

Review of the banks' financial analysis of new PCAs

Northern—Current Account Plus and the removal of DD and SO charges

Strategy

1. Prior to the supercomplaint, Northern had decided to introduce Current Account Plus.
2. [REDACTED]¹
3. [REDACTED]
4. [REDACTED]
5. [REDACTED]

Removal of standing order and direct debit charges on all accounts

6. [REDACTED]²
7. [REDACTED]

Launch of Current Account Plus and Savings Account Plus

8. Current Account Plus's charges compared with Northern's other accounts (eg Cashmaster, Chequemaster, legacy Current Account and Principal) are set out in Appendix 2.4 of provisional findings. [REDACTED], Current Account Plus attracts no fees in connection with:
 - (a) setting up, amending or cancelling direct debits and standing orders;
 - (b) arranging or renewing overdrafts; or

¹[REDACTED]
²[REDACTED]

(c) maintenance and management.

9. Direct debit and standing order fees were removed from all remaining accounts in February 2005. Arrangement and renewal fees were also removed on all PCAs in July 2005.
10. When launched, unauthorized borrowing fees, such as 'referral' (£25 per excess, £15 prior to December 2005), 'unpaid outward' (£38 per item—reduced to £28 from 3 July 2006) and 'card misuse fees' (£20 per item—removed from 31 October 2005) are the same across all accounts including Current Account Plus.
11. When launched, Current Account Plus offered lower *authorized* debit interest (9.99 per cent) than on other accounts (11.35 per cent (Chequemaster), 12.75 per cent (Cashmaster) or negotiable (IFCA and Principal)³). However, Current Account Plus attracted significantly higher *unauthorized* debit interest (27.99 per cent) than on other accounts (14.75 per cent (legacy Current Account and Principal), 17.75 per cent (Chequemaster) and 19.75 per cent (Cashmaster)).
12. Credit interest on Current Account Plus is 0.10 per cent, which is the same as Principal, Chequemaster and Cashmaster. IFCA pays no interest income.
13. The credit and authorized debit interest rates were aligned with Clydesdale Bank and Yorkshire Bank. The removal of direct debit and standing order charges, and no fees for arranging or renewing overdrafts, were also aligned with Clydesdale Bank and Yorkshire Bank. Charges for unauthorized borrowing were aligned with existing Northern current account tariffs. This suggests that there is not a rebalancing of fees.

[X]

³[X]

Financial appraisal of the combined impact of the proposed changes

14. [REDACTED]⁴

15. [REDACTED]

16. [REDACTED]

17. [REDACTED]

18. [REDACTED]

19. [REDACTED]⁵

20. [REDACTED]⁶

21. [REDACTED]

22. [REDACTED]

23. [REDACTED]

24. [REDACTED]

25. [REDACTED]

26. [REDACTED]

⁴[REDACTED]
⁵[REDACTED]
⁶[REDACTED]

27. [REDACTED]

28. [REDACTED]

29. [REDACTED]

30. [REDACTED]

Progress

31. [REDACTED] Northern noted [REDACTED] that:

... we have seen, [REDACTED] customers migrate from legacy accounts on to our new Current Account Plus. [REDACTED] We are seeing the flow of new business is improving for Northern as well. It is early days. We launched this in February and it does take time, particularly at this time when there has been a lot of publicity from all of the banks about different accounts and what have you, so it is difficult for the customers to relate one against the other. There is much noise in the market.⁷

32. A year after the launch, approximately [REDACTED] Current Account Plus accounts have been opened, of which approximately [REDACTED] are new to Northern (either switchers or new-to-banking customers).⁸ [REDACTED]⁹ [REDACTED]¹⁰ [REDACTED]

33. [REDACTED]

34. In April 2006, Current Account Plus came off 'sale' and was replaced by the new suite of Danske-style PCAs.

⁷[REDACTED]
⁸[REDACTED]
⁹[REDACTED]
¹⁰[REDACTED]

35. [REDACTED]

Northern—new range of PCAs

Strategy

36. The Danske 'vision' is to create a unique banking model that can be applied to all markets based on 'one platform—exceptional brands'. The model is based on a shared platform with local 'exceptional' brands. Northern migrated to the Danske platform in April 2006.

37. [REDACTED]

38. [REDACTED]

New account portfolio

39. [REDACTED]

40. In April 2006 Northern launched a new portfolio of current accounts:

- (a) Northern Access;
- (b) Northern Freedom;
- (c) Northern Choice;
- (d) Northern Choice Plus; and
- (e) Northern Prestige.

