Select Committee on Financial Exclusion

Corrected oral evidence: Financial Exclusion

Tuesday 29 November 2016

10.40 am

Listen to the meeting

Members present: Baroness Tyler of Enfield (The Chairman); Bishop of Birmingham; Viscount Brookeborough; Lord Fellowes; Lord Harrison; Lord Haskel; Lord Holmes of Richmond, Lord McKenzie of Luton; Lord Northbrook; Lord Shinkwin.

Evidence Session No. 19 Heard in Public Questions 185 - 192

Witnesses

I: Adam Land, Senior Director, Remedies, Business and Financial Analysis, Competition and Markets Authority; Professor Alasdair Smith, Chair, Retail Banking Market Investigation, Competition and Markets Authority; and Bill Roberts, Remedies Director, Lead for the Open API remedy, Competition and Markets Authority.

USE OF THE TRANSCRIPT

1. This is a corrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.

Examination of witnesses

Adam Land, Professor Alasdair Smith and Bill Roberts.

Q185 **The Chairman:** Thank you very much for coming. I know some people have had disrupted journeys; I hope yours were not too bad. I will go through one or two of the formalities first, if I may. Welcome to the evidence session of the Select Committee on Financial Exclusion. You have in front of you a list of interests that have been declared by members of the Committee. The meeting is being broadcast live via the parliamentary website; a transcript of the meeting will be taken and is published on the Committee's website, and you will have the opportunity to make any necessary corrections or amendments to that transcript. Thank you very much indeed, again, for coming. When we ask our questions, if all three of you do not feel the need to come in because it is not something particularly relevant to your area, that is fine.

Professor Alasdair Smith: We will try hard to have one person one question.

The Chairman: It helps us to keep to time. On the other hand, if one of you wants to come in on a supplementary point then please do so. I will kick off. I would be interested in your views about how the open banking standard, which is due to be fully introduced in 2019, should help to address financial exclusion, and your views on whether the right support is in place from all parts of the industry to ensure that the open banking standard works effectively. Who would like to take that one?

Professor Alasdair Smith: I will ask Bill to respond to that, but with one brief preface. We believe that the open banking programme is going to have a transformational effect on the way banks work for all customers, including financially excluded customers. I will let Bill elaborate on that.

Bill Roberts: We think open banking will help in two basic ways: it will help customers get a better deal for themselves, because they will be able to make a more informed choice, and it will help lenders make better decisions about who they are going to lend money to. Taking consumers first, consumers who are able to use the tools that open banking will facilitate will be able to help themselves find, for example, a more suitable current account for themselves. Consumers who are less able to use those tools can be helped by an adviser who will be able to look through one lens at all their accounts, the different credit cards they may be juggling, store card accounts or current accounts, to help them see where the money is coming from and where it is going to, and advise them. Thirdly, there will be applications which will be able to warn people when their finances are heading for trouble, and perhaps even, in some cases, avoid them making expensive mistakes by going, for example, into unarranged overdrafts.

Open banking will also help lenders, particularly in the context of consumers with thin credit files—people who do not have much credit history. There are already applications out there which use your transaction history as a way of scoring credit, and they will work better with open banking, so that will help people in two sorts of ways.

The Chairman: Thank you very much. Adam, did you want to add there or not?

Adam Land: No, that is fine.

The Chairman: Could I pursue that a little bit? The Committee has received evidence from various people who have said that previous competition measures by the Competition Commission have had little effect on inclusion in the market. Could you say a bit more about how these new measures will differ and how they are likely to lend themselves to greater financial inclusion?

Bill Roberts: I do not know which measures people are referring to that have not had that effect. I can only comment on the open banking measures, which release a huge amount of power. The one reason why people are so worried about confidentiality in the context of open banking is that transaction data is so rich. Because it is so rich it is extremely powerful, and unleashing that power through applications or to advisers, we believe, will have a very large effect, including on people who are financially excluded.

The Chairman: Have you done any work testing that proposition specifically in relation to financially excluded people, or is it something you think would, as a by-product, help them?

Bill Roberts: We have not done any research particularly with financially excluded people. We have done a lot of research which would have included people who are financially excluded. We have also talked to interest and pressure groups and specialist people, such as the Money Advice Service, on how these tools could be adapted or developed to help financially excluded people.

