

**Notice of decision to release Undertakings in relation to SME banking given pursuant to section 88 of the Fair Trading Act 1973**

**Introduction**

1. On the basis of advice from the Office of Fair Trading (OFT), the Competition Commission (CC) has decided to release the UK's four largest clearing banks, that is Barclays Bank Plc (Barclays), HSBC Bank Plc (HSBC), Lloyds TSB Bank Plc (LloydsTSB) and the Royal Bank of Scotland Group Plc (RBSG) (together, the four banks), from most of the Transitional Undertakings given by them in 2002. These undertakings require the banks to offer small and medium-sized enterprises (SME) an account that pays interest on credit balances of at least 2.5 percentage points below Bank of England base rate<sup>1</sup> or does not levy standing charges or charges for core money transmission services, or both.
2. The CC has decided to retain undertaking 11 of the Transitional Undertakings, which requires the four banks to notify the OFT and to publish all increases in charges and all new charges. The Behavioural Undertakings, designed to make the market more competitive by making switching easier and faster, by making prices more transparent and by prohibiting the bundling of different products and services, will remain in place. The CC has also decided to recommend that the OFT reinforce the awareness and the impact of the Behavioural Undertakings.
3. The CC issued a notice of its provisional decision for public consultation on 23 August 2007. The CC received eight responses to its consultation, and it has taken account of each of them in reaching this final decision as explained in the remainder of this document. The CC does not consider that its final decision differs materially from that set out in the notice of provisional decision.

**Background**

4. In 2002 the CC published its report into the supply of banking services to SMEs.<sup>2</sup> In its report, the CC found that Barclays, HSBC, LloydsTSB and RBSG, together had a market share in excess of 90 per cent. The CC also found that customers were unwilling to switch; this resulted from the perceived complexity of switching, the small benefit from switching, the importance of a relationship with their bank manager, and the lack of transparency in pricing. The CC further found that competition was restricted or distorted by the similarity of pricing between banks, by selective discounting, and as a result of entry barriers such as the need to establish branch infrastructure and the need to incur sunk costs.
5. Following that report, two sets of undertakings were agreed:
  - (a) The Behavioural Undertakings: nine clearing bank groups in the UK (including the four banks referred to in paragraph 1),<sup>3</sup> agreed undertakings aimed at increasing price transparency, reducing switching costs and limiting the bundling of current accounts with other banking services.

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<sup>1</sup> For example, if the Bank of England base rate were 6%, the four banks would offer SMEs an account that paid at least 3.5% interest on credit balances.

<sup>2</sup>CC (2002), *A report on the supply of banking services by clearing banks to small and medium-sized enterprises within the UK*, Cm 5319. This is available at: [http://www.competition-commission.org.uk/rep\\_pub/reports/2002/462banks.htm#full](http://www.competition-commission.org.uk/rep_pub/reports/2002/462banks.htm#full).

<sup>3</sup>AIB Group (UK) Plc, Bank of Ireland, Barclays Bank Plc, Clydesdale Bank Plc, HBOS Plc, HSBC Bank Plc, Lloyds TSB Bank Plc, Northern Bank Ltd and The Royal Bank of Scotland Group Plc.

- (b) The Transitional Undertakings: the four banks referred to in paragraph 1 agreed undertakings broadly requiring them to offer all SME customers either interest on credit balances of at least 2.5 percentage points below the Bank of England base rate, or no standing charges and free core money transmission services (such as direct debit payments and cash transfers).
6. Both these sets of undertakings are specified under paragraph 16(1) of Schedule 24 to the Enterprise Act 2002 (the Act) by the Enterprise Act 2002 (Enforcement Undertakings and Orders) Order 2004 (SI 2004/2181)<sup>4</sup> (the Order) with the effect that the power to supersede, vary or release these undertakings has been transferred from the Secretary of State to the CC.

### **OFT recommendation**

7. In accordance with section 88 of the Fair Trading Act 1973, and sections 4, 5 and 7 of the Act, the OFT carried out a review focused largely on the short-term impact of the Transitional Undertakings. In doing so, it also considered the overall impact of the Behavioural Undertakings on competition more generally. Following the completion of its review, the OFT submitted its advice to the CC in January 2007.<sup>5</sup>
8. The OFT concluded that on balance if the Transitional Undertakings were to remain in place the costs associated with them would outweigh the benefits. The OFT therefore recommended to the CC that it should release the four banks from these undertakings (the Recommendation).
9. In its consideration of the Behavioural Undertakings, the OFT noted some concerns about some aspects of the market and noted that it was in continuing dialogue with the banks as to how these might be addressed. The OFT concluded that the Behavioural Undertakings continued to facilitate the development of competition in the market and should remain in place. Accordingly, the OFT did not provide advice to the CC to vary, supersede or release the Behavioural Undertakings.

