy?



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Q172 **Professor Smith:** What your comparison shows is that using unarranged overdrafts as a permanent means of financing yourself for a whole month is a very, very expensive way of borrowing money. It is not a sensible position to be in. Someone who is in that position needs help in organising their funding, to look at alternative ways of managing their funds. Realistically, the number of customers who have permanent unarranged overdrafts is very small. Not surprisingly, the customer surveys that we did on overdraft use show that the vast majority of unarranged overdraft use is for very small numbers of days at a time.

Q173 **Rachel Reeves:** I am concerned. £1 billion per year from current account users is a large amount of money spread over a large number of people.

I come back to the financially vulnerable group of people, who I think we all have a responsibility towards. StepChange said that more than half of the people advised by StepChange in the first half of 2016 had overdrafts, and they owed an average of £1,679 on their overdrafts. This amounts to 93,000 people just who have used the StepChange debt charity. First of all, I do not think these are small numbers of people but the people who are struggling most are the people who cannot respond to your prompts and alerts but are also being ripped off by their banks. The reason why you are only charged £22.40 for a payday loan is because Parliament and the FCA acted.

Just to finish, Mr Chairman, I would come back to what Peter Vicary-Smith from Which? said at a hearing of this Committee. He said, "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." He went on to say—and I agree with him, and I agree with him even more strongly than I did when he gave this evidence—that the CMA "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 the banks that this is the wrong way to be making profits." It is a dereliction of duty, Professor Smith. It is a very disappointing report. You are letting down the most financially vulnerable.

Professor Smith: I do not think it is a dereliction of duty. As I said at the beginning, our focus in this whole inquiry has been looking at making competition work better. I know that our proposals on overdrafts are one area where we will make competition work better. As Adam has said, we have looked at the full range of overdraft users.

I agree with you that our measures will not directly address all of the problems of the most vulnerable overdraft users, with whom you are particularly concerned; I share your concern. It is not realistic for us to do that. In particular, when I look at what StepChange say about what they would like to see done, they say two things: first, that they would



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like to see our maximum monthly charge become a regulated charge set by the FCA, since we have not set it, at a level that would help vulnerable consumers; secondly, that they think banks should not be giving repeated unarranged overdrafts to vulnerable consumers.

On the first of those, I expect that the FCA would look very carefully at whether regulating the monthly cap is the right way to proceed. As we discuss in our report, one of the risks of regulating charges is that the product becomes less available to customers. Bank customers, vulnerable or not, who because they cannot get an unarranged overdraft find that their gas bill has not been paid have a different kind of problem to an unarranged overdraft charge. When you are looking at whether regulation is the right answer, you need to think very hard about whether that is going to have further consequences that will be undesirable.

Speaking for myself, because we, as the CMA, did not look at it, the second of the StepChange proposals is a much better way to proceed, and a way that is appropriate for the FCA to take forward: that the FCA, under the heading of responsible lending, should be putting pressure on the banks to talk to vulnerable customers who are making repeat use of expensive unarranged overdrafts and say, "Look, this is not a sensible way to organise your money. Can we talk about other arrangements that would be better for you?"

Just to emphasise, we recognised in our report that overdrafts are one of the more difficult areas to tackle. We have put in place a number of measures. As I have already admitted to you, we do not know with confidence exactly how effective these measures are going to be, although we are confident that they will have some effect. We have asked the FCA to look further at the overdraft alerts, the grace periods and the maximum monthly charge, to see whether the overall picture can be refined further and made still more effective, and we are entirely happy that within that the FCA should look, as you want it to look, more closely at the particular problems of vulnerable customers. I do not regard it as a dereliction of duty. I regard us as having set in train a process that the FCA will pick up and may well decide to take further, and we would be very happy if they took it further.

Rachel Reeves: You started a piece of work. You spent a lot of time looking at it. In that time, more people are being charged more and more money, and now you are passing the buck to the FCA. I think that is a dereliction of duty. You make the point about the gas bill being bounced. Most people's gas bills are not as much as £90 or £100 a month. The problem with these excessive charges on unarranged overdrafts is that they make it much harder the next month to pay the gas bill, the council tax or the rent, if you are racking up, every month, these unarranged overdraft charges. That is the real problem here. These charges are not helping financially vulnerable customers pay their bills. They are helping them get into more and more debt.

That is why I believe that either the charges should be equalised with



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arranged overdraft charges or they should be capped in the same way that payday loans are capped. The idea that you could be charged more by your high street bank for borrowing £100 per month than a payday lender beggars belief, and most people would be shocked to think that a payday lender is actually going to be better value for money for borrowing £100 than your high street bank. That is where I will end it, Mr Chairman.

Q174 Chair: I will give Professor Smith an opportunity to respond to that point if he wants. Frankly, if I may say so, your replies are reinforcing the sense of complacency that we get in response to what is a very serious concern, which is that of vulnerable groups paying large sums in overdrafts.

Professor Smith: I am sorry you say that, Mr Chairman. It is not an issue I feel complacent about. On the contrary, I have said we regard it as a very big issue and we regard ourselves as having made a very significant contribution to addressing it. We recognise that there is more to be done. That is not a story about complacency.

Q175 Chair: But what you are also doing on this specific issue is passing the buck to the regulator, are you not?

Professor Smith: As I have just explained to Ms Reeves, it is a difficult area and we have put strong measures in place. We think that there is more to be done when the FCA has an opportunity to see how our measures work. We can take further measures.

Q176 Chair: You have gone much further than that in your speech, have you not? What your speech effectively says, if I decode it, is that power should be taken from the CMA and passed to the FCA to conduct this. Is that not what your speech means when it says, "It's possible to imagine scenarios in future where a market study which points towards a need for demand-side remedies"—in other words, the consumer needs to do the heavy lifting—"may lead to a differently configured deployment of the respective powers of the CMA and a sectoral regulator"? You are not suggesting a configuration with fewer powers for the sectoral regulator, the FCA, are you? You are suggesting more powers for that regulator.

Professor Smith: I am sorry to repeat myself but you have repeated yourself. I do not accept that demand-side remedies are getting the consumer to do the heavy lifting. I repeat what I said earlier. We are putting tools in the hands of the consumer.

To answer the main point, the main connotation of that statement about the FCA and the CMA having a shared responsibility was not specifically about overdraft charges, but we can use overdraft charges to identify what I am concerned about there. One of the things we have learned in the past—

Chair: I apologise for interrupting, but rather than a history lesson on what you have learned in the past, what I really want to know is this: you



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are talking about a differently configured deployment of the respective powers of the CMA and the regulator, which in this case is the FCA. What did you mean by that?

Professor Smith: When we look at overdraft charges or other alerts, one of the things that we know from the work of the FCA itself is that the detailed design of how banks address consumers has a big impact on how effective measures are. Exactly when and how overdraft alerts are given will affect the impact, whether it is 24% or a larger number. We have, in this area and in other areas, asked the FCA to conduct programmes of randomised customer trials to make sure that these interventions are designed as effectively as possible. It is impossible to do a set of consumer trials within the statutory timetable of the CMA's remedies process. We have by law a relatively constrained time to—

Q177 **Chair:** So these are relatively detailed and technical changes that you are proposing. You are not proposing any fundamental switch in powers.

Professor Smith: No. I am just saying—

Chair: Perhaps you would like to set those down to us in writing, in depth and in detail, and we will take a look at them in due course.

Professor Smith: One sentence would do it. I am very happy to do that.

Chair: I have just given you an opportunity to do it and you have had about 10 sentences, but we did not get to the point.

Q178 **Wes Streeting:** I am going to pick up the theme of demand-side remedies. I will begin by picking up where Rachel Reeves left off on overdrafts. Looking at the review, you do not seem to have taken direct action to make it easier for people to switch overdrafts; instead you have just asked Bacs to undertake a review. Given the points you have made and Rachel Reeves made, about the proportion of customers who use overdrafts, either authorised or unauthorised, did you not consider overdrafts as an important barrier to switching?

Professor Smith: Yes. Overdrafts are a very important barrier to switching. Overdraft customers, as I said earlier, are the ones who feel that it is hardest to switch. The appropriate way for us to deal with that was to get Bacs to do something about it.

Adam Land: I slightly garbled my answer earlier, so I will give it another go. The other point is that open banking helps here, through the concept of a credit passport and enabling people to share information about money coming into their accounts and going out of their accounts with new lenders. That will enable customers to switch more easily, and with more confidence that they will get an overdraft facility elsewhere.

Q179 **Wes Streeting:** Say, for example, that I have a £2,000 overdraft and I live in my overdraft; at what point, when looking at switching, would I know that I can carry across my £2,000 overdraft?



Adam Land: That is a good point. The sequence that we see as being important is that open banking enables that information to be shared easily and efficiently with the new bank, and then we are looking at both the FCA and the Current Account Switch Service—Bacs, essentially—to look at obligations on lenders, for example, to give a firm overdraft offer during the process, and to make sure that CASS enables people to switch easily with overdrafts. The open banking is a really important first step in that, because that is what will make it easier for the new bank to offer a realistic overdraft facility.

Professor Smith: To give a one-sentence answer to your question, before you press the Current Account Switch Service button that says, “Yes, close down my old account and transfer me to the new account”, you have an assurance that your overdraft facilities in the new account are set up.

Q180 **Wes Streeting:** Are we certain that open banking will deliver that at this stage?

Professor Smith: That particular thing can be delivered by Bacs before open banking, yes. It is one of those areas where customers do not actually know what is currently available. Most banks, if you are switching, will make you an overdraft promise before you switch. Many customers switch thinking that they cannot get an overdraft promise from their new bank; this is a simple piece of information.

Bill Roberts: Can I just make two further points? One is that, if a bank is looking at a new customer, it will be a little bit wary about their credit history. One thing that open banking will do is enable the new bank to know as much about the customer’s credit history as the current bank does, so it puts them on a level playing field. The new bank would, in theory, be able to offer everything that the old bank does.

The second point to make is that one thing open banking will do is make it possible to unbundle overdrafts from current accounts. Currently, if you want an overdraft, you can only go to your current account supplier. Open banking will enable new services to come into being. There are some that are already available, not using the technology but that will look at your bank account, see if it is going into overdraft and make you a loan cheaper than your bank would in order to avoid you going into your overdraft. Those are the kinds of services that start to become available when open banking is adopted.