Adam Land: I guess if you look at open banking it is essentially a platform. We are creating some infrastructure. We came into the issue of open banking, primarily, by looking at competition for current accounts and at various ways in which we could have more competition for current accounts. As we researched it further, we saw so much more potential for the remedy we were putting in place to have wider positive social impact, and I think a lot of people have identified those benefits off the back of our investigations. There are a lot of people who are interested in developing applications, or you have people, such as the money and mental health group, who are thinking about how you could apply these tools and how those applications could be developed. Our initial focus was in some ways quite narrow, but as we have found out more and developed the remedy, we can see it has a lot of potential to bring benefits in lots of other ways. That probably answers your earlier question to some degree. Where we were looking at things such as in-home collected credit, we were looking in quite a focused way at remedies targeted at that slice of the market. I think they have had a positive but not a transformational impact on financial inclusion, whereas this is operating on a much larger scale. We are looking at personal current accounts, which are mass market products, so there is scope for people to develop applications that fit in with this. The incentives for companies out there to engage with this remedy is of a different order of magnitude from some of our earlier ones.

The Chairman: Scale is key here.

Adam Land: Scale is important if you are looking for commercial entities to make investments off the back of one of our remedies. This creates many opportunities for the scale and breadth of application.

The Chairman: Thanks very much. I am sure we will pick up a number of those points as we go through the questions.

Q186 **Lord Haskel:** Thank you for those general points about open banking, but I wonder if you could be a bit more specific and tell us how the open banking standard will help customers switch their current or savings account. What measures are going to be put in place to help encourage or nudge customers to switch and, more importantly, get the banks to co-operate?

Professor Alasdair Smith: There are a number of parts to the proper answer to that question. We have a very good current account switch service that operates very efficiently and makes it very easy to switch. It operates easily and reliably, but not many customers currently use it. The existence of a switch service has not transformed switching. Fundamentally, that is because it is very hard for a bank customer to work out whether it is sensible for them to switch. This is the fundamental problem in banking competition. If you want to know whether it is a good idea for you to switch your account, you need to look at the charges and rewards to your own account, which are often quite complicated, and at a different but complicated set of information about a competitor's account or, indeed, a different account with your own bank. Whether it is worth while switching from one to the other depends on how you use your bank account, how much you keep in your bank account balance, how often you go into overdraft, and so on. It is virtually impossible for a human being, however intelligent and numerically smart they are, to do that calculation properly.

Open banking makes tools available to consumers that say, "We have looked at your account and we see that switching to an interest-bearing account with your current provider would be a much better deal for you". Our research shows there are a lot of customers who would save not vast sums of money but £100 a year or, if they are an overdraft customer, maybe £200 a year, and they do not switch. They do not switch because some of them think it is hard to switch, which is not generally true, but mostly they do not know how much they would gain from switching. It is not that open banking will make switching easier, but it gives customers the information they need to be much more intelligent customers than they are at the moment.

Lord Haskel: The banks know. Is there any way of the banks giving them a hint that they should switch?

Professor Alasdair Smith: One of the things we are requiring banks to do is to give prompts to customers from time to time about switching. Particularly for customers going into overdrafts, we are requiring the banks to give them notice in the morning, "You are going into overdraft at the end of business today unless you do something", and we know that that kind of prompt has a big effect on customer behaviour. The FCA did research that shows customers can save 24% by responding to that. As far as switching is concerned, we are going to require banks to give prompts to their customers from time to time that say, "You should shop around". One prompt might be that at the end the year the bank says, "Do you realise you have clocked up £500 in overdraft charges with us? You ought to shop around to see if somebody else can give you a better deal."

Lord Haskel: Do people who want to switch feel trapped if they have an overdraft and they want to move?

Professor Alasdair Smith: Yes. Our research shows a lot of customers with an overdraft think, "If I have an overdraft I can't move; I'm stuck with my current bank and another bank won't want me", which is paradoxical because customers with overdrafts are among the most profitable customers to banks because the charges are so high. They are very attractive customers. The banks need to look quite carefully at them to make sure that they are not going to default on their expensive loans, but we want to get banks which operate a switching scheme to make it more friendly to customers with overdrafts so that they know before they switch that the bank they are switching to is going to give them an overdraft—they get that information in advance—and how much money they can save by switching.

Viscount Brookeborough: You said "shop around". That is, surely, the problem, in that it is not like wanting a book that a bookshop does not provide and you go to the next one down the road. How can one make it easier? When you use the phrase "shop around" or "switch", how is a person who has a simple bank account, lives in a terraced house and works 9 to 5 going to be encouraged and, indeed, where would they go? A one-stop shop?

Professor Alasdair Smith: If that customer in the terraced house has home insurance or motor insurance, most of them now shop around on price comparison websites. Rather than giving your information to a broker or to the insurance company that you have dealt with in the past, you give your driving information to a price comparison website and they then give you a list of offers. At the moment, that does not work for banking because, as I said earlier, the banking product is so complex, but when open banking is implemented it will be as easy for ordinary customers to shop around for banking products as it is for them currently to shop around for insurance products.