### **Decision partially to accept Recommendation**

10. The CC has decided to accept the OFT's Recommendation to release the four banks from the Transitional Undertakings with the exception of undertaking 11. Undertaking 11 requires the four banks to notify the OFT and to publish in a manner and within a period of time approved by the OFT all increases in charges and all new charges.
11. In addition to its decision on the Transitional Undertakings, the CC recommends to the OFT that it should:
- (a) raise awareness of increases in charges, new charges introduced or interest payments reduced in response to the release of the Transitional Undertakings;
  - (b) take account of any response by the four banks to the release of the four banks from the Transitional Undertakings in any future review of the Behavioural Undertakings;
  - (c) work with the nine banks subject to the Behavioural Undertakings to publicize their obligation under those undertakings, for example by working with

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<sup>4</sup>Which came into force on 4 October 2004.

<sup>5</sup>The OFT's report may be found at: [http://www.of.gov.uk/of\\_at\\_work/markets/services/SME-banking/](http://www.of.gov.uk/of_at_work/markets/services/SME-banking/). This report contains the advice submitted to the CC in January 2007 and further information provided by the OFT to the CC following discussions.

organizations such as the Federation of Small Businesses and the Forum of Private Business, and by taking advantage of the high levels of interest currently in the banking industry; and

- (d) explore with the British Bankers' Association whether and how to include the substance of the Behavioural Undertakings in the Banking Code.

### ***Decision on the Transitional Undertakings***

- 12. The CC's provisional decision was taken on the basis of the evidence and analysis contained in the OFT's report. The CC's final decision has been taken on the basis of the OFT's report and having considered the responses received to the consultation on its provisional decision. The CC therefore considers it appropriate here to set out firstly its consideration of the OFT's report and then to set out its consideration of the consultation responses.

### ***The OFT's report***

- 13. Overall, the CC noted that the OFT, in making its Recommendation on the Transitional Undertakings, had conducted a thorough review of the evidence in relation to change of circumstance and had considered carefully whether the change of circumstance it had identified was sufficient to release the four banks from those undertakings. The CC shared the OFT's view that there was some evidence to support their retention, though it did not interpret all of the evidence in the same way as the OFT. However, considering the OFT's report as a whole, the CC agreed that on balance there were sufficient reasons to remove these undertakings, with the exception of undertaking 11.
- 14. In reaching its decision to accept the OFT's Recommendation (with the exception of undertaking 11) the CC placed particular weight on a number of pieces of evidence cited in the OFT's report. The CC noted the stronger position of the 'challenger' banks (in particular HBOS, Alliance & Leicester and Abbey). This was evidenced by the increase in the market share of those banks from around 3 per cent in 2000 to around 9 per cent in 2006, the fact that switching data indicated that the challengers had been net winners, and the suggestion from the OFT survey that those SMEs that have switched or are considering switching are increasingly switching or considering switching to the challenger banks. The CC also noted the way in which the challenger banks had expanded their SME services since 2002. Noting the gains that SMEs could enjoy from switching to the challenger banks, this strengthening of their position appeared to be consistent with their posing a competitive constraint.
- 15. In considering the evidence on barriers to switching, the CC noted that only if barriers to switching were sufficiently low would the four banks be constrained in their ability to raise prices following a release of the Transitional Undertakings. The CC was concerned that actual levels of switching remained low. The OFT's 2006 survey for example showed an annualized switching rate of 4.3 per cent and showed that in three years prior to the survey 13 per cent of customers had switched, as compared to 12 per cent in 2000. The CC also noted that SMEs still typically stay with a particular bank for a very long period of time (the Warwick survey showed that the average length of the financial relationship was 15 years). The CC further noted the OFT survey showed that 25 per cent (up from 14 per cent in 2000) of those that had switched had encountered problems in doing so. However, it noted that the Transitional Undertakings themselves may to some extent have reduced the incentive to switch and also that the fact that the OFT survey had found an increased perception that 'all banks are the same' could indicate this. The CC also noted that

not all, or even most, customers would need to exercise a credible threat to switch in order to constrain a bank's pricing. It noted that the Behavioural Undertakings, which will be retained, are concerned in part with making switching easier. The CC also noted the OFT survey, which suggested that in response to a 5 to 10 per cent price rise 19 per cent of those SMEs surveyed would definitely switch bank, and a further 48 per cent would consider switching. In addition, the CC accepted that the Transitional Undertakings might have achieved a 'ratchet effect' by establishing an expectation among customers that an interest-bearing account or an account without standing charges or money transmission charges would be available so that it would be difficult for banks to abandon these offers.