Q181 **Wes Streeting:** Other members of the Committee will come on to open banking in a bit more detail, but just to clarify, you can give us certainty at this stage that, before someone is in a position where they have to make a commitment, or press the button, as you put it, to switch their accounts, they will know for certain, with any bank that they are switching to, that they will get the overdraft on the terms of their existing account.



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Professor Smith: No, they will know what terms the new bank is offering them before they switch. It is not that the new bank guarantees to give you the same overdraft; you can ask them the question, "Will you give me the same overdraft facilities as I currently have?" and you know the answer to that question before you switch.

Q182 **Wes Streeting:** That is an important clarification. That is the important point, is it not? The customer, before they press the button and make the commitment to switch, knows exactly what they would be switching to. However, that does not necessarily suggest, particularly for overdraft customers, that we would see greater competition and switching, particularly amongst the heaviest overdraft users who are least likely to switch. Not being able to switch your overdraft would be a major barrier, would it not, to someone switching?

Professor Smith: That is where what Bill said comes in. If the new bank can see a picture of your banking records in the past, it has much better information than it would have pre-open banking. One of the puzzling things about why competition does not work so well in overdraft is that overdraft customers are damned profitable customers for the banks. A customer who is a frequent overdraft user may feel that he is not the kind of customer that a bank wants to have, but the reality is, so long as he is not going to default, he ought to be a pretty attractive customer, so the banks should be fighting to get their overdraft customers. That is what the combination of open banking and improvements to the Current Account Switch Service will open up.

Q183 **Wes Streeting:** The other side of that double-edged sword is the point that Rachel Reeves was making: that some of the most vulnerable customers are also the most profitable, and that is one of the reasons why we need to improve competition in this area, because you want to see banks competing on things like overdraft charges and bringing the price down. That is not currently happening.

Professor Smith: I could not agree more.

Q184 **Wes Streeting:** Let me turn to another issue, which is about account number portability. You have taken the step of giving some customers the option of having components of their old account redirected to their new one indefinitely. Why did you not go one step further and mandate the development of account number portability?

Professor Smith: Because the improvements to the Current Account Switch Service, which we are getting Bacs to put in place, cost a small number of millions of pounds.

Adam Land: £25 million was the estimate we had in the report.

Professor Smith: The costs of account number portability depend on what version of account number portability you are looking at, but they are numbered in billions of pounds, so it seemed sensible to look at solutions that will work well for customers, are reasonably economical



and can be implemented quickly, rather than chasing a very expensive, long-term ideal that may well be outdated before it is achieved. Given the way that technology is moving, account number portability might well be an irrelevance in a few years' time.

Adam Land: Fundamentally, CASS is a good system and it works; people who use it report positively about the experience of using CASS. The problem with CASS is that perception is lagging behind reality and people who do not use it are concerned about the service, and they do not know enough about it. Small firms do not know about it at all, as a rule. We think that the better approach here is to use the system that technically works, and to make more people aware of it, make it work better, have it better governed, have it better promoted; you can do that for a fraction of the cost of trying something new that may or may not work.

Q185 **Wes Streeting:** Last year, an FCA study found that keeping the same account number would increase consumer confidence, and that not a majority but a significant minority of both individuals and businesses would be more likely to switch, so I am slightly surprised by the degree of scepticism you have placed on account number portability as a positive incentive that would encourage people to switch by giving them greater confidence.

Professor Smith: It would certainly give people greater confidence. There is no question of that, but it would be at a very high cost.

Q186 **Wes Streeting:** Your report cited estimates of the cost in the range of £2 billion to £10 billion, and you mentioned in your answer, Professor Smith, that that is largely dependent on the type of system that would be used. How much would you want to see these estimates fall before you felt that ANP could be justifiable on cost grounds? What would be a reasonable cost given the benefits?

Professor Smith: It is not just a question of how much the cost would fall but also a question of how well the enhanced switching service works and how the developments that go along with open banking develop. The biggest question in my mind is not the cost, although that is a very significant issue; it is the added value of it, which at the moment is positive, as you said, but relatively modest and may well become less. In any case, account number portability is within the remit of the Payment Systems Regulator. I do not know where it is on the PSR's priority list at the moment, but it is certainly on its list and is something that you might want to pursue with the PSR.

Q187 **Chair:** It would be really helpful if you could try to answer the questions more directly. You answered the question from Wes Streeting that, yes, behaviour would change a lot if we got to account number portability but it would cost a huge amount of money, so quite reasonably Wes Streeting has asked you what that number would have to fall to for the principal objection that you have just raised to no longer kick in. Could you have another go at the question?



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Professor Smith: What was the number for the CASS improvements? Was it £20 million?

Adam Land: Yes.

Professor Smith: I would look very sceptically at anything that was above a few hundred million pounds as to whether it was good value for money.

Q188 **Chair:** What do think the rent-seeking behaviour is yielding in aggregate in the banking sector?

Professor Smith: What rent-seeking behaviour?

Chair: Excess profits. You have done some economics, have you not? What do you reckon it is?

Professor Smith: At the moment, retail banking is—

Q189 **Chair:** Or what has it been over the last five years or 10 years? You must have looked at this. It is a core indicator for a competition regulator.

Professor Smith: As you know, the last five years have not been a happy time for banking profitability. Banks have not been excessively—

Chair: It is very difficult to get answers to questions.

Professor Smith: Sorry. I am trying to answer your question.

Chair: I am asking you for a number.

Professor Smith: Banks have not had excess profits in the last five years.

Chair: Okay, so it is negative.

Professor Smith: That is not because competition is working well. It is because they have had other problems to deal with.

Q190 **Wes Streeting:** What concerns me, really, about this is that I have not seen in any of your work any evidence that any sophisticated analysis was done to look at the costs and the options for account number portability alongside the social benefits of the extra competition that it might generate. There is a clear evidence base that suggests that account number portability is a reason for businesses and individuals lacking confidence or expressing concern about the risks of switching. It seems to me that you have placed a great deal of stock in other remedies proposed, and you can hear scepticism across the Committee about those remedies, but you have not gone for options that could be more radical, high-impact, and beneficial to the customer.

Adam Land: We would see open banking as being much more customer-focused and radical than account number portability. Account number portability and CASS are essentially about the plumbing that



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needs to work so that people have confidence in it, but what is going to attract people to new providers is having new services and products.

- Q191 **Wes Streeting:** I have acknowledged that you have placed greater stock in other remedies. My question was about what analysis was done to look at the cost of account number portability alongside the social benefits of the additional competition it would generate.

Professor Smith: The answer is that we did not do that analysis because, when you are doing a wide-ranging study such as this one, you have to make choices about where to focus your effort. We had to make choices. We focused our effort, for the reasons that Adam has just referred to, on areas like open banking, where we thought that high-impact changes could be driven by us. The numbers that were quoted earlier about the potential costs of account number portability suggested to us that this is not an area that was worth our while to explore, given the other things we were looking at and their potential. That is a judgment that we made.

- Q192 **Chair:** Did you not have the time, the resources or what?

Professor Smith: It is resources rather than time. You have a team doing a job and you decide which issues to focus on.

- Q193 **Chair:** You did not have the resources you needed to do this inquiry.

Professor Smith: I knew what your follow-up question would be to that. It would not have been sensible for us to attempt to do everything.

- Q194 **Chair:** You did not do it because it was not a sensible thing to do. I am trying to get to the heart of—

Professor Smith: It is not a sensible thing to do. Being realistic, there was a very big inquiry with a large team; you need to think about prioritisation, and prioritisation does not mean going to ask for more resources so that we can add something else on to an already very large inquiry. Prioritisation is not just about resources; it is also about what you focus your attention on, and it was right for us to focus on the things where we could add most value, and that is what we did.

- Q195 **Wes Streeting:** I am surprised you did not focus your attention here, because there was the work done by the FCA that identified account number portability as an issue of concern for individuals and businesses. We have also heard evidence during the course of our inquiry where witnesses have questioned the rationality of people switching, because even the small chance of something going wrong would expose customers to a lot of distress. It seems to me that a number of the witnesses we have seen in relation to this work seem to be thinking in practical, common-sense terms from the point of view of the customer and what they see as barriers, but these concerns have been disregarded. You have not even embarked on looking at an issue that has been identified as an issue by the FCA and by other witnesses.



Professor Smith: I do not have much to add to what I have already said. We made a judgment that this was not a particularly promising area for us to look at.

Q196 **Wes Streeting:** We will have to put this down as an area in which we agree to disagree. Let us move on to the governance issues. You have recommended altering the governance framework for the Current Account Switch Service to ensure that small banks and third parties get their voices heard. Have there been many examples of when the existing governance framework has led to decisions being taken that you do not believe were in the best interests of consumers or third parties?

Adam Land: A big concern with CASS is that, while what is good about it is that it works, helps customers switch and is reliable, what does not work with it is that it is not run in a way that is encouraging and engaging customers to switch. Part of that is down to the governance and the leadership structure that it had, which was quite an old-school, banking-committee type structure. Fresh blood is needed in that structure so that what is actually quite a success story—it is a good, functioning switching service—is well understood and known by customers. Getting different voices around the table into that would be of significant benefit.

Q197 **Wes Streeting:** But there are not any examples you can offer where you think the existing governance arrangements have fallen short.

Bill Roberts: There is one example that I can recall; it was to do with the amount that was being spent on promoting the service to SMEs. There is quite a substantial body of evidence that SMEs do not realise that this system, CASS, applies to them; they do not use it. There was disagreement, as I understand it, about the amount that should be spent. That was one of the reasons why we wanted to change the governance structure.

Q198 **Wes Streeting:** We will come on to the marketing campaign that you proposed very shortly, but I am just a bit surprised; we have just had a conversation about priorities in relation to your review not looking very seriously at the issue of account number portability and ruling that out as an option, but you do seem to have found time to make recommendations around governance without providing a great deal of evidence that the existing governance structure is not working. My questions would be: what problem do you think this recommendation will remedy? What improvements might we see and how might we measure it?

Adam Land: We are looking to see the new CASS team and governance develop the service in new ways—we have made some recommendations based on changes that we could identify that need to be done—and look to promote it better. The sort of indicator that you would want is, over time, for the customer perception of CASS, for people who use it and people who do not, to be similar; at the moment they are miles apart.