Q187 **Lord Northbrook:** I wanted to probe the rationale behind the CMA's proposal to require each bank to set its own maximum monthly charge for unarranged overdrafts rather than imposing a regulated cap, as was imposed for high-cost, short-term consumer credit.

Professor Alasdair Smith: First of all, we think that getting the banks to tell customers the maximum they can pay in a month in unarranged overdraft charges will be an important signal to customers that overdrafts can be expensive, that they need to do the best they can to manage their own finances because they are at risk of incurring high charges; it also sends them a signal that, "This is what my current banking provider could charge me. Is someone else offering a better deal on overdrafts?" Indeed, many people have said, "Why are you letting the banks set their own charges, because that is effectively requiring the banks to give information but it is not restricting what the banks will do?" We think that competition among the banks will put pressure on banks to keep their overdraft charges under control.

Regulating the charge has obvious attractions because it would mean that we would have control over the maximum that people would pay, but it also has risks. It has the risk, first of all, that the bank is no longer responsible for its overdraft charges. Those of us who have had unexpected overdraft charges in the past know it is an unpleasant experience; you feel very angry. Quite often you would phone up your bank and say, "Look, why are you charging me £25 for being, by mistake, £10 overdrawn last week?" The bank has to account for itself and say, "These are our charges; that is what we are doing; we are behaving well towards consumers". One risk with regulation is that a customer who is unhappy with unarranged overdraft charges complains to the bank and the bank says, "We are doing what the CMA told us to do. It is not our responsibility; go and complain to the CMA." There is something positive about getting banks to take responsibility for their own charges. Also, with any regulation you have to worry about the risk that when you regulate a charge, you might get people withdrawing from the market or being less willing to offer this service. That is the general issue we have been concerned about and we are happy—indeed, we have asked—for the FCA to look further at what can be done with overdraft charges. We regard what we are putting in place as the beginning of the story, and the FCA is going to look further at overdraft charges.

Let me make one point in that context about financially challenged customers. At least one charity, which does very good work with individuals with debt problems, has said the CMA should simply have regulated the charge at a much lower level than banks currently charge. I think it is probably right that if you want to do something with regulating overdraft charges for financially excluded customers, you would probably be looking at a monthly maximum that is much lower than the monthly maximums that banks currently charge. For those banks that currently advertise their maximum monthly charges, they are of the order of £90 or £100 a month. I suspect that very few poor households hit that £100 ceiling, but if you are getting two £25 charges in one month and you are a low-income family, that is a big problem. To use a monthly cap to address the problems of low-income households, the cap would have to be pretty low. Then you would have the risk that many other customers would find that this product, which is expensive but is valued by many customers—the ability to have an emergency loan from your bank in the form of an unarranged overdraft—might become much less available than it is at the moment. An example is someone who is in danger of going into an unarranged overdraft because their energy bill is going to be paid as a direct debit, and the bank says, "We are not paying your direct debit because we are not willing to extend you an unarranged overdraft". I suspect many customers, though they dislike paying an unarranged overdraft charge, would dislike even more having their energy bill not paid, with all the consequences that flow from that.

I am sorry, that is a very long answer, but it is an important issue and a big issue. I am not saying that a regulated cap would be the wrong thing; I am saying a regulated cap is something you would enter into only after looking very carefully at how it might affect different income levels of bank customers. We are very happy that the FCA is going to look at this, but we did not think it was a step we were in a position to take at this stage.

Lord Northbrook: Will you monitor the situation and see how it works out in, say, a year's time?

Professor Alasdair Smith: We will, although that will be in conjunction with the FCA. The FCA is doing further work on quite a number of our remedies to make sure that they are designed in the most effective way. Overdraft charges are the most problematic area in personal current account banking, not just for the financially excluded but for a whole range of customers. We think it is absolutely right that both we and the FCA do further work in looking at this and monitoring how our remedies work and how they should be further developed if they do not have as much impact as we, at the moment, expect them to have.

The Chairman: Do you have anything to add?

Adam Land: I think that is fine.

Q188 **Lord Harrison:** Professor Smith, regarding your statement at the beginning that open banking will be "transformational", you have not convinced me yet. I think there is a very big gap between what is proposed and the customer understanding the opportunities. Let me table the question I am meant to ask, which is, what are the implications of open banking and, more generally, the trend towards digitisation of services for customer privacy and data security?