16. The CC noted that there had been changes in the market shares of the four banks with [X] falling from [X] per cent in 1999 to [X] per cent in 2005, [X] falling from [X] per cent to [X] per cent, [X] rising from [X] per cent to [X] per cent and [X] remaining stable with [X] per cent. However, it also noted that these changes could have occurred for a number of reasons, including, for example, the different strategies pursued by HSBC and LloydsTSB on the one hand and by Barclays and RBSG on the other. The CC was not therefore persuaded that these shifts in market share necessarily indicated an increased intensity of competition. The CC further noted that the aggregate market share of these four banks remained high, at 85 per cent in 2006 as compared with 92 per cent in 2000. The CC also noted the changes in the banks' tariffs since 2002. However, since many of these changes represented attempts by the banks to encourage customers to use technology that was lower cost for the banks, it was not clear that these changes were indicative of increased competition.
17. The CC did not attach significant weight to the evidence cited in the OFT report that the Transitional Undertakings were having a negative effect on innovation. This evidence largely consisted of statements from banks that the undertakings have had a negative effect on investment and also about what they would have done in the absence of the undertakings. Whilst accepting that this might be true, there was no additional evidence from other sources that enabled it to be substantiated one way or another.
18. Similarly, the CC did not attach significant weight to the banks' argument that the need to comply with the undertakings had resulted in significant hedging costs. These estimated costs appeared to be highly dependent on the form of hedging policy chosen by the banks and the shape of the interest yield curve in recent years. These assumptions may not apply on a prospective basis. The OFT told the CC that it did not place great weight on this evidence.
19. The CC acknowledged the potentially distortive effects of price control remedies. However, it also noted that the CC inquiry group gave this full consideration during the original investigation and sought to ensure that the Transitional Undertakings allowed substantial opportunity for profitable entry and expansion. The CC did not therefore consider that the distortive effects of the price controls were likely to be a significant element in the change of circumstance identified by the OFT. However, to the extent that the benefits had diminished, the CC accepted that these distortive effects were a significant element in its consideration of the balance of costs and benefits now associated with the Transitional Undertakings and, it noted that in general, the distortive effects of price caps are likely to increase over time. In this regard, the CC noted that although it appeared that the inquiry group had expected the price controls to remain in place for around 'two to three years' they had now been in place for more than four years.

20. The CC noted that the original purpose of the Transitional Undertakings had been to mitigate certain of the adverse effects of the lack of competition which the CC had found in its 2002 report (specifically excess prices, which had manifested themselves in excess profits). They were not aimed at remedying the lack of competition itself, which the Behavioural Undertakings were designed to remedy. The CC noted that the four banks appeared to have complied with the Transitional Undertakings, and were offering SME accounts which offered either interest of at least 2.5 percentage points below base rate or no standing charges or money transmission charges (or both).
21. On the basis of the OFT's report, the CC considered what might happen if it were to release the Transitional Undertakings. Taking into account the stronger position of the challenger banks, the effect of the Behavioural Undertakings in making switching easier, the greater propensity of SMEs to consider switching, and the shift in customers' expectations (the ratchet effect referred to in paragraph 15), the CC considered it unlikely that banks would be able to raise prices significantly in a visible way. The CC also considered that the degree of scrutiny to which banks were currently subject would reinforce this constraint. However, the CC remained concerned that the opacity of pricing for SME banking services could allow banks to raise prices in ways that would not be immediately visible to customers.

### *Responses to consultation*

22. The CC received responses to its consultation from Barclays, HSBC, Lloyds TSB, HBOS, the British Banking Association (BBA), the Federation of Small Businesses (FSB), the Campaign for Community Banking Services and the British Retail Consortium (BRC). Broadly, the responses from all the banks and from the BBA welcomed the CC's provisional decision to release the four banks from the Transitional Undertakings. The FSB, the BRC and the Campaign for Community Banking Services, however, submitted that the Transitional Undertakings should be retained.<sup>6</sup> The responses may be grouped under different headings, each of which is discussed below.