People who understand the system and have been through it think that it is very good; people who have not used it are nervous and worry about it. As much as anything, a focus on developing and promoting the system, and articulating what the system can do, is really important, as is bringing fresh perspectives, including those of people who benefit from customer-switching, into the mix.

Q199 Wes Streeting: You are describing in common-sense terms reasonable changes to the governance structure. I am not quibbling with that; it is a common-sense move. My concern, listening to this part of the evidence and the responses to the Chairman and Rachel Reeves, is that we have some recommendations and concrete stuff here around governance; you have identified that you want a marketing campaign, and you have given some evidence that this could help with SMEs, for example, which would be welcome, but, looking at the recommendations compared to the other avenues you could have explored, it seems we have a marketing campaign and a series of incremental changes.

Can you see where I am going in terms of scepticism that this will address the scale and seriousness of the problem we have in terms of lack of competition? Without doing any review, I could have come up with some governance changes, because it just makes sense to involve the consumer voice and third parties—lots of other people are doing that in lots of areas—and a marketing campaign. What I have not heard from your responses, even on these issues, is how, looking at this issue in three to five years, we are going to come back and measure your degree of success. What have you established as the measures of success that we should judge you against in three to five years?

Professor Smith: Picking up on what Adam said, these changes to CASS are very much a response to the fact that CASS as a system works well, but it does not have sufficient customer recognition, including among small-business customers. Currently, when you ask customers, “How confident are you that CASS will do things without making mistakes?” you get disappointingly low numbers, given that CASS actually does work without making mistakes. When you ask small businesses, “Does CASS apply to you?” you too often get the answer, “No”. The measure of its success would be customer confidence, both among personal customers and business customers.

Q200 Wes Streeting: In terms of numbers, let us say in three years, where should competition be? What proportion of customers would you see switching accounts, and at what level would you like to see consumer confidence in CASS?

Professor Smith: I would like the vast majority of customers to have as much confidence in CASS as they have in the rest of the banking system.

Adam Land: A good indicator of where you would want confidence in CASS among the general population is at the same level as people who currently have confidence who have actually used it. The numbers at the



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moment are that, of people who have used it, around 80% or 90% are confident; 40% to 50% of people in general are confident. Given that the people who have used the system have a better understanding of whether the system works or not, we would think that, by better articulation of the opportunities of switching, you would be able to get that 40% number up towards 80% or 90%.

Q201 Wes Streeting: For percentage of customers switching, where would we be in three years?

Professor Smith: Significantly higher than it is at the moment. It is not an area in which it is particularly sensible to have a target, because switching is not an objective in itself. The low levels of switching that we currently have are an indication that competition is working badly, because it is linked to the fact that there are lots of customers who would gain from switching. The reason that the 3% switching level among personal customers is too low is because a lot of the 97% could make very significant gains by switching, including overdraft users. How high would you want the switching level to be? When competition is working more strongly, it might well be that customers get a much better deal without switching, so switching rates are not an objective in themselves. They certainly should go up, but how far depends on what else is going on in the market.

Q202 Chair: They are certainly a crucial indicator in working out how we get from where we are now to something that looks remotely competitive. Your question was about in three years' time, which should be, if your open banking proposal has any merit, bang in the middle of that period of transition, so what is your proposal?

Professor Smith: I would expect at least switching rates to double.

Chair: Okay. We have finally got an answer of sorts. Thank you.

Q203 Stephen Hammond: Good morning, gentlemen. One of the things that I assume was right at the heart of your focus was the free-if-in-credit model. To quote your final report of 8 August this year, "We do not consider that the erosion of the free-if-in-credit model should be an objective in itself", and yet much of the evidence we have taken from current and former regulators has basically said that it is the free-if-in-credit model that is at the heart of why there is not competition and transparency. You obviously consider that less of a problem.

Professor Smith: Yes. As I have already said, there are very serious competition problems in the current account market, but the fundamental problems are problems that customers have in choosing the right account for them. Free-if-in-credit is a part of that problem, but it is not the fundamental problem.

Q204 Stephen Hammond: Surely it is the fundamental problem, because what it perpetuates is the inability of a customer to be able to see exactly what the charging structure is and, perhaps more importantly, as you



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said, the transparency behind the implicit and explicit costs. That must be the real reason why people do not move their accounts around, or that competition is not there.

Professor Smith: It is not the lack of transparency about the account someone holds that is the fundamental problem. It is true that someone who holds a free-if-in-credit account does not know exactly what they are paying. Most free-if-in-credit customers know that the bank makes its money out of the forgone interest, but they do not quite know what that forgone interest is. The fundamental problem is that they do not know whether they are getting a good deal compared with the alternatives; that is the issue. For example, telling free-if-in-credit customers what their forgone interest was would be a small piece of information that very few customers would know how to act on, because the real issue is: "Should I get out of a free-if-in-credit account and move to an interest-bearing account?" and knowing a bit more about your free-if-in-credit account does not help with that.

Q205 **Stephen Hammond:** You make the contention that what will help is the open banking proposal. It seems to me the open banking proposal requires an extraordinary amount of effort from the consumer to figure out what their account is costing them, let alone the opportunities. As a starting point, even if I take your proposition—and I am not sure I do—that it is not helpful, the fact of the matter is that the open banking proposal will take an extraordinary amount of effort to work out what the options are.

Professor Smith: On the contrary, the open banking proposal will make it easy. Can I use myself as an example of this? I currently have a bank account that is not free-if-in-credit. It pays rewards according, believe it or not, to my monthly bills paid by direct debit. At the end of every month I get zero bank charges because I manage not to go into overdraft, and I get some rewards. I would like to know whether this account is good value. At the moment, for me to work out whether my account is good value would require me to look at other interest-bearing accounts and try to work out whether I would get more or less money from a different bank on an interest-bearing account than I currently get. That would be a formidable task. The point about open banking is that you press a button on your open banking application and you say, "Is there some other account in the market that I would get much better value from?"

Q206 **Stephen Hammond:** But it will depend on what information is going on to the standard and who is policing the standard, and at the moment it is true, is it not, that, although you say it is easy, a lot of people think that it is going to be a more complex procedure? At the moment, it is really the fact that, until there is an explicit financial incentive to encourage people to change accounts, they are not doing so, and they are unlikely to do so in the future.

Professor Smith: It is because they do not know.



Bill Roberts: Just to clarify, what open banking will do is precisely that. It will make it much easier—very simple—to compare the costs and the rewards of different accounts. The research we undertook showed people the existing scheme—the Midata scheme—which was referred to earlier, and a mock-up of how simple the new system would be, and the response to the new system, the simplicity of it and the way that it took account of forgone interest as well as charges, went down very well with the people we showed it to, particularly SMEs. You forget sometimes that free-if-in-credit is a payment plan that is common for consumers but not for SMEs. They have to pay for every transaction, and it is really hard, if you do not know precisely how many cheques and how much cash you have paid into your account after you have used the branch, to know what the costs would be of switching. This does it for you.

Q207 **Stephen Hammond:** Do you not think that for the PCAs it would have been better to have as an objective an erosion of the free-if-in-credit model?

Bill Roberts: It is being eroded at the moment because people are becoming aware of the benefits of switching to non-free-if-in-credit accounts. Less than half of new current accounts being opened are free-if-in-credit.

Q208 **Stephen Hammond:** I have a problem with what you have just said about how easy it is all going to be is: you decided not “to carry out a robust profitability analysis which would give us certainty”. You did not conduct a full profitability analysis of the PCA market. The question mark is around why. Also, do you think banks know how much money they make from each type of customer, or expect to make?

Professor Smith: Can we just be clear that we are now talking about something completely different from customer choice? You are asking about bank profitability and where banks make their money.

Q209 **Stephen Hammond:** There is a direct link, is there not? If the open banking standard is right, people will have to work out exactly what cost there is for each product, so the banks will have to be able to put up reliable information. If you have not analysed overall profitability, how can you be sure, or have any confidence, that what is going to be up there is the right information?

Professor Smith: I am sorry, Mr Hammond. With respect, there are two entirely separate issues bound up there. For the open banking systems to work, there needs to be open information about customer charges on different accounts, so that if I want to know whether one bank is better for me than another, I need to know its prices, just as if I want to shop in one supermarket rather than another, the relevant comparison is what the prices of the products on the shelves are. Profitability analysis is something that we would conduct if we were doing a competition survey of supermarkets. We would then be very interested in the relative



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profitability of different kinds of supermarkets. That is of no interest to customers. It is a different issue.

Q210 **Stephen Hammond:** Are you clear that you did a robust price analysis of each product?

Professor Smith: We have a robust analysis of where banks currently make their money on current accounts.

Q211 **Stephen Hammond:** That implies you must have done. By “making money”, you must know what the individual product profitability is.

Professor Smith: We know that banks make very different levels of revenue on different kinds of customers. We know that all customers are profitable. We know that some customers are much more profitable than others; in particular, at the two ends of the spectrum, we know that the most profitable customers are customers who have large balances in their current accounts and customers who make frequent use of overdrafts—especially unarranged overdrafts—and that banks make money, but much less money, from the customers in the middle, who do not have large balances and do not often go into overdrafts.

So, yes, we do know the profitability picture, but just to emphasise, that is a completely different set of questions to the question of whether open banking is going to give the right information to customers.

Q212 **Stephen Hammond:** We may have to disagree on that point, because I think it is fundamental to being able to understand what is going to be charged. If you do understand the overall profitability from what banks are generating from current accounts, does that mean you have a clear idea of whether those current accounts are showing excess profits or not?

Professor Smith: Yes, we do know that retail banking has not, in recent years, been a business with excess profits.

Q213 **Stephen Hammond:** You said you “analysed available information from banks’ annual reports and accounts, together with selected industry publications”, etc. That must have told you product-by-product cost and profitability, and that should give you information that is available that should be published and should be clear. Why did the report not do that?

Professor Smith: The report did do exactly what I said a moment ago. Overall, personal current accounts are a profitable but not excessively profitable business for banks. Some classes of customers generate much more revenue than others. That is the picture.

Q214 **Stephen Hammond:** You have done a profitability analysis and yet your report says that it has not been possible to carry out a robust profitability analysis. Are you telling me that the profitability analysis that you did came out of analysing the annual reports and the accounts rather than what banks were telling you?