Professor Alasdair Smith: I will ask Bill to answer your main question, but let me respond to your first question by saying that open banking is based on a technology called open API—open application programming interfaces. That technology has transformed many existing customer services. Many people now rely on their smartphones to tell them when the next bus is coming, where the best quality Indian restaurant is within half a mile, how to get there, how customers rate it, and so on. Open banking promises to give us a different kind of relationship from the one we currently have with our bank. Among the things that might happen would be that a customer does most of their financial transactions through an application on their mobile phone that is not their own bank's, but that of some third party that has carefully managed access to their bank account. It monitors your bank account and perhaps sends you a message saying, "It looks like your current account is going into overdraft tomorrow, so we have moved some money from your savings account into your current account". Or it sends you a message saying, "Your current account is going into unarranged overdraft and that is going to be an expensive experience for you, but the emergency lending service—not with your own bank but one you have signed up for—is going to push £100 of emergency borrowing into your current account this afternoon for half the cost that your bank would charge you." Your whole banking relationship changes. Your relationship with your existing bank might become more distant than it currently is, and you get access to financial help and advice of a kind that you simply do not have at the moment.

Adam Land: The only thing I would add to that is that people who are not currently banks will be able to transform and improve the service of financial and banking advice and support you get. The banks are going to have to respond to that; they are not going to want to sit there and say, "There are these people who are telling my customers how they can manage their money better. What am I doing? I am just sitting here keeping their money safe." The banks will have to think, "I want to be offering a better service to my customers so that they can stay in the game". In the same way as retailers have had to respond to online competition to offer a better service, you can see that some banks will respond positively to this challenge and, similarly, will want to enhance the customer's experience, save the customer money and help tackle financial exclusion. It is difficult at this stage, because the applications we are looking at are a year to a year and a half down the line, but the potential to see in banking markets what has happened in numerous retail markets is very large indeed.

Lord Harrison: You have both been fertile in broadening the area of people who know about banking, which means that, Bill, you are going to give a marvellous answer to my question.

Adam Land: Thank you very much. Bill, over to you.

Professor Alasdair Smith: Indeed, I was very conscious, as I was speaking to you, that I was illustrating the motivation behind your question by talking about digital applications, and your question was, are we imagining that customers are now going to have to rely on digital applications? Bill.

Bill Roberts: Follow that, I think, is the challenge. If I could say something very specifically about the second part of your question, which was to do with security, yes, we are absolutely aware of that. If anything is going to undermine this remedy, it will be that people simply do not have confidence in these tools when they appear. They may say to themselves, "Hang on. Does this mean sharing my transaction data, my current account information? I don't like the sound of that so I am not going to do it." Yes, we are fully aware of that, as are all the providers and fintech companies we have talked to.

The approach we have taken is to say that the measures we put in place should be risk-based. Clearly, the risk varies, first of all, with the kind of data you are talking about and, secondly, with the functionality of the tools that you are using. To take the data point first, we are requiring the banks to make available through open APIs what you could describe as open data by the end of March next year. This is data that relates to, for example, the location of ATMs and whether they are accessible, for example, by disabled people—what height they are. That is not confidential information; that is in the public domain already. We have given them until the end of March to release that.

When you start talking about transaction data, bank account data, that is a completely different kettle of fish. When you also, on top of that, look at some of the functions that APIs can perform, not just reading your bank account data but taking money out of your bank account, that starts to become seriously risky. We are requiring the banks to provide different levels of security for those different levels of risk. For the lowest levels of risk we have given them the shortest amount of time; for the highest levels of risk we have given them over a year—18 months, basically—to get this together. They do not have to develop the tools they will need to do that; the tools for authentication, security and encryption are all readily available; you just need to choose, not quite off the shelf, the particular authentication protocols you are going to use and apply those. I have to say that everybody who is involved in this project is fully aware that if the public lack confidence in the security of these measures, they will not be used, and the huge investment that the banks are being forced to make in implementing this will be lost.

Lord Harrison: Thank you very much.

The Chairman: Can I follow up on a couple of points that were made there? First of all, you were talking a lot about the new apps being developed. The Committee has taken a strong interest in the whole issue of digital exclusion and the overlap between financial exclusion and digital exclusion, and of course the two are not synonymous but there is an overlap. My first question is, what sort of thinking have you been doing, as you have been focusing on new apps, about how that is going to impact on people who are digitally excluded? Secondly, you talked about people perhaps having a more distant relationship with their bank in the future. A lot of people I talk to—and I think I would include myself—rather hanker after a closer relationship, so that you do not always have to ring a call centre and speak to a different person every time, which is rather different from the relationship one used to have with one's bank. Could you give a quick response to both those points?