### *Sufficiency of change of circumstance to justify release*

23. In their responses, the banks and the BBA all supported the view that the change of circumstance identified by the OFT was sufficient to justify the release of the Transitional Undertakings. Barclays noted in particular the potentially distortive effects of the Transitional Undertakings on competition, which it said would increase the longer the Transitional Undertakings remained in place. It said that releasing the transitional undertakings would increase the levels of innovation and competitive differentiation in the sector. Barclays also emphasized that it believed competition in the market was increasing and had been enhanced by, among other factors, the Behavioural Undertakings, particularly in respect of increased price transparency and the availability of price comparisons. It said that competition occurred in SME banking on both price and non-price factors and did not accept that pricing was opaque, citing the OFT's customer survey, which showed that 83 per cent of customers were satisfied with the transparency of pricing information on their accounts. The BBA also said that it believed pricing was transparent and switching

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<sup>6</sup>The Federation of Private Business did not submit a response to the consultation. However, the CC noted that its press release stressed the need for small businesses to shop around for the best deal and noted the tension between campaigning to lower regulatory burdens and for retention of these price controls.

was easy; it believed that its Business Account Finder<sup>7</sup> was helpful to small businesses and their advisors.

24. The FSB expressed concern that, although there had been some changes in the market since 2002, it did not consider these sufficient to warrant release of the Transitional Undertakings. It emphasized the continued high concentration of SME bank accounts held by the four banks. It also emphasized the difficulties faced by SMEs in switching banks.
25. The FSB provided a copy of its latest Report on Small Business Banking, based on a survey of over 4,000 FSB members.<sup>8</sup> The FSB recognized that there had been an improvement in the market since the CC's 2002 report, but said that this was not enough to warrant lifting the Transitional Undertakings, noting that just under 70 per cent of small businesses still banked with the four banks. It also noted that of the fifth of respondents to its survey that had tried to switch banks in the previous year, more than 45 per cent had found the experience quite difficult or very difficult with a further 20 per cent claiming that they had been unable to switch at all.
26. The FSB also noted that awareness of the undertakings among its members had been low and that more than half of the respondents to its survey said that they had not been offered either an account bearing interest of at least 2.5 percentage points below base rate or free money transmission services, or did not know which option was offered by their bank. It also noted that more than 45 per cent of respondents believed that their banking charges had increased over the last five years and that 28 per cent believed that they had been incorrectly charged. In addition, the FSB suggested that the findings of its recent survey suggested that the banks had not complied with the Transitional Undertakings.
27. The BRC said that evidence from its members supported the comments of the FSB. Specifically, it believed that the removal of the Transitional Undertakings would be premature, arguing that the 5 per cent reduction in the market share of the four banks was small and was not sufficient to constrain their pricing. The BRC also noted that a substantial proportion (40 per cent) of retailers who had attempted to switch banks had reported that the experience was difficult and prolonged and that awareness of the difficult and prolonged switching process may deter SMEs from seeking to switch. It expressed the view that the 'price transparency' obligations on the banks (under the Behavioural Undertakings) had not generated real improvements and—like the FSB—evidence from its members suggested that banks had either not offered either of the required options or had offered the option that was cheaper for them (ie interest of at least 2.5 percentage points below base rate). The BRC suggested that, rather than lifting the Transitional Undertakings, the CC should retain the requirement to offer free money transmission services, including the renewal of overdrafts, for at least a further two years.
28. The Campaign for Community Banking Services considered that the release of the Transitional Undertakings was premature and cited research showing that in over 1,000 rural and urban communities small business customers requiring frequent access to a bank counter service had no local market choice. It said that in 95 per cent of the 1,500 communities having one or two banks remaining those banks were covered by the Transitional Undertakings. It argued that there was no appetite on the part of entrants into the small business banking market (such as Abbey, Alliance & Leicester and HBOS) to enter those local markets, with the implication that the loss

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<sup>7</sup>The BBA Business Account Finder is available at: <http://www.bba.org.uk/grabexit/?url=http%3A%2F%2Fwww.moneyfactsonline.co.uk%2FmfBAF%2F>.

<sup>8</sup>The FSB Report on Small Business Banking 2006 is available at: <http://www.fsb.org.uk/documentstore/filedetails.asp?id=377>.

of the Transitional Undertakings would leave customers in those local markets unprotected. It believed that the larger banks were seeking to close branches in larger rural and suburban communities in favour of 'high footfall' town and city centre locations, which will increase the number of 'no choice communities'.