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Professor Smith: We did two kinds of profitability analysis. One was looking largely at other people's analysis of the overall profitability of retail banking. If you want to look at banking profitability, there are a number of issues with different banks having different definitions of retail banking. We did not think that it was productive for us to spend a lot of time doing our own profitability analysis but we had access to quite a lot of other profitability studies giving an overall picture of the profitability of retail banking. We also looked in much more detail at the different revenues and costs of different parts of the current account market.

Q215 **Stephen Hammond:** I hear what you say: there are different definitions from bank to bank. I take it you say that none of the larger banks in the UK treat all of them in a similar way, and yet, of two or three of the challenger banks that we have had here, one said, "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 that they would be "very surprised" if other banks did not have that view; another one said, "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". Is there a difference, therefore, in the ability to understand this line of business between the challenger and the main banks?

Professor Smith: No, any of the big banks would have made the same statement.

Q216 **Stephen Hammond:** Why did the big banks not tell you what their numbers were?

Professor Smith: You have obviously been looking at chapter 5 of our report. You will find in chapter 5, and especially appendix 5, of the report a great deal of information about what the banks told us about the profitability of different kinds of current accounts and the lifetime profitability of customers. The broad picture that I have just given you is based on very careful analysis by our excellent staff of a very large amount of material that challenger banks and large banks gave us on those issues.

Q217 **Stephen Hammond:** Can we move on? You did say a moment ago that one of the areas where banks at the moment make significant profits is with, effectively, loyal customers; loyal customers were actually subsidising offers to new customers.

Professor Smith: If you want to call customers who do not switch loyal customers, then, yes, we know from our analysis that there are very substantial gains from switching to be made by customers who have overdrafts and who could switch to a bank that charges less for overdrafts, and customers who have large balances on their current accounts could made substantial gains by getting out of a free-if-in-credit account and going into an interest-bearing account. If you want to call loyal customers the people who stick with free-if-in-credit accounts when



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they would do better to move, or the overdraft customers who are loyal because they think they have to be loyal, then, yes, the banks make more money out of loyal customers than they make out of switchers. That is the case. That is the main evidence that competition is not working well in this market.

Q218 Stephen Hammond: What is there in your remedies that is going to sort that out?

Professor Smith: Open banking, among other things. Almost all of the whole swathe of remedies is about getting better information to customers, not just about price but about quality, which we have not mentioned; giving them more confidence in the switching service; and giving them the ability to take information about their current bank to a new bank and get an overdraft offer before they switch to a new bank. It is all about making the market work better in the ways that it does not currently.

Q219 Stephen Hammond: You used yourself as an example and I will use myself as an example. I have banked with the same bank for 30 years. Would it not have been easier, rather than telling me to go and look through the open banking proposal, just to put a proposal in place telling banks that they should put their existing customers on the best available deals? Why should that not be the remedy, rather than telling me to go and look at open banking?

Professor Smith: By "the best available deal", do you mean that your bank should switch you to an interest-bearing account if it decides that that is in your interest?

Q220 Stephen Hammond: The onus should be on my bank. You know very well that one of the major banks, Nationwide, has run a particular campaign saying, "We do not offer different deals for different types of customers". I am saying: should there not at least be an onus to tell me exactly what the best available deal is that they are offering?

Professor Smith: There are two separate issues here. One of them is about leaving customers stranded on accounts that are no longer offered to new customers. That is not really an issue in the current account market. It is an issue in the savings market where many customers get stranded on savings products that pay even less than the savings products that have been offered to new customers. In the current account market, it is not a matter of customers being stranded on out-of-date accounts. By and large, banks offer free-if-in-credit accounts and interest-bearing or reward-bearing accounts, and they are both offered to active customers. If you are on a free-if-in-credit account that is not the best account for you, it is not that somehow you are on an account that is no longer offered; it is that you are on an account that is still offered to customers who want a free-if-in-credit account but it might not be the best account for you.

Q221 Stephen Hammond: Could it not have been a remedy that that should



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have been forced upon them? Elsewhere you have talked about getting texts from banks telling you that you are about to go into overdraft. Why not the same things for loyal customers, saying, "Have you thought of...?"

Professor Smith: That is indeed one of the remedies on our list: that customers will be given periodic prompts from their bank to say, "You might not be on the best account for you; have a look around. There is the Current Account Switch Service and comparison services that will tell you if you are on the best account." I absolutely agree with you that that is a good thing to do and we are getting the banks to do that.

Q222 **Stephen Hammond:** Finally, while free-if-in-credit remains the dominant type, you have mentioned reward accounts. Do you see that as a welcome change in the market?

Professor Smith: Yes, because that is an example of competition working. It is an example of where the banks had some high-revenue customers, the customers with high current account balances, and the advent of reward accounts is competition beginning to work in that segment of the market.

Q223 **Stephen Hammond:** Are you confident that the open banking proposal will enable customers to have adequate information to compare those accounts?

Professor Smith: Absolutely.

Q224 **Kit Malthouse:** Good morning. This is my first morning, so you will have to forgive me if I am playing catch-up slightly. I just want to pursue a bit more what Stephen Hammond said. I am intrigued at the end of the telescope that you have chosen to come from. Your basic approach seems to be that the problem is essentially with sluggish and ill-informed customers rather than structural problems with the market and the banks. I wonder if you could just expand a bit more on why you think free-if-in-credit does not create two sort of customers where, no matter how well informed, they are still not going to switch or shop around. Free-if-in-credit creates one customer who stays in credit the whole time and is broadly indifferent—free-if-in-credit accounts are broadly the same, as far as I can tell, with no massive differences apart from a little bit of reward here and there—and it creates people who are in overdraft who, as you said earlier, are either reluctant to, or feel that they cannot, move because they perhaps have a slightly irregular credit history and therefore shifting, if it becomes more transparent, makes their indiscretions in going into an unauthorised overdraft even more plain and no one would want them as a customer. Those two groups, no matter how well-informed they are, are unlikely to switch, are they not?

Professor Smith: No, I do not think that that is the case. As we were discussing in the earlier discussion, a lot of customers with overdrafts are very attractive customers for the banks to have because they are very profitable but it is very hard for them to switch.



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Q225 **Kit Malthouse:** Is it your perception that banks currently “hard-market” people for overdrafts and want to give bigger and bigger overdrafts because it is more profitable?

Bill Roberts: I would not go that far, no.

Q226 **Kit Malthouse:** If it is so profitable, why are they not marketing hard on overdrafts?

Bill Roberts: I think that you would have to ask them why that is.

Chair: I was hoping you would answer.

Q227 **Kit Malthouse:** If your contention is that the overdraft is the most profitable part of the bank, why are they not pushing them hard?

Professor Smith: The most profitable customers are actually the customers with high credit balances and, as I said earlier, there is more competition for them.

Q228 **Kit Malthouse:** Your contention was that they should be fighting for these customers. Why are they not now?

Professor Smith: There has been quite a significant increase in competition for these customers in the last few years when one of the banks launched a very ambitious advertising campaign for a new current account model that paid very generous rates of interest—much more generous than savings accounts pay.

Q229 **Kit Malthouse:** That is not marketing the overdraft. Why are they not pushing an overdraft? I have not seen any bank advertising that, “If you have a £5,000 overdraft, come to us; we want you.”

Professor Smith: Sorry, I misunderstood your question. They think that overdraft customers are hard to move, which they are. Why would you invest in trying to move customers who are hard to move?

Q230 **Chair:** You have told us that we are going to be using marketing to encourage switching and get greater competition in this market in every other sphere that you have discussed today. Now you are telling us that, in the area where they are making huge profits, they are not prepared to do so because they do not believe that they can persuade people to switch.

Bill Roberts: One possible reason why the banks do not compete on that particular ground might be that their appetite for risk is not high and they are not able to know whether that customer will default on the overdraft.

Kit Malthouse: That is exactly the point that I am making.

Bill Roberts: If they had access to the customer’s past history, as they will get through open banking, they will be more able to judge. The customer who is borrowing money from you is only profitable if he pays you back. If they can see that the customer has a history of paying back on the overdraft then, yes, they may well feel more able to do that in just



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the same way as credit card companies do; there is a lot of advertising for credit card companies offering people credit.

Adam Land: You do see some variation among banks now in terms of the overall package, particularly for arranged overdrafts with buffer zones and so on. You see that the banks are thinking about the overdraft facilities that they offer, and that is part of their overall differentiation.

Q231 **Kit Malthouse:** The other aspect of my question was, if it is so competitive or these are such valuable customers, I am very struck by how similar the overdraft terms are across a number of banks. Quite a lot of them carry this £6 a month standard charge, and it is strange that different companies would all coalesce around the same monthly charge at £6. This is why I ask the question about the end of the telescope: it all looks to me like a sort of informal arrangement that, "We will all be broadly the same because we do not actually want these people to move around a huge amount". That is why, I guess, I am concerned by your lack of regard for the free banking model creating these groups of trapped consumers or disinterested consumers.

Professor Smith: We are agreeing that overdraft customers do feel trapped but, as Bill has just explained, there are good reasons why competition does not work very actively for them. That is the fundamental problem. Yes, there is a problem in this part of the market.

Q232 **Kit Malthouse:** Do you think that having greater availability of their credit history will mean that they are able to move more easily?

Adam Land: It is about being able to see quite how much you could save. It is not the case that all overdrafts are at the same rate, and people do pay very different amounts to what they could get in the market. It would be easier to make those comparisons with open banking than without, and it would be easier to move with open banking than without as well. Those are important factors. In addition, we are looking to enable customers to avoid paying unnecessary charges as well, and that is where things like the prompts come in. There is a package of measures that we are looking at in order to give overdraft customers a better deal both from their own banks and in terms of giving them a better opportunity to switch to the best products in the market.

Q233 **Kit Malthouse:** Sorry; I am getting a little bit confused. I thought you had said that part of the reason that banks did not want to market aggressively for overdraft customers at the moment was partially because they could not calculate the risk and they might have a sense that people with an overdraft might have a slightly chequered credit history and therefore they might not want them. As Wes Streeting said, those are often the most difficult customers to deal with and they will often be the ones, perhaps, who are more likely to go into unauthorised overdraft. If they do that more often than not, they are less likely to be able to move and therefore they are more likely to be exploited with regards to charges. You have said that alerts reduce charges, and that



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may be right, but it reduces the number of times you get charged, not the overall charge. My charge for going into an unauthorised overdraft stays the same but I might avoid it two times out of 10. Is that right?

