4 The market

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Introduction

4.1. This chapter considers the markets in which banks and other deposit-taking and lending institutions, such as building societies, compete.

4.2. The banking sector has been subject to considerable change in recent times, both within the UK and elsewhere in the world. The following points were put to us:

(a) Regulators have become less protective of banks and more transparent in their working. In the UK this process started in 1971 with the authorities' introduction of 'Competition and Credit Control' which led the clearing banks to abandon their interest rate agreements and to more competition between different types of banks (for example, clearing banks and merchant banks).

(b) Competition in some areas—wholesale and corporate banking—has become increasingly global in nature.

(c) Financial markets have been available as a substitute for banks: for example, large companies have a choice between borrowing from banks and issuing debt.

4.3. The Cruickshank report also noted that the trend of change has been toward greater competition, and commented positively on the financial stability of the sector in the UK, and the openness of the regulatory regime. However, the report also found competition problems in all the markets it investigated. Regulatory barriers to entry were high and producers were represented on the board of the industry's regulator. The Cruickshank report and the Government's response are described further in paragraphs 4.17 to 4.20.

4.4. Lloyds TSB and Abbey National both operate across a range of banking and financial services markets. Such markets may be classified initially according to the customers:

(a) markets for financial products sold to personal customers;

(b) markets for financial products sold to SMEs;

(c) markets for financial products sold to larger firms (corporate banking); and

(d) wholesale banking (for example, money market and foreign exchange dealing).

Corporate and wholesale banking are not considered further in this chapter as they are global markets which have many competitors and well-informed customers. We received little comment on corporate and wholesale banking and only one concern was expressed to us (see paragraph 6.190). The remainder of this chapter therefore deals with markets for personal customers and then with markets for SMEs.

Regulation

4.5. Providers of banking and financial services may be subject to regulation both as to the prudence of their lending and investment decisions and as to their conduct in relation to consumers. The framework for regulation is laid down in EC directives, which are required to be implemented in member states through national legislation, and also in the FSM Act and the FSA's handbook. Banking and financial services products are not subject to price control but are, like other products, subject to competition law.

4.6. Once the FSM Act comes into force, the FSA will become the sole specialist regulator of financial services (the FSA is already the banking regulator and acts as insurance regulator under delegated powers from the Treasury). The FSA will have four objectives: maintaining market confidence, promoting public understanding of the financial system, protecting consumers and fighting financial crime. It will also have to have regard to a set of principles of good regulation including a proportionate approach to rulemaking, facilitating innovation in the financial sector and ensuring that regulatory requirements do not distort competition. The FSA will have powers to investigate, fine, make public statements and withdraw permission to undertake regulated activities or impose special conditions for doing so. Under the new regime, the DGFT reports on any regulatory provisions or practices that have a significant anti-competitive effect and can refer them to the CC. If the CC finds that there is a significant unjustified anti-competitive effect it recommends action to be taken by the FSA. The Treasury is then required, after consultation, to issue directions to the FSA (but can override the CC in exceptional circumstances).

Banking

4.7. Under the Banking Act 1987, all UK deposit-taking businesses must be authorized by the FSA (except for deposit-taking businesses based in other European Economic Area countries which are authorized by the regulators in their own countries). The FSA is also responsible for the supervision of businesses authorized by it and as such is the prudential regulator of Lloyds TSB and Abbey National. Deposit taking is not subject to formal conduct of business regulation.

4.8. The FSA sets each bank a minimum ratio of capital to risk-weighted assets (exposures to other banks and public sector entities have a risk weight of 20 per cent, loans secured by residential mortgages 50 per cent and most other loans 100 per cent). There are separate ratios for trading book assets (typically those marked to market daily and where any gains or losses are recognized in the profit and loss account) and for banking book assets (including loans, leases and non-trading book investments). The FSA tends to set minimum capital ratios above the level required by the Banking Consolidation Directive which broadly implements the 1988 Basel 1 Accord. In January 2001 the Basel Committee on Banking Supervision issued a draft new Capital Accord, which is scheduled for implementation in 2004. The draft new Accord envisages a risk-weighted asset calculation based on a bank's own internal risk ratings, where these are judged robust by the regulator, rather than one that defines risk weights only by type of asset.