29. The CC considered that the FSB's small business banking report did suggest a low level of awareness of the Transitional Undertakings. However, the CC considered that the evidence contained in that report was not sufficient for it conclude that the banks had not complied with the Transitional Undertakings.
30. The CC was sympathetic to the problems experienced by small businesses in switching bank accounts. However, it noted that it was not necessary for all small businesses to switch (or threaten to switch) accounts in order to provide an effective competitive constraint. Put another way, the fact that one-fifth of respondents to the FSB's survey had switched accounts in the last year and the fact that 55 per cent of them had not found it difficult could be seen as indicative of a significant constraint on banks. In addition, the CC noted that, to the extent that small businesses did find it difficult to switch banks, the recommendations it was making in order to enhance the impact of the Behavioural Undertakings should help to address this issue.
31. The CC noted the concerns expressed by the Campaign for Community Banking Services. However, it noted that in its 2002 report the CC had found the market for supply of banking services to SMEs to be national. This meant that, although customers may value choice at a local level, banks' pricing decisions and constraints on those pricing decisions operated at a national level. Provided that, on a national scale, sufficient SMEs switch or threaten to switch to constrain the pricing of the four banks all customers—even those with no choice at the local level—will benefit. Concerns about lack of choice at the local level, while important to those customers, are not therefore something that should affect the CC's assessment of whether this change of circumstance is sufficient to justify release of the Transitional Undertakings.
32. Overall, the CC considered that the responses received relating to the sufficiency of the change of circumstance in justifying the release of the Transitional Undertakings did not cause it to change its provisional decision.

### *Retention of undertaking 11*

33. HBOS said that it expected the retention of undertaking 11 to improve pricing transparency for customers and businesses generally. Lloyds TSB said that although it would have preferred undertaking 11 to be released, it was fully prepared to accept its retention. Lloyds TSB also asked that the CC review the retained undertaking 11 after a relatively short period and consider whether its retention was still justified.
34. Barclays and HSBC expressed concern about the CC's provisional decision to retain undertaking 11, the requirement to provide the OFT with information in relation to increases in charges and in relation to the introduction of new charges. These respondents argued that the existing transparency and publicity measures in the Behavioural Undertakings rendered the retention of undertaking 11 of the Transitional Undertakings unnecessary and unduly burdensome. HSBC noted that undertakings 21–24 of the Behavioural Undertakings in any case require the banks to publish price information and that undertaking 27 of the Behavioural Undertakings gives the OFT the ability to request information from the banks. It also noted that HSBC and other Banking Code subscribers already write to customers to give them notice of increases in charges or new charges, make details of charges and interest available to customers via telephone, website and staff, give 14 days' notice before

deducting interest or charges for standard account services from accounts, provide at least 30 days' notice of changes in terms and conditions to the disadvantage of the customer. In addition to this, HSBC also updates statutory notices and the business banking price list in branches on the day of any change (and posts the price list on its website) and provides updates to other website operators (such as Business Money and Moneyfacts) allowing them to update their websites. Barclays also expressed the view that, in addition to the measures contained in the Behavioural Undertakings, existing transparency measures in the Banking Code (as well as the availability of price comparison websites, for example) also help to render the retention of undertaking of the Transitional Undertakings unnecessary.

35. Broadly, Behavioural Undertakings 21–24 require the nine banks subject to them to publish information on their standard tariff charges for money transmission services, and on their standard rates of interest on business current accounts and short-term deposit accounts held by SMEs, in a form approved by the OFT and within a time and in a manner approved by the OFT. They are also required to make this information public without charge and to draw the availability of this information to the attention of customers. In addition, the banks are required to notify SME customers that they have incurred unauthorised overdraft charges and interest, and of the level of the charge or interest payment that has been applied. Transitional Undertaking 11 requires the four banks subject to the those undertakings to notify the OFT and to publish in a period of time approved by the OFT, all increases in tariff-based charges for money transmission, all increases in standing charges, all new charges for new money transmission services, and all new charges for existing money transmission services and all new standing charges.
36. While Behavioural Undertakings 21–24 would, indirectly, allow the OFT to observe changes in charges, they do not require the banks to provide the OFT directly with information on those changes. The CC does not therefore consider that Transitional Undertaking 11 simply duplicates Behavioural Undertakings 21–24. However, given the obligations on banks under Behavioural Undertakings 21–24, the CC's view is that the additional burden on the four banks from the retention of Transitional Undertaking 11 is likely to be low. For these reasons, the CC did not consider that the responses received in relation to the retention of undertakings 11 should cause it to change its view that undertaking 11 should be retained.
37. The CC has specifically considered whether undertaking 11 should be reviewed after a relatively short period. The CC considered that undertaking 11 would be best considered at the same time as any future review of the Behavioural Undertakings. This is likely to be the most efficient way of handling such a review, and would also allow the OFT and the CC to take a view on the appropriateness of undertaking 11 in the light of the impact of the Behavioural Undertakings more generally. Noting the recommendation it has made with the aim of enhancing the impact of the Behavioural Undertakings, the CC considers that it would be helpful if the OFT could conduct such a review in, say, three years' time.