Adam Land: If you want to change the level of the charges, you need more competition.

Q234 **Kit Malthouse:** However, these people are not subject to that competition because the nature of the way that they have conducted their affairs means that they will be unlikely to be able to move.

Adam Land: It depends on how you define your terms. There are 10 million people who have an unarranged overdraft and 20 million who have an overdraft. A lot of those people can switch and can move and can be subject to competition. There will be some people who are in a parlous financial state and they may have a number of problems, including the fact that it is harder for them to change accounts; however, we think that there is a lot of scope for millions of customers to get a better deal on overdrafts as a result of our remedies.

Q235 **Kit Malthouse:** However, you do not accept the structural arguments that have been made about the model of banking. That is not an area where you wanted to push or press. I am interested in your conversation with the banks. When you talk to the banks about all this stuff, were there avenues that you wanted to pursue, like the structural issue of banking, that they put you off?

Professor Smith: When you say the "structural issue of banking", what do you mean?

Kit Malthouse: The structural issue of free banking, and that the free banking model causes a problem.

Professor Smith: No, they did not particularly want to argue that free banking was not a problem. Frankly, the big banks would have been very happy. They did not argue that we should get rid of free banking but, had we mandated them into free banking, the biggest gains would have been with the big banks.

Kit Malthouse: How?

Professor Smith: Because they would then be enabled to charge monthly fees to all of their customers, including customers at the moment who actually pay nothing.

Q236 **Kit Malthouse:** At the moment, my understanding of the free-if-in-credit banking model is that the people who are effectively getting free banking are subsidised by those who are in overdraft, so the charges on overdrafts and unauthorised overdrafts are proportionally higher because of having to run the free banking model. The overall charging level could fall and you could get more transparency on what the charges actually are that you are paying as a consumer, because free banking often is not free; there are charges associated with things.



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Professor Smith: It is not the case that some customers subsidise others. It is the case, as I said earlier, that some customers get a better deal out of the current model. If someone is a customer with a relatively modest income, who therefore has a relatively modest current account balance, but who manages their account so that they do not run into overdraft very often, they actually get a pretty good deal out of free-if-in-credit banking because they get unlimited use of ATMs, direct debits and so forth for only the forgone income of their relatively modest balances. They are not being subsidised but they are getting a relatively good deal and making a relatively small contribution to the fixed costs of the banking system.

Q237 **Kit Malthouse:** If you are assigned an overdraft, you do not think the bank is making a loss on that customer.

Professor Smith: No, I do not.

Kit Malthouse: They are still making a profit on that customer.

Professor Smith: They are still making a profit. They are making a contribution to cost. A lot of the business of personal banking has a high level of common cost and relatively low marginal cost per customer, so even customers who are making relatively modest contributions to bank revenue are still profitable customers.

Bill Roberts: To add to what Alasdair said, another piece of evidence we looked at was whether switching rates in countries where free-if-in-credit is uncommon were any different; basically, they were not. Countries where free-if-in-credit models are uncommon have just the same low level of switching rates as we do in the UK. Similarly, switching rates for SMEs who mostly do not benefit from free-if-in-credit were similar too. The evidence would not suggest on its face that that is a big factor in switching.

Q238 **Kit Malthouse:** To return to the point I made earlier, do you think that the competition that you are trying to introduce will mean, while the alerts will reduce the frequency of charging, that the overall charges on overdrafts may fall over time?

Adam Land: Where the remedies help with the overall level of charges is really about the ease of making comparisons. There are massive savings that people who can switch can make by getting to the right provider. That is quite hard to calculate with pen and paper, and it is quite hard to calculate with a spreadsheet. We have done it with a spreadsheet. It will be much easier with open banking.

Q239 **Kit Malthouse:** I do not know whether you acknowledge the sense of frustration that a lot of us have that your remedies largely leave the banks unmolested. There are one or two fiddles around the edges to introduce some competition but the general practices and approach seem to be effectively unchanged. There is a suspicion that there is such a small group of them that their ability to coalesce around the same broad level of charges and interest rates and all the rest of it means that people



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become indifferent about switching.

Professor Smith: I do not think that our remedies leave the big banks unmolested. Open banking is going to hit them with a transformational change in the way competition works in this market.

Q240 **Chair:** When you say, Professor Smith, that it is not the case that some customers subsidise others, when pressed on that a little you said that that was because the marginal cost of banking was low. Someone has to pay for the platform on which the whole retail banking offer depends, so is it not important to look at the average cost per account? If you do that, are some customers subsidising others?

Professor Smith: You are then into scholastic arguments of what subsidy means.

Chair: It is not very scholastic. It is really very elementary.

Professor Smith: Sorry, Chairman; you asked me a question and I was trying to answer it.

Chair: I know but I am afraid that the first few words you used were pretty extraordinary. I am not asking you for a scholarly analysis of the concept of a subsidy. I am just asking you, if we look at the average costs of this sector of banking, whether some customers are subsidising others.

Professor Smith: My answer to that question is that they not, in a meaningful sense of subsidy. Leaving aside young people's accounts and people on basic bank accounts, which are loss-making, some other classes of customers, as we have discussed several times already, make large contributions to bank revenues. Even the customers in the middle who get a better deal from free-if-in-credit banking are covering their costs. In that sense, they are not subsidising anybody. They are making a smaller contribution to the fixed costs of the retail banking operation than some other customers are. That is the picture that I have described several times already.

Q241 **Chair:** Contribution to the retail banking operation or, as most banks call it, a platform. Do you know what the cost of that is for each bank?

Professor Smith: Roughly speaking, yes, because we know how much revenue banks make per customer.

Chair: If you had said "no", I would have referred you to the answers you gave earlier on revenues. The answer is "yes". You may not know the exact number but you have a pretty good idea.

Professor Smith: Yes.

Q242 **Chair:** Do you know how many retail customers there are?

Professor Smith: Yes, we know.

Q243 **Chair:** Right. When you divide one number by the other number, you



get to a number. Do you know roughly what that number is?

Professor Smith: Yes, so, if the revenue per customer is £176 and banks do not make very much profit, then the cost per customer is a bit less—not much less—than £176 and you can multiply that by the number of current accounts and get a number. I am not quite sure what you do with the number but you can get the number.

Q244 **Chair:** Is it the case that some customers subsidise others, using that as a measure?

Professor Smith: That is not a helpful way to describe what is going on in the market and I would stick with the previous description I offered, which is that some customers make a much bigger contribution to bank costs than others, but all customers, bar basic bank accounts and young people's accounts, cover their costs and make a contribution to bank costs.

Q245 **Kit Malthouse:** Can I phrase that in a slightly different way? Is it the case that some customers are permitted to make a smaller contribution to a bank's costs because others are making a higher contribution?

Professor Smith: Yes, it is the case that, if competition were to work more vigorously in the future and banks make less profit out of customers with high current account balances and also make less profit out of customers who are frequent current account users, then the overall pricing structure of the market will change and customers with modest current account balances and no overdraft use would probably find themselves paying more for the banking than they currently do. I am sorry to tax the patience of the Chairman by adding one further sentence: that is a feature of virtually every market that we know of. There are a variety of customers. Going back to the supermarket example, supermarkets make different amounts of money out of different kinds of customers. If you go to the supermarket to buy milk, the supermarket does not make much of a contribution to its costs out of you. If you go there to buy alcohol, the supermarket is probably making a bigger contribution to its costs. That is normal business.

Q246 **Kit Malthouse:** That is absolutely true but, in the supermarket analogy, one set of the customers is not trapped into buying certain products. As you said yourself, overdraft users feel trapped and cannot switch.

Professor Smith: Absolutely. In supermarkets, we would worry if customers for some reason were not able to shop around and did not have the information to shop around. We would not worry and we do not worry if supermarkets make a larger contribution to their common costs out of some customers than others. That is the way competitive markets operate.

Q247 **Chair:** Furthermore, on the pint of milk or half litre of milk, there is a price, is there not? You know what it is. You are not trapped and you know how much you are paying: two big plusses which do not exist in



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banking. That is why we are worried. That is why, if you feel that your answers are not being given the weight that they deserve, it is because we have been on the consumer end—that is voters coming to us complaining about the service that they are getting—for a very long time, and so have our predecessors around this very same table. Do you understand that?

Professor Smith: I do understand that, and I think you should tell your constituents that we have produced a very strong report that is going to make it much easier for them to find out which banks give them good service and good value in the future.

Chair: They are on the way; the cavalry is coming.

Q248 **Helen Goodman:** We will see if they are on the way for my constituents. Last week, HMRC came to give evidence to us about what had gone wrong when people did not get their tax credits payments. Tens of thousands of people wrongly had their tax credits stopped and now HMRC is having to repay them. Would you say, Professor Smith, that those people had some control over their finances and their overdrafts in the period when their tax credits were stopped?

Professor Smith: Clearly not, and they may well have incurred overdraft charges as a result of this failure.

Q249 **Helen Goodman:** Unfortunately, yes, and now the taxpayer, in addition to repaying the money that they should have had in the first place, is giving compensation of £100 to quite a large number of these people to pay for those costs that they incurred. The system that we have of these extraordinarily high overdrafts is being further subsidised by the taxpayer. Would you accept that?

Professor Smith: I do not imagine that the redress payments for this particular failure are a very material item in the banks' profit and loss accounts. Viewed from the perspective of the banking market, this is a relatively small-scale issue. It is a big issue for the individuals, of course.

Q250 **Helen Goodman:** Yes, exactly. Mr Land, you worked on payday lending, so you will be very well aware that people who are financially excluded—the 1 million or 2 million people who do not have bank accounts—very much overlap with those people who are digitally excluded. Are you conscious of this?

Adam Land: Yes.

Q251 **Helen Goodman:** We know that 11 million people are not functionally literate on the net; 5 million people have never sent an email. For this group of people, who also tend to be people on low incomes, your open banking remedy is not really going to be very helpful, is it?