Residential mortgages and personal loans

4.9. Brokerage and lending activities in the provision of personal secured and unsecured loans up to £25,000 are regulated under the Consumer Credit Act 1974. The Act and regulations made under it cover the terms on which credit may be advertised and provided and also the enforcement of creditors' rights. For the most part, mortgage lending is not currently subject to conduct regulation but this will change: approximately nine months after the FSM Act comes into force, residential mortgage lending (but not mortgage advice) will be regulated by the FSA.

Insurance and investment

4.10. Businesses carrying out insurance and investment activities, and (in the case of certain long-term insurance contracts) those advising on them, require authorization and are regulated. As noted above, once the FSM Act comes into force the FSA will be the sole statutory regulator.

Self regulation

4.11. Lloyds TSB, Abbey National and other major banks adhere to the Banking Code, a voluntary regime supported by the British Bankers' Association (BBA). It sets out a voluntary non-statutory code of good banking practice for dealing with personal customers in the UK. The most recent version became effective on 1 January 2001. There is also a Code of Mortgage Lending Practice, supported by the UK Council of Mortgage Lenders (CML). Lloyds TSB told us that it and others were working to produce a banking code for business customers; it expected this to be launched in March 2002.

4.12. The Banking Code Standard Board is responsible for monitoring banks' and building societies' compliance with the Banking Code: its rules provide for a contractual relationship with subscribing banks and building societies and cover issues such as disciplinary procedures and penalties. Subscribing banks and building societies fund the Banking Code Standard Board through annual subscriptions but its board of directors must contain a majority who are independent of banking interests. It monitors compliance in a number of ways including a self-certification questionnaire; compliance visits by its own officers and independent experts; monitoring the media; and its own market research, such as mystery shopping exercises. Such an exercise in early 2000 tested whether the information required under the Banking Code was made available to the mystery shoppers either verbally or in writing or was clear from the documentation (or, in the case of Internet enquiries, whether the relevant information was clearly available on the web site). Around 1,500 enquiries in total were made about current accounts, savings accounts, cash, independent savings accounts (ISAs) and loans. The results showed that compliance was less than perfect. For instance, on current account opening, average compliance for 12 pieces of information was 63 per cent. Compliance was better for savings account opening (average 84 per cent) and inquiries about cash ISAs (average 72 per cent).

4.13. Following the Cruickshank report, HM Treasury initiated a review of the effectiveness of banking services consumer codes, which focused on the Banking Code and Mortgage Code. The review reported to the Treasury at the end of May 2001.

4.14. Consumer complaints are investigated by the Financial Ombudsman Service.

CAT standards

4.15. In order to assist consumers, the Government has also introduced CAT (fair Charges, easy Access, decent Terms) standards for two products (ISAs and mortgages). These standards are not mandatory and providers continue to offer both products that meet CAT standards and products that do not. In January 2001 the Treasury issued a consultation paper proposing the introduction of further CAT standards for basic bank accounts and credit cards (the paper envisaged that the standard for credit cards would not cover charges: CAT would in this case stand for Comparability, Access, Terms).

Universal Banking Services

4.16. During May 2001, the Government announced it had reached agreement with 11 institutions[1] for the introduction of Universal Banking Services. This comprises agreement by the institutions:

(a) to make their basic bank accounts accessible through post offices and straightforward to open for those without bank accounts;

(b) to contribute financially to a new card-based Post Office account which would accept credits only from Government agencies and only via automated credit transfer and from which cash could be withdrawn via post offices with no transaction charges. Such an account might be suitable for benefit recipients who are not yet ready to open a basic bank account.

The Government stated this was a major step forward both in ensuring the future of the Post Office network and in bringing those people currently without bank accounts into the financial mainstream.