#### *Inter-bank agency agreements*

38. Both the FSB and the Campaign for Community Banking Services in their responses emphasized the importance of access to branches for small businesses. The FSB expressed concern that inter-bank agency agreements (which allow the sharing of counter facilities by banks) were not as widespread or effective as they might be. The FSB noted that while small businesses are embracing new technology as a way of communicating with their banks, nearly 47 per cent of small businesses still visited their bank on a weekly basis, and 10 per cent visited their bank on a daily basis. The Campaign for Community Banking Services expressed concern that awareness of

the inter-bank agency agreements is too low amongst potential users and therefore they are not as widely-used or effective as they might be.

39. The CC's 2000 report did contain a recommendation that the banks explore the scope for greater use of inter-bank agency agreements, with a view to addressing the barrier to entry identified as a resulting from the need for a branch network. This recommendation was implemented in the Behavioural Undertakings, with undertaking 25 requiring the nine banks to investigate the feasibility of sharing branches and to publish their findings not later than 12 months after the publication of CC's 2002 report. The CC understands that the banks have complied with this undertaking.
40. The CC notes that, as discussed in paragraph 31 above, notwithstanding the importance of choice to local customers, the market for SME banking services was found in 2002 to be national. The CC has considered the OFT's analysis of the market on a national level and has reached its decision on that basis, it does not consider that any lack of inter-bank agency agreements would alter its decision. Neither does the CC consider that there is scope for it to take any further action in respect of inter-bank agency agreements in relation to this decision.

#### *Decision on Transitional Undertakings*

41. The CC has decided that the Transitional Undertakings, with the exception of undertaking 11, should be lifted. The CC has decided that undertaking 11 of the Transitional Undertakings, which requires the banks to notify the OFT and to publish notifications of new charges and increases in charges, should be retained.

#### *Recommendation that OFT raise awareness of increases in charges, introduction of new charges or reduction of interest payments in response to the lifting of the Transitional Undertakings and take account of any such response in any review of the Behavioural Undertakings*

42. In its provisional decision, the CC proposed to recommend that, were the banks to increase charges, introduce new charges or reduce interest payments in response to the lifting of the Transitional Undertakings, the OFT should raise awareness of this. The CC also proposed to recommend that the OFT should take account of any such response to the release of the Transitional Undertakings in any future review of the Behavioural Undertakings.
43. In its response to the provisional decision, Barclays expressed concern about how the retention of undertaking 11 would interact with the CC's recommendation that the OFT raise awareness of any increases in charges or new charges introduced in response to the lifting of the Transitional Undertakings. It argued that competition in SME banking takes place in relation to non-price factors as well as price. It was concerned that the OFT may, for example, publicize the introduction of a new charge while not publicizing the fact that the new charge related to an innovative new service. Barclays expressed concern that this continuing regulation could put at risk the benefits to the SME banking sector of releasing the banks from the Transitional Undertakings as envisaged by the OFT in its report. Barclays asked for more information on how the CC envisaged that the OFT should act on this recommendation.
44. HSBC said that it was not clear what a recommendation to the OFT to raise awareness of increases in charges or introduction of new charges would add to the obligations already contained in undertakings 21–24 of the Behavioural Undertakings

and it asked for more clarity as to the CC's intention in relation to this recommendation. HSBC argued that, since the recommendation related to charges raised or introduced 'in response to the lifting of the Transitional Undertakings' if the CC did conclude that additional action by the OFT were required, it should be for a limited period of time—it suggested 18 months—following the release of the Transitional Undertakings. HSBC further questioned whether the CC's recommendation to the OFT to take account of increases in charges or new charges introduced in any future review of the Behavioural Undertakings added anything to the OFT's statutory duty to consider whether there has been a 'change of circumstance'.