Adam Land: One important thing to bear in mind—and Bill is probably a good person to pick this up—is really the ubiquity of mobile phones and particularly smartphones, and the penetration that has happened a great



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deal. It is fair to say, when talking about access to the internet and so on, that that does not come through; mobile phones are a much more widely spread piece of technology that people are much more comfortable with, including people who are not particularly comfortable going on the internet. That is something that open banking really taps into, and that is a powerful aspect.

Another aspect of open banking for the people who are digitally excluded, including smartphones, is that open banking will also help bodies who advise customers in financial difficulties as well because, even if the customer themselves finds it hard to use the tools, you can see people in Citizens Advice and StepChange offices helping their customers plan their finances by making the sort of comparisons that we are looking at and using the money management applications.

I totally get where you are coming from but it is wrong to say open banking is just for the well-off. It is something that has a very wide range and a very wide reach.

Q252 Helen Goodman: I agree with you that people can go into Citizens Advice and get help, but you must be conscious of the fact that those rural areas that have weak broadband are also the areas that have poor mobile phone signals, and that there is a big overlap with that as well. For vast swathes of the countryside, this is not really a practical option for them, is it? When I am talking about the countryside, that includes a mixture of people on all incomes, obviously.

Adam Land: We are using the technology that is available and that enables us to make a real difference, which that was not an option for Donald Cruickshank or John Vickers when they did their reports, and I do not think we would apologise for making use of the technology that is available. By making banking markets work more competitively, we improve the offer for everyone. For example, we are increasing competition on service quality and that will feed through to all customers—you cannot differentiate on that—and the offers will improve across the board. Even the people who are most digitally excluded, including from smartphones, will see some benefits from this, and the direction in which this is going is that the proportion of people who have access to digital tools, particularly via smartphones, will continue to rise.

Bill Roberts: Things have moved on quite a lot and are moving quite rapidly. We know that over 70% of the population have a smartphone. Yes, younger people tend to use the internet to bank but more than half of the people in the 45-to-65 age range bank online too. 2.5 million people between 70 and 100 are banking actively online.

Helen Goodman: Which means that 10 million are not, of course.

Bill Roberts: There are groups of people who will not benefit directly from this. As Adam said, the tools that will become available will enable debt counsellors, for example, to sit down next to someone and, instead of going through a big pile of paper bank statements to try to understand



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how they are spending their money, they will be able to use the tools that will let them say, "Your money is coming in at this point in the month and you are spending this much on this and this much on that". They cannot do that at the moment as easily as they will do with open banking.

Finally, people will benefit from the new services that come in that currently are not there. There is a benefit to greater competition. Even if you do not have direct access via a smartphone, you will benefit from the greater competition that will arise from all of this.

Q253 Helen Goodman: 25% do not have smartphones. Broadband has not been fully rolled out. We had another report over the weekend about the weak mobile phone signals. All of these things correlate with people who are elderly, are on low income, live in rural areas and have disabilities. Unfortunately, these are the self-same group of people who are likely to be particularly hard-hit by the high overdraft payments, are they not?

Bill Roberts: No, not necessarily, and I would not equate being old with not using the internet.

Helen Goodman: You should do because old people are less likely to use the internet than young people.

Bill Roberts: They are less likely to go in for online banking—certainly I would agree with that—and they tend not to use smartphones but they use other devices for their banking. Nonetheless, I accept the point that there will be people who do not have smartphones and who do not have easy access to broadband. That is why I was emphasising the overall effect that greater competition will have, even on people who do not have that sort of access. With regard to the very financially challenged people, debt counsellors will be able to use new tools that do not exist at the moment to help those.

Q254 Helen Goodman: We have also had evidence from the Federation of Small Businesses; they are very concerned about the branch network, as indeed people in rural areas are. I do not know to what extent you looked into this issue of the banks closing branches. I would have thought it came into your assessment of service quality. Obviously, where they are closing branches in rural areas, which they tend to do, this overlaps again with the areas that do not have access to new technology. Are you not failing to address the needs of these groups of people and hastening the banks' branch closure programme by focusing on open banking as your main route for change? These people will be doubly disadvantaged, will they not?

Bill Roberts: The majority of our approach with open banking has been to try to change the environment within which these things operate. I agree undoubtedly that there may be people who need to pay cash into banks who do not have a local branch and who will be disadvantaged. I do not think we disagree there.



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Professor Smith: The decline in the use of the branch network is not going to be driven by open banking; it is driven by the fact that the business of banking has moved online and especially on to smartphones. Open banking is taking account of that. I do not think that open banking is driving that process or is going to drive that any faster than it is going.

Q255 **Helen Goodman:** What are you doing to address the problem of the concentration of bank closures in communities where there are high numbers of low-income people or which are rural areas? What is your proposal for addressing that problem?

Professor Smith: That is clearly a difficult process where it is happening. It is not an issue that we have taken steps to address. We know that there are things going on like increased use of the post office network as a banking vehicle and, as Adam was talking about earlier, there are various ways in which even a banking system that is operating on 20th century tools can be made accessible and reform of it can be made helpful to people who do not have ready access to bank branches or to digital tools. Some of this, I am afraid, is the way the world is going and it is not very easy to see that there are not necessarily very easy things that will put it right.

Q256 **Helen Goodman:** You say that but we were discussing how profitable the banks were a minute or two ago. Some of my constituents, who are facing another closure of HSBC in Barnard Castle on top of the one that took place in Shildon a couple of years ago, do rather wonder whether, if the banks perhaps spent a little bit less money on the pay of the people at the top, there might be a bit more money for services for the customers.

Professor Smith: I can tell you that you are not going to get me into the business of defending bankers' pay.

Q257 **Helen Goodman:** Good; I am glad to hear it. Would you agree that, when you are assessing the profitability of the banks, it might be worth looking at whether or not some of the very high salaries that are taken are in fact economic rent, as the Chairman was saying?

Professor Smith: There is a high salary problem, yes. It has historically been more focused on investment banking rather than retail banking, but there are plenty of people in retail banking who have very generous salaries as well.

Helen Goodman: Tens of millions of pounds.

Professor Smith: If one is concerned about the closure of rural branches and thinks that something should be done about that, then one has to come forward with proposals for what should be done about it. As I say, one of the concrete things we know about, which seems like a good thing, is the use of post office networks. Frankly, if somehow we found some magic way of driving down bankers' pay, I have to say I am a bit sceptical about whether that in itself would lead them to take a more



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relaxed view of rural bank closures. I do not see there being a very strong link between the two.

Q258 **Helen Goodman:** Ironically, do you think it might be the case that, if we had less competition with respect to the infrastructure and the banks were to share the infrastructure at local level, we could have a wider rural bank network in the rural areas and in the countryside?

Professor Smith: We were told that, apart from the post office issue, there is quite a lot of sharing.

Q259 **Helen Goodman:** Not between the banks. There is sharing with the church and sharing with the pub, but is there much sharing between the banks themselves?

Professor Smith: There is at least in the somewhat negative sense that the last bank branch left in a neighbourhood comes under very strong social pressure not to close down. In that respect, it is not exactly the banks co-operating but they certainly feel under pressure not to be the last one out.

Adam Land: ATMs are a good example of pooling infrastructure. If there is one ATM in a town, essentially that is something that customers of a range of banks can use. There is scope for sharing infrastructure in the sense between banks, which is what access to an ATM does, or between banks and non-bank providers.

Q260 **Helen Goodman:** If we had more of that sort of behaviour, would that cut across the competition rules in any respect? Would you object if they started doing that?

Professor Smith: That is a very good question, and we did indeed consider this when we were discussing with the banks those sorts of questions. We took a pretty relaxed view and we do not think that banks doing some co-operation about ensuring that services are retained in rural communities would give rise to a competition problem. It is not something that we would be anxious about.

Q261 **Helen Goodman:** Unfortunately, they do close the last bank in town. Is the lesson from this not that the only way we are really going to tackle financial exclusion is if the Government have a fairly energetic programme themselves for dealing with it?

Professor Smith: That is not an issue that we have focused our investigation on and it is not something that, off the top of my head, I have a great pearl of wisdom to offer you. I completely accept that, for the community affected, it is a very big issue about the way that banking is evolving and that the risks need to be considered by the appropriate public bodies. It is not an issue that we have particularly focused on with some exceptions like the question you just asked about whether we would be worried from a competition perspective if the banks did some collaboration on this; the answer is "no".



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Q262 Helen Goodman: Another issue is the de-risking of bank customers and the impact of that on both SMEs and individuals. I had an example of this in my constituency only last week: somebody telling me that filling in the money-laundering forms was a job that was going to take a whole weekend and he was doing this for a voluntary organisation; even though he was registered as an accountant, because he was the treasurer of the voluntary organisation, this was a job that was going to take a whole weekend. Do you think that this might also be adversely and inappropriately impacting on some groups of people?

Adam Land: One thing that we have done when we were looking at small businesses is about standardising information requests that go to small businesses when they are opening a current account across the providers so that you do not have to do six separate different sets of things. That is in train and we are putting that in place as it clearly drives people nuts that you have to go through a lot of red tape. That is one area where we have been able to make a difference.

Q263 Helen Goodman: How have you made a difference?

Adam Land: Essentially by getting the banks to work together on a standard set of questions that small businesses can work through when they are applying, so rather than each having their own slightly different take on the money-laundering directives and so on, actually having a common approach to collect the core information that they need to fulfil their obligations without each asking a slightly different set of questions. We get the general point and that is an area where we have found a specific issue and have put in place a specific remedy.

Q264 Chris Philp: I would like to start by briefly returning to the question of bank profitability in the area of retail banking and, in particular, personal current accounts. In your report, did you form a proper comprehensive view of the net profitability of the major banks' retail banking operations in order to determine whether or not those profits were reasonable or whether they were excessive?

Professor Smith: As I said earlier, the main way that we looked at the overall profitability of retail banking was by drawing on work that had been done by others. It is not a very easy period of time in which to form a judgment about the overall profitability of retail banking given that some banks have not recovered—and we know who they are—from the aftermath of 2008. The picture of the general profitability of retail banking is that retail banking is profitable but not greatly in excess, if in excess at all, of a reasonable estimate of the cost of equity. As I said earlier, it is not a business where there is currently evidence of excess profits.

Q265 Chris Philp: When you say not in excess of a reasonable cost of equity, in this context, what do you deem a reasonable cost of equity to be?

Professor Smith: I do not have a number in my head, but of the order of 8% to 10%.