The Cruickshank report

4.17. In November 1998 the Chancellor of the Exchequer established a review of competition in UK banking, led by Don Cruickshank. Mr Cruickshank reported in March 2000 and the following were amongst the most important of his findings and recommendations:

(a) There were competition problems in all three of the main areas considered: wholesale money transmission, services to personal customers and services to SMEs. However, in relation to banking services for personal customers (but not wholesale money transmission or services for SMEs) there were some encouraging signs of new entry and increased competition.

(b) Payments systems providing wholesale money transmission should in future be regulated in order to deliver competitive outcomes.

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[1]Barclays, Lloyds TSB, RBS/NatWest, HSBC, Abbey National, Halifax, Alliance & Leicester, BoS, NAB, Co-operative Bank and Nationwide.

(c) The Government should refer the supply of banking services to SMEs to the CC.

(d) Until UK merger law was reformed, the Government should refer all mergers between financial suppliers to the CC if the merging entities had material shares of the relevant market or if each had material shares in related markets from which there was the real possibility that one might enter to compete with the other.

(e) The Government and/or the FSA should act to increase transparency in banking supervision, ensure effective competition scrutiny of the financial services sector, eliminate regulatory distortions, provide better product information and ensure adequate redress and consumer representation.

4.18. Following the publication of the Cruickshank report, the Government immediately referred the supply of banking services to SMEs to the CC (see paragraph 4.115). The inquiry has not yet been completed. Regarding mergers, the Government said in its response to the Cruickshank report that a key task of the mergers regime was to maintain and promote effective competition, including the possibility of new entry, and that the Secretary of State would continue to refer bids to the CC when he believed, on advice from the DGFT, that they would have an adverse effect on competition. However, the Government also stated that, since assessing market power was complex, the merger of two entities with material market shares was not automatically anti-competitive.

4.19. In December 2000 the Government issued a consultation document relating to its proposed new regulatory regime for payment systems (which differed in some respects from the proposals in the Cruickshank report). It proposed new rules governing participation in the provision of payments services in the UK and giving the DGFT new powers in enforcing and modifying the rules. Legislation would be required and the new rules would be designed to:

(a) require price transparency in the provision of retail payment services;

(b) require access to payment services to be provided on fair, reasonable and non-discriminatory terms;

(c) require wholesale charges for payment services to be derived through a published methodology based on legitimate costs, anticipating future cost reductions and efficiency improvements;

(d) require firms to cooperate in the development of payment systems; and

(e) place restrictions on the governance and control of payments systems where there was a material effect on competition.

4.20. The Government also accepted the majority of the recommendations covered in paragraph 4.17*(e)*. It stated that it would conduct a formal review of the FSM Act after two years which would take account of all relevant material including a retrospective analysis of the actual effects on competition of FSA and Government measures. The FSA stated in its response that it had recognized from the outset the importance of the potential impact of regulation on competition and it noted that the FSM Act gave roles to the DGFT, the CC and the Treasury in reviewing the impact of its rules and practices on competition. The FSA also said, however, that in some areas there was a very difficult trade-off between competition and other objectives of regulation, including market confidence and consumer protection. The FSA stated that this difficulty was particularly acute when considering the authorization of new entrants to the financial services industry.

Market definition: personal products

4.21. It is necessary to consider the product and geographical markets within which Lloyds TSB and Abbey National compete. This section deals with the personal markets: SME markets are dealt with in paragraphs 4.117 to 4.119.

Product markets

4.22. The main financial products marketed to personal customers are:

(a) PCAs;

(b) deposit accounts (and similar savings accounts);

(c) mortgages;

(d) other loans;

(e) credit cards;

(f) insurance (life assurance and general insurance);

(g) other long-term investments; and

(h) pensions.

Some of these products are substitutes and in recent years more flexible products, combining the attributes of more than one of the above, have been introduced (for example, current account mortgages combining a PCA with a mortgage). Nevertheless, most consumers still seem focused on separate products: the Cruickshank report, for example, stated that even where products with the same broad functions were substitutes in theory—for example, credit cards and overdrafts—consumers generally did not use them in this way. Among the parties providing us with views, there was little disagreement that each of the main product markets could be viewed as a separate economic market for the purposes of our inquiry. Lloyds TSB, while accepting the above market definitions, emphasized that the markets in question were characterized by ease of supply-side substitution: Lloyds TSB's view was that the implied economies of scope facilitated entry into adjacent markets.