We do not consider the Northern Access account further since it falls outside our market definition.

41. The main differences (compared with all Northern accounts) from the perspective of Northern's revenues streams are:

- (a) The new accounts pay more credit interest (2 to 3 per cent) compared with its older accounts (0 to 0.1 per cent). [REDACTED]
 - (b) No transaction fees, but limits on the number of free branch cash withdrawals (13) and cheque transactions (13) per quarter on Northern Freedom and Northern Choice.
 - (c) Quarterly fee (£30 for Northern Choice Plus and £50 for Northern Prestige).
 - (d) Lower authorized overdraft interest than Current Account Plus.
 - (e) No change in unauthorized overdraft interest rate.
 - (f) No changes in unauthorized overdraft fees compared with Current Account Plus (ie paid item fee: £25 and unpaid item fee: £28).
42. Northern's target was to attract up to [REDACTED] customers to the new PCA products in the first year, whether from other Northern accounts or switchers. Current Account Plus had attracted [REDACTED] new customers over the previous year, [REDACTED] of whom moved from an existing Northern product.
43. There was no mass migration of customers to the new products. Existing customers were notified of the new products; however, they would need to be taken through the various options offered via the new accounts. Northern told us that it could not switch customers automatically, as some aspects of the new accounts (eg limits on free cheques) may not be considered cheaper for the customer.
44. [REDACTED]
45. On Northern Freedom and Northern Choice accounts, account holders would be offered 13 free cheque transactions and 13 free over-the-counter withdrawals per quarter. [REDACTED]

46. One interpretation of this pricing structure is that Northern is trying to move customers away from using higher-cost transactions when cheaper methods exist. For example, there is a limit on the number of free cash withdrawals over the counter but no limit on or charge for the number of cash withdrawals via an ATM. Similarly, there is a limit on the number of free cheques but no limits on or charges for using a debit card or direct debits.

47. [REDACTED]

48. [REDACTED]

Financial appraisal

49. [REDACTED]

50. [REDACTED]

51. [REDACTED]¹¹

52. [REDACTED]

53. [REDACTED]¹²

Conclusion

54. The financial impact of Northern's changes can be summarized as follows:

- (a) the removal of standing order and direct debit charges reduced income; and
- (b) the removal of the standing order/direct debit charges, combined with Current Account Plus, was forecast to be revenue enhancing, due to significant growth in

¹¹[REDACTED]
¹²[REDACTED]

account numbers. Actual performance appears above expectations for retaining existing customers but lower than expectations for winning new customers.

55. The new account portfolio appears to have a significant negative impact on both fees and net interest income (NII). However, it is being driven by a desire to grow the business (and become number one again) and is to be run alongside an efficiencies programme.

Ulster—new charging structure (Project Hanover)

56. From 18 November 2005, Ulster restructured its PCA offering by:
- (a) the removal of all transaction charges and account maintenance charges providing transaction-free banking to all PCA customers, irrespective of whether their account is maintained in credit or debit;
 - (b) the removal of a number of ancillary charges, including standing orders and direct debit charges, for both PCA and business customers; and
 - (c) customers outside their overdraft limit will incur monthly charges for breaching the limit (post-Hanover: £30; pre-Hanover: nil), paid referral charge (post-Hanover: £30 per item up to £90 per month; pre-Hanover: £13 per excess), card misuse fee (post-Hanover: £30; pre-Hanover: nil) and unpaid outwards charge (post-Hanover: £30 per item; pre-Hanover: £38). The £6 unpaid inwards fee is removed post-Hanover.
57. These were changes to existing terms and conditions rather than new PCA offers. As such, all PCA customers moved to the new charging structure automatically.

Strategy

58. [REDACTED]^{13,14}

59. [REDACTED]¹⁵

Financial appraisal of the proposed changes

60. [REDACTED]

61. [REDACTED]

62. [REDACTED]

63. [REDACTED]¹⁶

64. Ulster highlighted that its 'out-of-order' assumption was key to the financial analysis. The base case assumes that [REDACTED] per cent of customers will operate their accounts outside the arranged overdraft, and Ulster noted that [REDACTED]. Prior to the introduction of the Hanover tariff, Ulster estimated that approximately [REDACTED] per cent of customers exceeded their authorized overdraft limit on a monthly basis. [REDACTED]¹⁷ Ulster has assumed that the anticipated reduction ([REDACTED]) would occur as customers change their behaviour as a result of an extensive customer communications exercise. Ulster has performed two sensitivities: [REDACTED].