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Q266 **Chris Philp:** If I told you that the return on equity for RBS's personal banking business—excluding litigation cost, which clearly reduces it materially, but those are one-off figures—is 26%, you would therefore consider that to be excessive by your own benchmark.

Professor Smith: That would be a very high rate of return, yes.

Q267 **Chris Philp:** Additionally, Barclays' return on equity across their personal and business banking is 12%; that is also in excess of your 8% target figure.

Professor Smith: Yes, but one needs to not look at numbers like that that come up in isolation. There are a wide range of estimates of returns to equity and profitability of the banks, and we have looked across a broad range, and the judgment that I have described to you was a broad judgment from a whole range of different sources.

Adam Land: In addition, they have considerably evolved over time.

Q268 **Chris Philp:** I have been looking at your report to try to get to the bottom of these profitability analyses. On page 108 of your report, at paragraph 5.49, you say, "We do not have a comprehensive view of personal current account profitability across all the banks". Bearing in mind, by your own admission, that you do not have a comprehensive view of profitability across all the banks—those are your words, not mine—how can you possibly make the judgment you just did in saying that profitability is not excessive?

Professor Smith: Because there you were asking me about the profitability of retail banking, which is a much more broadly based business than personal current accounts.

Q269 **Chris Philp:** What is retail banking if not the operation of personal current accounts and the associated services?

Professor Smith: Business current accounts. Some banks include a wider range of corporate banking in their retail banking and of course all of the business of the lending of the retail banks: the mortgages that they lend out and their business lending business. All banking is a two-sided business because you are taking deposits and you are making loans. The retail bank is all of that. The personal current account business is one component of that.

Adam Land: With retail banking, you essentially have a platform that is the branch network, the IT system and so on, which comprise the retail bank from which the bank sells a range of products. It is possible, and we have been able to identify revenue streams for individual products, and that is what we have done; those are the numbers that we have been talking about. You can look at the contribution towards the cost of running that platform and, again, we have talked about that. However, we cannot sensibly slice up that part in terms of the costs.

Q270 **Chris Philp:** You have said, in relation to the retail bank as a whole—the



platform, as you put it—that a reasonable benchmark is an 8% return on equity, which is about what the stock market returns in the long term, so it strikes me as a reasonable benchmark. I cannot see anywhere in this 800-page report, unless you can direct me to it, any table that summarises the return on equity for the retail banks that you refer to and compares it to the 8% benchmark. I cannot see that table anywhere in this 800-page report. If it exists, please direct me to it.

Professor Smith: There is not a table because, as I said earlier, what we did largely was to draw on other studies and, depending on what their focus was, what time period they covered and what assumptions they make about readers' costs, you get a range of numbers, so we made a broad judgment drawing on that full range of studies. It is not that we have done one set of studies that has produced one table. We have made a judgment about this.

Q271 **Chris Philp:** If a competition authority is trying to ascertain whether a particular industry sector or area of activity is or is not anti-competitive, a proper like-for-like comparison of profitability strikes me as being an inherent part of that analysis. If what you are saying is correct, you have simply taken some numbers provided to you, which are not like-for-like, and, as a consequence, have not published anything in this report; that strikes me as a very serious deficiency as a piece of analysis.

I will move on briefly now to overdrafts, which my colleagues have discussed at some length. You have mentioned that unauthorised overdrafts constitute a significant component of income. If you exclude interest income, it is about 25% of the income; if you include interest income, it is about 14%. Given that unauthorised overdrafts are so expensive—and, as Rachel Reeves highlighted, apparently are potentially three to four times as expensive as a payday loan—why do you think it is reasonable for banks even to allow unauthorised overdrafts to occur? If somebody who has reached their limit puts their card in a cash machine, should the bank not simply refuse to dispense the cash? If they seek to make a transaction when their funds are exhausted, should the bank not simply refuse to facilitate the transaction in order to avoid the unauthorised overdraft even being incurred in the first place?

Professor Smith: That is a perfectly reasonable proposition, and it was a proposition that was put to the Committee by Diane Coyle when she spoke to you. Our view is that unarranged overdrafts are a service that is used by many customers. It is an expensive service but it is a service that gives customers flexibility; if you simply had a blanket ban on unarranged overdrafts, then you would come back to the issue of the unpaid gas bill. When the direct debit comes in to pay the customer's gas bill, the customer is up against their overdraft limit so the direct debit is then bounced and the individual is then in trouble with their energy supplier and with their credit rating.

Q272 **Chris Philp:** The circumstances that you are describing are very similar to the circumstances that payday lenders also provide finance for. In



relation to payday lenders, as Rachel Reeves pointed out, there is now a statutory cap on the amount of interest or cost of funds a payday lender can levy, which is, very broadly speaking, £20 to £25 per £100 borrowed over a month, which is about one-third the level of many equivalent unauthorised overdraft costs. Given that the regulators have seen fit to cap, effectively by statute or by regulation, the maximum charges in relation to payday lenders, is there not a case to apply a similar cap to unauthorised overdrafts, which, as a product, are very similar if not identical to a payday loan?

Professor Smith: As a product, I would disagree with you: they are not very similar to a payday loan because a payday loan is taken for a period of time whereas with unarranged overdrafts a customer can go in and out of it on a daily basis. They are quite a different kind of product and it has a very different kind of charging structure. That has the implication that, if you were to look at regulating the cost of unarranged overdrafts—and we have not set our face against that—it would be a complicated regulatory task and one would need to look very carefully, as we have discussed earlier, at the risk that that would lead to unarranged overdrafts no longer being available to customers who wanted them. Therefore, a proposal to look at capping unarranged overdrafts is something that, if the FCA were to look at it in doing the further work on overdraft charges that we have asked them to do, they would need to look at it quite carefully. It would not be safe simply to say, “It works for payday loans so it is going to work for unarranged overdrafts”.

The other thing that is worth thinking about in relation to capping is that we are requiring the banks to set a maximum monthly charge. That is a decision for the bank to make: “What level of maximum monthly charge are we going to set?” As we have discussed earlier, the maximum monthly charge will get a lot of attention—we hope, we intend and we know. The banks will need to think, “What is the signal that we are sending about our charges?” They have the responsibility for setting these. If a regulator comes in and says, “Okay, your maximum monthly charge for everybody is whatever it is”, what does the aggrieved customer then do when they have been hit by what they would regard as unfair unarranged overdraft charges? They call their bank and what does the bank say? The bank says, “The FCA have told us what charges to set; we are just doing what the FCA has told us.” It removes the pressure from the banks to be responsible for their own actions and we need to think quite carefully about that.

Q273 **Chris Philp:** Simply because a charge falls below the maximum does not make it reasonable. It depends what the charge is for.

Professor Smith: I am just saying that it takes pressure off the banks to be accountable and responsible for their own behaviour towards customers if they can snuff off some of the responsibility on to a regulator. I am not saying that that is a killer argument; I am just saying that it is one of the things that we need to think about.



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Adam Land: It is an important risk. You are trying to set a ceiling on something and the risk is that you set a floor on the same thing, to put it metaphorically.

Q274 **Chris Philp:** At the moment, the average charges seem to be three times the level of those levied by payday lenders who are widely criticised for being usurious.

I am now going to move on to the question of open banking. Let me start with the single most substantive proposal that you have actually made. In your speech, the list of things you are not doing was rather longer than your list of things you are doing, if I might say so, Professor Smith.

Professor Smith: I am sorry but that is simply not the case. There are 17 things that we are doing and the slide of things that we are not doing had the word “five” on it. If we are going to be rhetorical, let us at least be precise.

Chris Philp: I have the speech in front of me.

Professor Smith: I have it in my head.

Q275 **Chris Philp:** I will not test you on it to validate whether you have every sentence.

Some concerns have been raised with this Committee about the governance of open banking. For example, Mark Mullen of Atom Bank said the following to this Committee on 18 October, so about two weeks ago: “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 of the city of the future to those banks and letting them steer the course for open standards.” He goes on to say, “The permanent members of the steering group are the four biggest banks and Nationwide”. Do you accept Mark Mullen’s criticism that the governance of this enterprise is inappropriately in the hands of current dominant market players?

Professor Smith: No, he is wrong.

Bill Roberts: I would agree. He seems to have misunderstood the situation. That analysis is completely incorrect.

Q276 **Chris Philp:** Can you explain why?

Bill Roberts: We have done two things. We have created a forum where standards for security data and the governance of the whole process of managing it will be set up. We have called that the implementation entity. That will be run by a steering group and, yes, the banks that we have imposed these obligations upon will be on it—the nine banks named in our report, including some of the smaller ones—but challenger banks, price comparison websites, and consumer and customer representatives will also be represented on that steering group. They will be



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representatives who know and understand the requirements of PSD2 so that a lot of the technology that is developed there can be re-used.

Q277 **Chris Philp:** What is the sovereign governing entity for the implementation group? Is it the steering group? I am looking at this diagram.

Bill Roberts: The top of the tree is the implementation trustee.

Q278 **Chris Philp:** That is Andrew Pinder. Does his authority trump that of the steering group? If he disagrees with a steering group recommendation, can he overturn it?

Bill Roberts: As it said very clearly in our report, and as it says in his mandate that the banks are signing up to, if he cannot achieve consensus, he can impose a decision and the banks have to agree to that.

Q279 **Chris Philp:** Does that mean they have to accept it or they have to consent to it?

Bill Roberts: They have to do what he says. They are paying for all this; he is driving.

Q280 **Chris Philp:** Mr Pinder is working, apparently, at least three days a week and the budget for the implementation entity, it says here—and correct me if it is wrong—is £2 million.

Bill Roberts: That is for November.

Chris Philp: That is for one month. Right, what is its annual budget?

Bill Roberts: It is not yet fixed but it will probably be in the order of £70 million to £75 million.

Q281 **Chris Philp:** Funded by these nine banks, okay. It was suggested in the *Financial Times* on 9 August, so just after the report was published, that “the regulator”—meaning you—“is also deploying a technological smokescreen to distract from its failure to back a break-up of the banks. These often struggle to keep their own systems running, let alone make data accessible to third parties.” Do you accept those criticisms?