Professor Alasdair Smith: Adam, do you want to address the first one?

Adam Land: Yes. You have summarised it well, in that digital exclusion and financial exclusion overlap but they are not the same thing. Particularly, mobile technology—mobile phones—has changed the pattern on digital exclusion. I think we were criticised earlier for relying on websites when you could only do that on a laptop, whereas now mobile phones are a much more broadly based communications tool and a way of accessing the internet among people. We totally recognise that there will be some people who are either uncomfortable with technology or are not there. We will not have a perfect answer to everything but we would say, first—a point that Bill made earlier—for people who are not comfortable using digital technologies for open banking because they do not feel they have the capability, we see the benefits of open banking as being an opportunity for advisers, using the tools that open banking is providing, to sit down with a client with a tablet or in front of a laptop and take them through how they can use the tools to manage their money. We would see that as an opportunity.

The second point I would make is that there are measures in our remedy package which are not solely digital. One area we are doing a lot of work in is service quality. We are going to require banks to compare service quality using, essentially, the same metrics and the same survey and then to communicate that in a very public way to all customers, both in branches and online. With that measure, people who are not online but go into branches would be able to see who is offering the better service and how their provider compares. Also, you cannot fake that, so those benefits would go to all customers whether they are digitally savvy or not. We would not say we have emphasised the digital side of our remedies, partly for the point Lord Harrison was making—that we have a selling job to do there—but there are also measures there which we are looking to benefit all customers.

Professor Alasdair Smith: As far as distance from your bank is concerned, I did not mean that it would be compulsory for all customers to step further away from their bank. The fact is many customers are choosing to have a more distant relationship with their bank than customers used to have. For example, many younger customers do not use bank branches at all—not all of them; some do but many do not—and are happy to deal with their bank entirely through a mobile phone application. Many of us prefer a closer relationship with our bank, and that is still possible. The fact that I have a mobile phone app, which I use a lot, does not stop me going into my branch if that is a helpful thing for me to do. In the same way, the kinds of tools I talked about in response to Lord Harrison's question are not compulsory tools for everyone to use; they are tools we think many customers will find useful. Clearly, there are some aspects of the increasing digitalisation of banking, in particular the closure of bank branches, which cause problems for people who value their close relationship through a local branch. That is the way the banking industry is changing, but hopefully there will still remain the personal contact for people who value it.

The Chairman: Thank you. That has been an important point for the Committee.

Q189 **Bishop of Birmingham:** Sticking with banks, the overview of the retail banking market commented on the ability of challenger banks, or new entrants, to gain market share, noting that there is quite a slow take-up. I wondered how the measures created to facilitate switching might help the performance of challenger banks, and whether any element of this part of the market would help increase financial inclusion.

Professor Alasdair Smith: On the first part, yes, we think that increasing switching will make life easier for challenger banks. Indeed, our analysis suggests—and some of the smaller banks have told us this—that low levels of switching are one of the biggest barriers to entry. The existing banks do not have to work very hard to hold on to their customers; most of us stick with our existing bank and do not shop around even when it would pay us to do so. Therefore, a bank that comes along with a higher level of customer service or innovative products builds up its customer base quite slowly. I can think of at least two of the smaller banks who told us that in spite of introducing very attractive products, their market share has moved quite slowly. There are real benefits to competition from newcomers who bring innovation to the market, if customers are more responsive to innovation and to service quality. That is one of the things we have not talked about so far. Customers are not very well informed about the service quality of different banks, and there are significant differences. Making more information available about service quality, which we are going to do, will also be an encouragement. Those entering the market with new deals that they think will be attractive for customers are going to be rewarded for their innovation faster than they are at the moment.

Bishop of Birmingham: May I ask a supplementary, which may not have come in somewhere else? You talk about more information, but has the CMA given any guidance about the quality and communication skill of that information—rather than the solid blocks of very small-print, extra information that is often provided about starting up or switching—or the level of interest that we were talking about earlier?

Professor Alasdair Smith: We are certainly aware of that. For example, one of the things that has been done in the past in an attempt to improve banking competition is to require the banks to provide annual statements of information, and all the evidence is that we all bin them. You get this piece of paper from your bank at the end of March showing your charges during the year, you look at it for five seconds and think, "I can't be bothered". The FCA's work shows it has had no impact on the market. Whereas if a bank sends you a mobile phone alert at 10 am saying, "You have until 4 pm to sort out your unarranged overdraft or you are going to be hit by a £20 charge overnight", lots of customers respond to that. The design of remedies is very important. In quite a lot of the areas where we want to implement remedies, we are asking the FCA to look carefully at what remedies will be most effective by shooting just the right level of information at customers so that they respond to it.