45. Although it did not directly link the retention of undertaking 11 with the recommendation that the OFT raise awareness of increases in charges, introduction of new charges or reductions in interest payments, Lloyds TSB argued that its retention should be seen as an interim measure for a relatively short period.
46. Taking account of the responses received to its consultation the CC remains of the view that the OFT should raise awareness of increases in charges, the introduction of new charges and the reduction of interest payments in response to the lifting of the Transitional Undertakings, and has decided to recommend that it do so.
47. The CC accepted that beyond a certain point in time, the likelihood of higher charges, new charges or lower interest payments being responses to the lifting of the Transitional Undertakings will diminish and that consequently the relevance of this recommendation will also diminish. The CC therefore thought about applying a specific time limit to its recommendation. It considered that HSBC's suggested 18-month limit on the recommendation (and the retention of undertaking 11) was likely to be too short a period, noting that if the banks were to react to the lifting of the Transitional Undertakings by changing their charging structure this could take longer than 18 months to implement. However, the CC considered that it was difficult for it now to take a view as to the period of time over which this recommendation would remain relevant. The CC considered that the OFT, as it monitored and enforced the Behavioural Undertakings and undertaking 11 on an ongoing basis, would be well-placed to take a view on whether changes introduced were in response to the lifting of the Transitional Undertakings or not, and the CC expected that it would do so.
48. As noted in paragraph 37 above, the CC considered specifically the question of whether undertaking 11 should be reviewed after a relatively short period of time. The CC considered that any review of undertaking 11 would be best done in conjunction with a review of the Behavioural Undertakings and that it would be helpful if the OFT could conduct such a review in, say, three years' time.
49. The CC also noted the banks' concern about the way in which the OFT would raise awareness of changes in charges and interest payments, and specifically the suggestion that changes in charges may reflect changes in services. However, the CC does not intend to prescribe how best the OFT should comply with this recommendation. The CC considers that, where there are particular reasons for changes in charges and interest the banks will be free to point these out to the OFT. It will then be for the OFT to decide how best to take account of this in raising awareness of changes introduced as a result of the lifting of the Transitional Undertakings.

### ***Recommendations on the Behavioural Undertakings***

50. The CC noted the observations, made by the OFT in its report, on the impact of the Behavioural Undertakings in the context of the impact of both the Transitional

Undertakings and the Behavioural Undertakings taken together. In this final decision, as in its provisional decision, the CC wishes to stress that its decision to release the Transitional Undertakings with the exception of undertaking 11 should not in any way be seen as indicating a lesser need for the Behavioural Undertakings (and undertaking 11 of the Transitional Undertakings). The CC agrees with the OFT that these undertakings should remain in place, certainly until the OFT has undertaken a full review in the future.

51. The CC shares the concerns raised by the OFT in relation to the impact with the Behavioural Undertakings. With these concerns in mind, the CC has decided to issue a series of recommendations to the OFT with the aim of enhancing the impact of the Behavioural Undertakings. Each of these recommendations is discussed in turn below.

*Recommendation that OFT work with the relevant banks to publicize the obligations they face under the Behavioural Undertakings*

52. As noted in relation to its decision on the Transitional Undertakings, the CC was concerned that actual levels of switching have remained low. The CC also noted that the OFT had observed a very low level of compensation payments made by the four banks, which appears not be consistent with the banks complying with their obligations under the Behavioural Undertakings in a pro-active way (for example by making customers aware of the existence of compensation and encouraging eligible customers to apply for it). The CC also noted the OFT's observation that awareness among SMEs of the undertakings was low. This was not necessarily an indicator of a failure on the part of the banks to be pro-active (as customers may not know that what banks are doing is a result of the undertakings). However, the CC considered that increased awareness among customers of the obligations placed on the banks not to impede switching and to pay compensation if certain stages of the switching process are not completed in the required time or if errors occur, could increase their propensity to switch or threaten to switch and thereby enhance the impact of the Behavioural Undertakings. In its provisional decision, the CC therefore proposed to recommend that the OFT work with the relevant banks to publicize the obligations they face under the Behavioural Undertakings. The BBA indicated in its response to the provisional decision that it has good relations with the FSB and the Forum of Private Business, and looked forward to working with them to raise awareness of the Behavioural Undertakings.
53. In their responses to the provisional decision, two of the banks (HSBC, HBOS) welcomed the proposal to recommend that the OFT should raise awareness of the Behavioural Undertakings. HSBC noted that this would be especially welcome in so far as the Behavioural Undertakings seek to encourage switching. Barclays said that it believed low awareness of the Behavioural Undertakings among SMEs may be—as the CC had suggested—a result of SMEs not knowing what banks had done as a result of the undertakings, but it looked forward to discussions with the OFT and bodies such as the FSB and Forum of Private Business on how the Behavioural Undertakings could be further publicized.
54. Taking account of the consultation responses, the CC's final decision in respect of this recommendation is the same as its provisional decision. The CC has decided to recommend that the OFT work with the relevant banks to publicize the obligations they face under the Behavioural Undertakings. The CC would hope that this could be done, for example, by working with organizations such as the Federation of Small Businesses and the Forum of Private Business, and by taking advantage of the high levels of interest currently in the banking industry. The CC notes that the responses

from the banks to the provisional decision indicated a willingness to work with the OFT and small business organizations and it considers that this provides a good basis for implementing this recommendation. The CC would also hope that such activity could become part of, or complementary to, the OFT's wider work on banking and could be undertaken in a way that would be consistent with its more general advocacy role.