Geographical markets

4.23. Both Lloyds TSB and Abbey National operate throughout Great Britain. Both their combined share and the overall market structure tend to be fairly similar throughout Great Britain (see Appendix 4.1) nor has our attention been drawn to any differences in company strategy between regions. In the light of this, we did not consider in any detail the issue of whether there are separate geographical markets smaller than Great Britain, for example Scotland. If there are, the analysis for each of the separate markets will be similar to the analysis for a single Great Britain market.

4.24. Abbey National has branches in Northern Ireland but Lloyds TSB does not (although it markets some products in the province which are delivered by telephone or post, including savings and mortgages, its share is very small). We have considered the extent of demand-side and supply-side substitutability between Great Britain and Northern Ireland. On the demand side it is in general impractical for Northern Irish consumers to visit branches in Great Britain (and vice versa) so there is a gap in the chain of substitution in the provision of PCAs where branches are important to customers (see paragraph 4.54). On the supply side the leading PCA providers in the province are different from those in Great Britain and are locally based (although two of the four leading PCA providers belong to groups (RBS Group and NAB) which also own banks in Great Britain, they are operated separately and market different accounts with different terms and conditions). In these circumstances, we consider that there are separate PCA markets in Great Britain and Northern Ireland. Since Lloyds TSB does not compete in the Northern Irish PCA market, the merger has no effect on that market and we focus only on the market in Great Britain.

4.25. Branches are less important for personal financial products other than PCAs and in some cases the leading suppliers in Northern Ireland are similar to those in Great Britain. Most of those providing evidence suggested there was a national market, referring in particular to uniform pricing across geographical regions. Accordingly, we consider other personal financial products on the basis of a UK market (some of our data relate only to Great Britain which, however, accounts for over 97 per cent of UK population and GDP).

4.26. The existence of different currencies and, in relation to PCAs, payment networks suggest that the product markets are no wider than the UK. No one suggested to us that the markets for personal products were wider than the UK.

Overview of personal financial markets

4.27. Table 4.1 shows a summary of market share data for the main personal banking markets. The table shows that the merger has the largest effects in the PCA, savings account and mortgage markets.

TABLE 4.1 **Market shares and concentration in personal banking markets, Great Britain, 2000**

					per cent
	PCAs	*Savings accounts*	*Mortgages*	*Loans*	*Credit cards*
Big four banks					
Barclays	18.2	10.4	7.7	6.5	21.7
HSBC	13.8	4.9	2.4	6.0	9.3
Lloyds TSB	22.0	10.0	9.4	12.0	13.6
RBS/NatWest	18.1	5.8	4.3	7.7	16.8
Other traditional banks					
BoS	2.1	2.4	1.4	2.6	4.3
NAB	3.7	1.7	*	2.1	2.1
Building societies and ex-building societies					
Alliance & Leicester	3.4	3.9	4.2	2.6	2.8
Abbey National	5.1	12.9	13.2	5.7	1.7
Halifax	4.9	17.8	20.0	2.4	3.3
Nationwide	2.9	10.6	8.1	1.4	*
Others	5.8	19.6	29.3	51.0	24.4
Total	100.0	100.0	100.0	100.0	100.0
Total market share (pre-merger)					
Lloyds TSB	22.0	10.0	9.4	12.0	13.6
Big four banks	72.1	31.1	23.8	32.2	61.4
All traditional banks	77.9	35.2	25.2	36.9	67.8
Four-firm concentration ratio	72.1	51.7	50.7	32.2	61.4
Total market share (post-merger)					
Lloyds TSB	27.1	22.9	22.6	17.7	15.3
Big four banks	77.2	44.0	37.0	37.9	63.1
All traditional banks	83.0	48.1	38.4	42.6	69.5
Four-firm concentration ratio	77.2	61.7	58.4	37.9	63.1
					number
HHI†					
Pre-merger	1,424	906	861	370	1,146
Post-merger	1,649	1,164	1,109	507	1,192
Change	224	258	248	137	46

Source: FRS [*Details omitted. See note on page iv.*].