65. Overall the new charging structure appears to be broadly revenue neutral:

- (a) The proposed changes and the removal of the fees noted in paragraph 56 would reduce income by £[REDACTED] million a year. The fee reduction was known and certain.

¹³[REDACTED]
¹⁴[REDACTED]
¹⁵[REDACTED]
¹⁶[REDACTED]
¹⁷[REDACTED]

It was far less certain how much income will be earned by the new out-of-order fees. Ulster estimated it to be £[redacted] million a year, which would largely offset the fee reduction.

(b) [redacted]

(c) However, Ulster told us that it:

faced significant risks in switching its charging model to the new structure. It was certain that the bank would lose income as a consequence of removing a number of fees and charges as well as introducing a higher authorised overdraft 'buffer' limit. It was much more difficult to predict the likely level of unauthorised overdraft income and, in particular, how customers would respond to this fundamental reorganisation of the bank's charging structure. [redacted]¹⁸

66. [redacted]

67. [redacted]

68. [redacted]

69. [redacted]

70. [redacted]¹⁹

Progress

71. In March 2006 Ulster told us that, since the launch of Hanover in November 2005, current account openings with Ulster increased with a [redacted] per cent uplift week on

¹⁸[redacted]
¹⁹[redacted]

week in Q1 2006 compared with 2005. Via the Switcher service, switching-in has increased from [X] per week in Q4 2005 to [X] per week in Q1 2006; [X].

72. At March 2006, Project Hanover was £[X] ahead of plan. The out-of-order rate prior to Project Hanover was estimated to be [X] per cent a month. The financial appraisal assumed [X] per cent, and in June 2006 the actual rate was [X] per cent. Ulster told us that Project Hanover was in its early stages and customer behaviour was difficult to predict. Although the number of customers incurring unauthorized borrowing fees was greater than the Business Case envisaged, Ulster anticipated that the level of unauthorized overdraft fee income would reduce significantly over the coming months as customers became increasingly familiar with the new charging structure. The bank's experience generally was, in any case, that unauthorized borrowing was higher around the Christmas period than at other times of the year.
73. Ulster told us that it had already taken a number of steps, both before and after the implementation of Hanover, to communicate these changes to customers and it was planning a number of further measures in order to ensure that its customers and potential customers understood the new charging structure and more customers avoided incurring charges. [X]

Conclusion

74. Project Hanover presented significant risks, uncertainty and complexity for Ulster. It is therefore difficult to forecast without significant uncertainty. Ulster's forecast was that Project Hanover would be broadly revenue neutral. To date it has been revenue enhancing because the out-of-order incidence is greater than forecast.

Bank of Ireland

Strategy

75. [X]

76. [X]

77. [X]

78. [X]

79. [X]

80. [X] On 7 September 2006 Bol announced its plan to implement a fee-free PCA for both new and existing customers on 24 November 2006.: The new pricing plan will remove:

- (a) all transaction charges;
- (b) all account maintenance charges; and
- (c) all overdraft arrangement and renewal fees.

81. In addition, the following changes to the ancillary charges are planned:

- (a) remove set-up, amendment, cancellation and stop payment charges for direct debit and standing orders for all customers;
- (b) increase the referral item fee from £14.50 to £19 for all customers;
- (c) reduce the maximum number of daily referral item charges from 5 to 3; and
- (d) introduce a new unauthorized overdraft usage charge for personal customers at £19 a month. The unauthorized usage charge will not apply where the unauthorized balance is less than £20. Furthermore, in order to allow PCA

customers sufficient time to prepare for this new charge, implementation of this charge will be delayed until Quarter 1 2007.

82. [X]

Financial appraisal of the proposed changes

83. [X]

84. [X]

85. [X]

86. [X]

87. [X]

88. [X]

89. [X]

90. [X]

Conclusion

91. It appears that if customer behaviour remains unchanged, the new product will be broadly revenue neutral. That is to say, income forgone is broadly offset by new fees or increased fees relating to unauthorized overdrafts. [X]

First Trust

92. First Trust told us that it is considering launching a new fee-free PCA charging structure designed to reduce the loss of PCA customers, attract switchers in, and therefore increase market share. We have reviewed First Trust's draft proposals.

Strategy

93. [REDACTED]²⁰

94. [REDACTED]

95. [REDACTED]

96. [REDACTED]

Financial appraisal of the proposed changes

97. [REDACTED]

98. [REDACTED]

99. [REDACTED]

100. [REDACTED]

101. [REDACTED]

Other changes and alternatives considered

102. [REDACTED]

²⁰[REDACTED]

103. [REDACTED]

Conclusion

104. [REDACTED]