Bill Roberts: No, not at all. There is a distinction to be made between the banks and infrastructure technology, i.e. between the plumbing, the stuff that works, the ATMs and the APIs that we are requiring them to adopt. They are quite different technologies, and one does not depend on the other. It is certainly not a smokescreen. We have also seen the *FT* comment rather more positively about these proposals, suggesting that this is actually a game-changer rather than a smokescreen.

Q282 **Chris Philp:** RBS has been effectively unable to disentangle the Williams & Glyn IT system and TSB are still using bits of legacy Lloyds Banks systems. Given that those two examples suggest that these legacy banking systems are extremely creaky, to put it politely, what level of



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confidence do you have that they will be able to provision the API with the data you require it to? The API is only as good as the data that gets fed into it.

Bill Roberts: It is a completely different task. The infrastructure technology that they are using is quite different from the technology that we are using to pick up people's bank statement information and pass it to an authorised and trusted third party. It is completely different.

Q283 **Chris Philp:** That brings me on to my next question, which is to do with security. As I understand it, authorised intermediaries—so presumably companies in good standing—will, via the API, be able to effectively suck account data from pretty much any bank account in the country. Were one of those authorised intermediaries, either because of a malfeasant member of staff or because they were the victim of a hack, themselves to be susceptible to some security breach, the malfeasant party would have access to account details for pretty much every individual and small business in the United Kingdom.

Bill Roberts: That is completely incorrect.

Q284 **Chris Philp:** In what way is it incorrect?

Bill Roberts: They are not sucking. The information is only passed to the third party, who will be regulated and licensed by the FCA, when you as a customer say, "Send this information to this person for a certain amount of time". Your bank will then do that, having first checked, electronically, that they are who they claim to be and that they are the proper people to receive that information.

Q285 **Chris Philp:** Given that we have seen various examples of data security breaches in all kinds of different companies, how can you be sure that this is not effectively creating some sort of opening or gateway into the UK's banking data, which clearly does not exist already, and every time you create a gateway clearly it carries security risks. What is your level of confidence? What assurance can you give the Committee and the public that there is no chance at all of any sort of security breach?

Bill Roberts: Never say never but the standards that we will be applying will be the very highest. In terms of authentication, we are talking about two-factor authentication and security standards at the very highest level applied to the most sensitive data. These standards have all been agreed upon and they will have to be adopted.

Q286 **Chris Philp:** You have mentioned that the customer has to request this information, so really the ball is in the customer's court, as it were, and some of my colleagues have made this point. Given that customers have not been particularly forthcoming in changing their banking arrangements—for example the 3% churn rate—what makes you think there will be a significant change in behaviour and what do you think will prompt that?



Bill Roberts: Saving money: there will be a big incentive for people to save money.

Q287 **Chair:** However, they could save money now.

Bill Roberts: They do not know how much they can save.

Chair: They do not trust the switching process even now. You were giving those figures only a moment ago, Mr Land. Sorry.

Chris Philp: Could you answer the Chairman's question?

Bill Roberts: At the moment we know that 90% of SMEs get their general business loans from their current account provider. They do not even look around for an alternative. One reason why the incumbent bank has a big advantage is because it has access to the small business's transaction data over the years. To give that small business the chance to get a loan they want—not necessarily a cheaper loan—they will be able to use one of the currently three finance platforms that are being created under the Small Business, Enterprise and Employment Act that they can go to. At the moment, it is quite hard for the providers on those platforms to judge the affordability or the creditworthiness of the SMEs so it is quite hard for them to get those loans. Once they can ship over, and they are sending over their data to these people, they will have a much wider choice of lenders, both conventional and alternative, to go to. These platforms are out there at the moment and they are operating but they just do not have the data feed that they need to work really effectively with small businesses.

Adam Land: The other thing that will drive take-up is the applications themselves. What we are harnessing essentially is the creativity of the technology companies in this country. There are applications that are essentially comparison tools, and they will be marketed and promoted. There are also money management services that I have talked about with Mrs Reeves earlier and, again, those things will be attractive to customers and small businesses. On the small business side, you have applications that help businesses link their current account and the information about money going in and out of their banks straight through into their accounting platform, so that they can run their businesses more effectively. We see some push coming from the application providers with the opportunity to make more money and so on.

Q288 **Chris Philp:** Professor Smith, you have heard how your colleagues have answered my question. What is your target and aspiration for current account and small business account switching rates two or three years hence, once these measures have been implemented?

Professor Smith: As I said earlier, it is very hard to forecast these things, but I appreciate that saying "a substantial increase" is not an appealing answer. I would hope to see at least a doubling of switching rates.



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Q289 **Chris Philp:** A doubling over a two-year time period. We will see if that happens. Professor Smith, finally, in terms of implementation, your report published on 8 August said that, by the end of March 2017, which is now not so far away, the most basic information will be released and available—for example, prices, terms, conditions and branch locations. Is that on track, Professor Smith?

Professor Smith: May turn to the colleague who is dealing with it? You have asked a very practical question about the detail and I turn to the colleague who has his hands on that.

Bill Roberts: The answer is “yes”.

Q290 **Chris Philp:** It is on track. Are you on track to have all aspects of the open banking standard for sharing transaction data up and running by early 2018 at the latest?

Bill Roberts: Everybody we have talked to has said that this is very challenging but doable; it is a matter of priorities. The banks will have to give this a lot of priority to make it happen but a lot of work has been done already; since even before we published our report, work had started in some areas. Yesterday, I saw proof of concept being developed that was very encouraging in terms of confirmation of payee using APIs developed jointly by the banks sharing the same technology. That happened yesterday so, yes, they are on track.

Q291 **Chris Philp:** When HSBC said last June that they did not consider it possible to meet the CMA timeframes, were they wrong?

Bill Roberts: It is a matter of priorities. They can do it if they give it enough priority and we are telling them they have to do it. It is an order. Remedies means remedies.

Q292 **Kit Malthouse:** I just had one quick question on another matter that we have not really covered, if that is alright. We have not really talked about SME credit, and your solution seemed to be largely shopping around. I am afraid that, given I have only just joined up—I was confirmed yesterday and have had a quick scramble through the report—I wondered whether you had considered the actions of the Bank of England with regard to the banks and their impact on competition for SME lending. We have seen recently the Bank of England agreeing term loans to the banks with very low rates that will have an impact on competition, particularly against non-bank lenders; I declare an interest as a director of a non-bank lender. Have you considered that aspect of the funding of banks over non-banks as something that might have an impact in competition terms, i.e. entrench their near monopoly?

Professor Smith: Yes, the challenger banks have been very vocal to us about the advantages that the established banks have. They see one of the big advantages—and they are right—as being the established banks’ access to customer deposits from current account customers as well as from retail and wholesale savings accounts.



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Q293 **Kit Malthouse:** Specifically the Bank of England, because the Bank of England is making very cheap wholesale credit available to banks. You have a banking licence, you have access to funding for lending and they are now introducing term loans, which are very cheap and are not available to non-banking licensed lenders.

Professor Smith: As a general matter, we would be in favour of whatever increases in credit are coming through the actions of the Bank of England being available on equal terms to all participants in the market.

Q294 **Kit Malthouse:** However, you have not considered that?

Professor Smith: No, we have not.

Adam Land: That was not our focus. I think you were right the first time that our focus is really about widening the choice for small businesses, putting pressure on pricing, improving customer service and widening access for small businesses.

Kit Malthouse: I know I speak for the industry generally in that they would be very interested if you were to form a view about that, particularly the anti-competitive or competitive nature of their actions.

Q295 **Chair:** Professor Smith, I do not think there has ever been a competition inquiry that has been more enthusiastically empowered to do its job by Parliament, by other regulators, by the press, by everyone I can think of but, above all, powered by the general climate in which you have written, because the banking crash has changed the terms of trade in the favour of regulators, frankly, with respect to the reform of banks. Almost all of those people who have empowered you have concluded that you have dropped the catch. I do not think that there has ever been a competition inquiry that has received such unequivocal condemnation—and certainly very strong criticism—from those very same people who empowered you to do the job than this one.

That leaves us with two possibilities, and I am going to give the last word to you. One possibility is that all these people—the challenger banks, most academics, the consumer groups and the specialist financial commentators—are all wrong and that we are on the threshold, which is unprecedented in modern British banking history, of a period of much greater competition and consumer choice triggered primarily by your open banking initiative, which you have developed in the course of your report; There is another possibility, and that is that you are wrong and the sorry history of consumer detriment in retail and SME lending and banking will continue. The core question that you have to convince the public about, who are listening to this now, is why you are right and these other people are wrong in sum, and I would like you to do that now.

Professor Smith: I will do that. First, let me gently disagree with your characterisation of the response to the report. It is not the case that most commentators have been negative about it. It is not the case that



most academics have been negative about it. There has been a mixed response with some extremely positive comments, particularly from people with interests in small business banking. Some of the most negative response, for example from the challenger banks, is about the capital requirements issue that you have chosen not to discuss with us today. I would have been happy to explain why I think the challenger banks were wrong about that but we have not covered that.

Q296 **Chair:** Perhaps you could put that in writing. We have asked for one other thing, so perhaps you would like to set out in detail for us the core allegations of the challenger banks, as you see them, and your response to them.

Professor Smith: I think I can do no better than to direct you to the excellent comments on this issue that Sam Woods made to this Committee at his appointment hearing.

Chair: I will not take Sam Woods' evidence; I will take yours and I would be grateful for the written evidence that I have just asked for.

Professor Smith: Okay, we will do that. There has been a very positive response from some quarters, and people who appreciate the potential of open banking and the things around it are very clear that there is a transformational change. In your summary of responses, you did not refer to the extremely successful financial technology sector in London that is extremely positive about the potential of open banking and whom I might have expected to have given evidence to you that might have helped inform your overall picture of what we are aiming to do.

I am confident that this is a very strong report and that the package of measures that we are putting in place will have a transformational effect. We have perhaps discussed it enough, and we should agree that the only way of determining who is right on this is to see what happens in practice over the next three or four years. I am confident that the work of our group will result in a major change for the better and that, when people look back at the CMA's report of 2016, they will see it as a landmark that really changed the direction that this market has gone in. Only history will prove which one of us is right.

Chair: I am merely rehearsing the arguments that have been put to us. Thank you very much indeed for coming before us. It has been a long hearing, longer than we normally run, and that gives you an indication of our concern about this issue as it affects so many millions of people. Thank you very much indeed.