Bishop of Birmingham: Excellent. Thank you very much.

Q190 **Lord Fellowes:** You will have heard there was quite a bit about payday lending on the radio this morning, but I do not think it answered my question, which is: to what extent have the recommendations and remedies identified in the CMA investigation into payday lending been implemented?

Professor Alasdair Smith: You are the best person to answer that, Adam.

Adam Land: I will answer that. I worked on the payday lending case before banking. The thing for the Committee to have in mind when they think about payday lending remedies is to look at the totality of what was done in the payday lending market over the past three to four years by ourselves and the FCA. If you look back to about 2012, 2013, then, essentially, it was like the Wild West. The market had been growing at this incredibly rapid rate for four or five years, with very light-touch regulation—in hindsight, too little regulation would be the view. The first thing that was necessary was to clear up the market and get rid of the worst behaviours in the market. That was done, essentially, by the FCA and I think they tackled irresponsible lending and tightened up lending criteria. There was this big problem with what they called "roll-overs". You would take out a one-month loan, you would roll that over for another month and then another month and another month so, essentially, you would be taking out a six-month loan but at one-month rates. They sorted that out and made a difference there. Then there were concerns about what are called continuous payment authorities, where you give the lender the authorisation to go to your bank and keep coming back to see if they can make the payment. Very bad practices had evolved in the market, and that was the first thing that needed to be done.

Then, obviously, you had the price cap, which is in the news today, as you say. Parliament decided to introduce that to put a safeguard around prices and to deal with broader issues around affordability and the cumulative cost of that borrowing. That is the context in which our remedies pretty much take all that as given. We are saying, "You have a price cap; that makes the worst case slightly less worse, which is a positive, but we want to make sure you have some scope for competition beneath the cap so that you can get better outcomes for customers". There is still demand for short-term lending, so it is a matter of getting competition there. That is the context of our remedies.

In terms of your question, there are about five or six areas where we have either made recommendations or taken action ourselves. The first thing we did, and what we said was the most important thing for competition, was around improving the comparison sites that are available for customers. If customers are going to take out a payday loan or a high-cost loan, at least take out a cheaper one, was the view. When we looked at the comparison sector, it was terrible, in the period we were looking at, so we recommended that the FCA authorise comparison site providers and put in place clear ground rules to make sure their customers are able to make a proper comparison. They have now introduced those rules, which I believe are coming into place on Thursday. That is a tick, essentially. They did a lot of research to fine-tune the rules, which is why it took a year or so to do, but they are now coming into place.

A second area we introduced ourselves is what is called a summary of cost of borrowing. The issue there is that each individual payday loan might be quite small; the amounts you are borrowing might not be huge and even the interest—it is not trivial for the people concerned—is not huge, but people pay more than they are expecting if they incur late fees and so on, and if you take out three or four loans in a year you can find you are spending a significant amount on interest. This is just coming into place so I cannot tell you about the impact, but we are requiring lenders at the end of each loan to tell customers about the outturn of the loan and about the running total of their spend on interest and charges over the year. That is in place and is something we have done.

We highlighted some broader areas for the FCA to look at, and I think it is not quite as clear-cut. Action has been taken in those areas but they have taken it across a broader canvass, so it is not quite as simple an answer. One area we were very concerned about was what we call lead generators. These are brokers. People google "payday loans", a number of names come up, some of them would be Wonga and other payday lenders, and others would be brokers—essentially, lead generators. They look exactly like a payday lender but in fact they are taking your details and marketing the customer to whoever was the highest bidder for that customer. We said that is completely non-transparent; people think they are going to a lender or to a price comparison site and, in fact, they are a lead and they are being auctioned around the market. We required much clearer disclosure of this side of the market, which the FCA has done. I also note that the FCA, in its report this morning, has tightened up more broadly on brokers in that area using its regulatory powers. That is a positive story.

The FCA is taking some further action on a couple of remedies aimed at widening access to other forms of credit. That is an important aspect of remedies around financial inclusion, which are to do with real-time data sharing and what we call "soft searches", so you can search for a product without leaving a black mark on your credit rating. The FCA has been taking action there. We talked earlier about operating on a larger scale, and those are issues that apply to the financial services sector and work done there. That is all good.

One area where, possibly, I would like to see more done—I am sure this will be looked at in the review the FCA has announced today—is late fees and charges. That is the most opaque aspect of charging for any of these products and for payday loans. We now have quite a tight price gap, in my opinion, on the 80p per £100 daily rate for a payday loan, but we were definitely concerned that there was less visibility and less competitive pressure on what you pay if you are late. That is probably still an area for more work, in my view.