*Included in Others.

†Herfindahl-Hirschman index of concentration. It is calculated by summing squared market share percentages.

Note: Market shares reflect shares of all banks and joint ventures within the group (eg RBS share includes Virgin). Because of sampling variation, market shares may not be accurate to the one decimal place shown.

4.28. Income may be earned by financial institutions in these markets in two ways: by charging fees and by paying/charging customers interest rates that are lower/higher than market interest rates. We estimate that, in 2000, income from PCAs was £5.3 billion and income from all five personal banking markets was about £30 billion.

4.29. In the other personal financial markets (insurance, other long-term investments and pensions) not shown in Table 4.1 the shares of both Lloyds TSB and Abbey National are smaller (their combined share is 12 per cent or less).

4.30. The majority of demand for personal banking products is met by organizations with a national or regional network of branches, which can be divided into two main groups:

(a) Traditional banks, including Barclays, HSBC, Lloyds TSB and RBS/NatWest, often referred to as the big four banks, BoS and Clydesdale (owned by NAB, which also owns Yorkshire Bank). In Northern Ireland there are four traditional banks: Northern Bank (owned by NAB), Ulster Bank (owned by RBS Group), Bank of Ireland and First Trust Bank. All these traditional banks can trace their UK roots to the development of local private and joint stock banks in the eighteenth and nineteenth centuries (this applies to Lloyds Bank but not TSB: TSB developed from the trustee savings bank movement). Large banks developed as the result of mergers between smaller banks, especially in the periods between 1880 and 1917 and between 1962 and 1969. By 1970, there were only four major clearing banks in England and Wales and a further two in Scotland, the largest of which (the predecessor of RBS Group) also owned some smaller English clearing banks. During 1987 to 1990, a new participant emerged when NAB acquired Clydesdale, Yorkshire Bank and Northern Bank, all of which had previously been within the sole or joint ownership of the other British banks. More recently, further concentration occurred in 1995 when Lloyds bought Cheltenham & Gloucester and subsequently merged with TSB; in 2000 when NatWest was acquired by RBS Group and when Barclays acquired Woolwich, a former building society that had entered the PCA market. During the course of our inquiry a merger was proposed between BoS and Halifax (see paragraph 3.5). BoS and Halifax have said they intend the merged company to position itself as the 'pro-competition champion' across the major retail banking markets and to provide good value business banking facilities in competition with the big four.

(b) Building societies and former building societies, which are or were mutual institutions making loans for house purchase and attracting retail deposits to finance these loans. Following the liberalization of financial markets in the 1980s, some societies diversified from savings accounts into PCAs. The largest organizations in this category include Abbey National, Alliance & Leicester, Halifax, Nationwide and Northern Rock plc (Northern Rock). Of these, only Nationwide remains a mutually owned building society: the other four have converted to plc status and are currently quoted on the London Stock Exchange. Consolidation has affected this group as well: the number of building societies has declined from 1,723 in 1910 to 68 societies plus five converted societies[1] today. Apart from the acquisitions, noted above, of Cheltenham & Gloucester by Lloyds TSB and Woolwich by Barclays, significant concentrations have included the acquisition of Girobank in 1990 by Alliance & Leicester (Girobank is operated through post offices and was set up in 1968 as an alternative money transmission service to that of the clearing banks); the merger of Halifax Building Society and Leeds Permanent Building Society and the subsequent acquisition by Halifax of the Birmingham Midshires Building Society (Birmingham Midshires); and the acquisition by Bank of Ireland of the Bristol and West Building Society.

Other participants in personal banking markets include the Co-operative Bank, which owes its origins to the co-operative movement; US banks including Capital One, Citibank, HFC Group and MBNA; and insurance companies which have diversified into personal banking, including Prudential and Standard Life. Sainsbury and Tesco have entered the market through joint ventures with BoS and RBS Group respectively. Virgin has also entered the market through a joint venture with RBS Group.