### *Recommendation to explore incorporating Behavioural Undertakings in the Business Banking Code*

55. In its provisional decision, noting the OFT's finding that awareness of the Banking Code among SMEs was much higher than awareness of the undertakings, the CC proposed to recommend that the OFT explore with the British Bankers' Association whether and how to include the substance of the Behavioural Undertakings in the Business Banking Code. The CC noted that this would not only have advantages in terms of increasing the impact of the Behavioural Undertakings but would be in line with the general principles of better regulation.
56. In their responses to the CC's provisional decision, some banks asked for greater clarity as to the CC's intention in recommending that the inclusion of the substance of the Behavioural Undertakings in the Banking Code. Whilst Barclays believed that some elements of the Behavioural Undertakings could apply beneficially to the industry as a whole through inclusion in the Banking Code, this may not be appropriate in all instances and further discussion with the banks would be necessary<sup>9</sup>. It also wanted greater clarity from the CC on the timetable for future reviews of the Behavioural Undertakings and how these would fit with its recommendation that the substance of those undertakings should be incorporated in the Banking Code, stressing its desire to minimize any legal and market uncertainty. Lloyds TSB's concerns stemmed from a lack of clarity as to how the recommendation was intended to interact with the recently completed review of the Banking Code and any subsequent revisions of the Code. Lloyds TSB made clear that it would support the early incorporation of the Behavioural Undertakings into the Banking Code, since this would ensure that the benefit of those undertakings became available, as soon as possible, to customers of all banks who were signatories to the Code. HSBC supported the CC's suggestion that consideration should be given to including the substance of the Behavioural Undertakings in the Banking Code. HSBC expressed the view that the substance of a number of the requirements was already included in the Banking Code. HSBC also noted that it may be difficult, given the timing, to include the Behavioural Undertakings that were not already embodied in the code in the next (2008) revision.
57. The CC wishes to make clear that it did not intend that the question of whether the Behavioural Undertakings should be incorporated into the Banking Code should be explored in the revision of the Code that is due in 2008. The CC noted that the 2007 Independent Review of the Banking Code<sup>10</sup> (at paragraph 150) recommended that, subject to the CC's decision on the OFT's report, the banks should align the Code requirements with those of the Behavioural Undertakings, provided that this did not weaken the Code. The CC also noted that in the Sponsors' Response to the

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<sup>9</sup> Barclays noted that the Behavioural Undertakings were designed to address specific issues identified by the CC in its 2002 report, which existed in respect of those banks that are subject to the undertakings. It noted, in addition, that the Behavioural Undertakings referred to SMEs with turnover of £25m or less, whereas the Business Banking Code referred to SMEs with turnover of under £1m.

<sup>10</sup> Available at: <http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=155&a=11538>.

Independent Review<sup>11</sup> in relation to this recommendation (point 50 on page 23), the sponsors agreed that they would consider the CC's decision and would work with the OFT and small business representative bodies to consider appropriate amendments to the Code. This position is also reflected in the BBA's response to the consultation on the CC's provisional decision, in which it said that it would work with the OFT on this issue. The CC therefore considers that its recommendation goes with the grain of thinking in relation to the Code. Should there prove to be insufficient time to consider incorporating the Behavioural Undertakings in the Banking Code in its next revision (due in 2008), the CC considers that the question should be revisited in the following revision of the Code (due in 2010). The CC does not consider that it would be appropriate for it to specify this recommendation more closely and considers that it will be for the OFT to decide how best to progress this work, in discussion with the BBA.

*(Signed)* CHRISTOPHER CLARKE  
*Deputy Chairman*  
21 December 2007

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<sup>11</sup>Available at: [http://www.apacs.org.uk/payments\\_industry/documents/Sponsors\\_Response\\_to\\_the\\_Banking\\_Code\\_Review\\_2007.PDF](http://www.apacs.org.uk/payments_industry/documents/Sponsors_Response_to_the_Banking_Code_Review_2007.PDF).