Lord Fellowes: The market in payday lending has contracted. Is that a good sign, or is it just fewer people paying a higher price, or what?

Adam Land: We were talking about this on the way here. It is very hard to interpret that number. It is pretty clear that there was an oversupply back in 2012 and 2013; people were lending irresponsibly, I think would be the word, so some people were getting loans who should not have had loans for their own good, and that was part of the impact assessment that the FCA did when they introduced the price cap. You can see that that is an impact. Generally, one of the risks of introducing a price cap is that you create a gap between supply and demand. You restrict supply because people are not there. That is always a risk. Looking at the document the FCA published this morning, they are clearly alert to that and I think they are taking a lot of interest in seeing where are people going if they are not getting a payday loan. Are they not borrowing? Are they going to illegal lenders? That is a very important issue. I would not pretend to know the answer, but it is clearly a very important issue.

Lord Fellowes: Thank you very much.

The Chairman: I know Viscount Brookeborough wants to come in. Could I ask for a very brief answer to this, please? Just to understand your relationship with the FCA, because we are seeing them next week, for example, would you have been consulted on the review beforehand and had a chance to feed in your thoughts? Is it broadly a good thing and will you be working with them jointly? What is your relationship?

Adam Land: Yes, we work closely with the FCA and consulted them pretty extensively through our investigation. They now have competition powers and consumer powers, so we see our role as very much complementary to them. We have done one-off, large investigations where we create partly the evidence base they can then use as a standing regulator. We are putting in place remedies, but the long-term home for a lot of these issues will be the FCA because they can return to the issue. It is a close working relationship.

Viscount Brookeborough: Has any analysis been done of the customers who go for payday loans? Clearly, there are two groups: those who do not have bank accounts, who would have absolutely nowhere to get the money; and those who have bank accounts, but their bank is not giving them enough information and enough of a service in order that they go to a bank where the loan would be more secure and at a lower interest rate? Do we have an analysis?

Adam Land: We do quite a lot. It is a few years old now. I will try to be brief. We found a big difference in demographics between high street payday lenders and online payday lenders. If you look at online payday lenders at a high level, it is not completely atypical or as different from the rest of society as I had expected. You certainly do not have the very richest and you probably do not have the very poorest, but you have quite a spread of society using online payday lenders such as Wonga. High street payday lenders reflect much more the communities in which the shops are located, so that is a much lower income demographic—less likely to work, and so on.

Viscount Brookeborough: Is it the inability to communicate with their banks that forces them into that? Secondly, you have said that some of the people who go to them are wealthier. Why on earth do wealthier people go to payday lenders when they can go to their bank?

Adam Land: When payday lenders came along they were very good at technology and marketing. They caught on to the fact that a lot of people engage with financial services using their mobile phones. We are getting there six years later, but they were very clear about that and there was a convenience aspect to that, particularly with the online lenders. People thought, "I would like to be able to get a loan quickly because I need it this weekend; I do not want to go to a bank manager". There are quite a number of reasons. Other people liked the fact that a payday loan was a fixed-term loan for a fixed amount, and people were worried about credit cards where you have an open-ended line of credit. You have an expert in this area in the room as well, but when you look at the research there is quite a diverse picture in terms of people's motivations for payday loans. It is best not to have a single model, but I think it is important to get the idea that, certainly, when we looked at the online market, it was quite a broad cross-section of society.

The Chairman: Thank you very much. We are going to have to press on a bit now.

Q191 **Lord McKenzie of Luton:** I have some questions about basic bank accounts. We have heard evidence that perhaps the banks could do more to promote these. How would you rate the success of the agreement on basic bank accounts between the Treasury and the major banks? What more might be done to promote them and how do you see, if at all, the role of the Post Office and Post Office accounts in all of this?

Professor Alasdair Smith: I have to preface my answer by saying we did not focus our inquiry on the basic bank account, which is a regulated product that is there for a good reason. It is not a product the banks make money out of. Our focus was on the competitive part of market. Clearly, the basic bank account is an important product for those customers for whom a conventional current account with overdraft facilities is not available. It is important that it be promoted and that customers for whom it is a useful product know about it. Once again, I have to go back to open banking and say one of the things that open banking might do is raise awareness of basic bank accounts for those customers for whom it is the best product. Equally, for customers who have a basic bank account but could actually move to a more attractive and flexible product, the whole business of more information and more switching applies to them as well. There is scope for opening up the market for this product.

Lord McKenzie of Luton: Why do you think the agreement only covers the nine largest banks and not a number of the newer institutions; the ones you were referring to earlier—again, perhaps including the Post Office?

Professor Alasdair Smith: I think you would have to ask the Treasury, which I think was responsible for the agreement. I imagine it is simply that a basic bank account makes losses. There is very little income stream for the bank associated with it, and I imagine the Treasury simply made a pragmatic decision: "We are going to stick this loss-making product on banks; let's stick the obligation on the bigger banks who have wide, national coverage so they will be accessible to most customers, and most of them have the broader financial back to bear the modest burden of the basic bank account".

Lord McKenzie of Luton: Do you see a role for Post Office accounts in all of this?

Professor Alasdair Smith: One role we see for the Post Office is in relation to the closure of bank branches. Accessing banking through the Post Office is going to become an important point of access to banking for those customers who need local banking and for whom the closure of conventional bank branches is a problem.

Lord Shinkwin: Citizens Advice has told us that while basic bank accounts are very useful for some people—for example, those who perhaps have problems with being offered a current account—awareness is low because there does not appear to be much advertising. I am encouraged by what you said a few moments ago about the importance of promoting basic bank accounts. I would be interested to hear who should carry the burden of advertising basic bank accounts. Should it be banks themselves, as a cost of doing business in the UK, or the Government?

Professor Alasdair Smith: I do not see any reason why it should not be borne by the banks themselves, just as a practical matter. The cost of mounting even a pretty effective campaign to publicise basic bank accounts is not huge compared with the financial resources of the banks. It seems to me entirely reasonable that the banking sector, as part of the overall deal of supplying this regulated approach, should also be responsible for effectively promoting it.

Lord Shinkwin: That is helpful, thank you.

The Chairman: Thank you very much for that. A final quick question from Viscount Brookeborough.

Q192 **Viscount Brookeborough:** Finally, what is the one thing you would most like this Committee to consider recommending, when it draws up its final report, that would affect most people and would have the greatest impact over the largest area?

Professor Alasdair Smith: We have talked about and have emphasised how open banking is at the centre of our proposals. We have discussed how open banking is going to develop lots of technology-based improvements to the banking market which are going to have a big effect, we hope, across the board. This Committee will naturally be anxious about the possibility that, whatever the best intentions of new products developed in open banking, the financially excluded will be far down the priority list. I would regard it as positively helpful if you put pressure on everyone involved in the open banking programme—the banks themselves and the financial technology companies—by saying that one of the ways Parliament is going to look at this in three years' time is not just, "Has this generated a broad improvement in competition in the market?", but "Has that improvement in competition improved the situation for the financially excluded in particular?". As we have said, there is plenty of scope for new products to be developed under open banking that will be very helpful to the financially excluded, but it requires people to put in the effort to do it.

Viscount Brookeborough: A lot of what you have said has been about clients, and you have repeated "customers, customers". Some of the most financially excluded people are not your customers, but the 1.4 million people who do not have accounts, people with dormant, sleeping accounts and people who do not care about accounts. Do you believe there is enough outreach to those people? Clearly, a lot of the information you have given is only available to people who already have a certain level of literacy.

Professor Alasdair Smith: As Adam said earlier, one of the ways that open banking can reach out to those dormant, digitally excluded or otherwise excluded customers is by the development of products that will be of particular use to advisers in citizens advice bureaux, or wherever, so an adviser can sit down with a client and say, "Look, you are not managing your finances very well; I understand that you have difficulties of various kinds but let's sit down together. I have access to these tools and I can use them to give you better advice than I can give you." That is the kind of development that, among others, I very much hope will come out of open banking. I think it will be helpful to have pressure from Parliament on those developing these products to make sure that they address the full range of social needs.

The Chairman: Thank you very much indeed. Adam, a little earlier on in response to a question from Viscount Brookeborough, you talked about some analysis you had done on different types of customers. I think the question was around payday lending and the like, and you said it was five or six years ago. Would you be able to let the Committee have a note about that?

Adam Land: Yes. It is in our reports, so I will be able to direct you to the right parts of those reports.

The Chairman: That would be very helpful.

Professor Alasdair Smith: Incidentally, on the same page, as it were, in the banking inquiry we did a lot of work looking at overdraft users. Perhaps less surprisingly than in the case of payday loans, users of unarranged overdrafts come from the full income spectrum. The heaviest users of unarranged overdrafts are people who are pretty well off.

The Chairman: Thank you very much indeed. It has been a very helpful session, so thank you very much for your time.

Professor Alasdair Smith: Thank you.