4.31. Table 4.2 shows the number of bank and building society branches in the UK. Over the period from 1990 to 2000 the table suggests that the number of branches fell by about 30 per cent. After the big four, Halifax, Abbey National and Nationwide have the largest branch networks. After these three come BoS (the branches of which are concentrated in Scotland), NAB (the branches of which are concentrated in the traditional areas of its UK subsidiaries: Scotland, Yorkshire and Northern Ireland) and Alliance & Leicester.

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[1]The four previously mentioned plus Bradford and Bingley plc (which does not provide PCAs).

TABLE 4.2 **Number of branches of retail banks and building societies, 1990 to 2000, UK**

	Years ended 31 December			
	1990	*1995*	*1999*	*2000*
Banks				
Lloyds	2,111	1,770	1,385	1,325
TSB	1,489	1,084	924	913
Cheltenham & Gloucester	183	231	221	210
Lloyds TSB group	3,783	3,085	2,530	2,448
RBS	841	687	648	648
NatWest	2,805	2,215	1,712	1,643
Ulster Bank	89	90	109	91
RBS group	3,735	2,992	2,469	2,382
Barclays	2,586	2,050	1,899	1,727
Woolwich	541	462	405	402
Barclays group	3,127	2,512	2,304	2,129
HSBC	1,957	1,701	1,662	1,668
Halifax	750	1,083	909	832
Leeds Permanent	424	-	-	-
Birmingham Midshires	125	120	-	-
Halifax group	1,299	1,203	909	832
Abbey National	681	678	765	755
National & Provincial	315	326	-	-
Abbey National group	996	1,004	765	755
NAB	710	699	620	604
BoS	515	411	350	334
Alliance & Leicester	409	397	319	309
Other banks*	484	603	423	416
Building societies				
Nationwide†	755	690	681	681
Other building societies	2,258	1,748	1,619	N/A
Total	20,028	17,050	14,640	14,177‡

Source: CC calculations on data provided by the BBA, Lloyds TSB and Nationwide.

*Bank of Ireland, Bristol & West, Co-operative Bank, First Trust Bank and Northern Rock.
†Nationwide also has 211 agencies, making 892 outlets in total.
‡Assumes same number of other building societies as for 1999.
Note: Figures supplied by Lloyds TSB (shown above) differ slightly from those shown for Lloyds TSB by the BBA.

Personal current accounts

4.32. PCAs offer individuals access to money transmission services, including automated credit transfers, direct debits, standing orders, debit cards and cheques. PCAs also provide deposit-holding services to individuals, since cash may be easily paid into and withdrawn from PCAs, and may also act as a source of credit, through overdrafts. The Cruickshank report noted that the money transmission services of a PCA have no effective substitutes but the other two functions do.

4.33. The great majority of individuals have some access to at least one PCA: a survey for the DGFT found that 86 per cent of households had a PCA.[1] The same survey noted that it was becoming increasingly difficult for consumers to be without the facilities offered by a PCA. With encouragement from the Government, most banks are now offering basic bank accounts without overdraft facility and cheque book but with facility for payment by direct debit and standing order and in some cases a debit card (requiring online authorization for all transactions). Basic bank accounts are suitable for those who experience difficulty with financial management and are accessible through post offices (see paragraph 4.16). The wider provision of these accounts may lead to a further increase in the percentage of households with access to a PCA. The proposed CAT standard for basic bank accounts includes the

[1]*Vulnerable consumers and financial services*, the report of the DGFT's inquiry, January 1999.

following suggested provisions: no charges for everyday transactions; no risk of overdraft; no requirement for initial or regular deposits; access to cash machines, cash and cheque deposits and automated transactions. Lloyds TSB's basic bank account meets the suggested CAT standard but Abbey National's basic bank account (the Instant Plus Account) does not do so as it requires a monthly credit of at least £250. However, Abbey National's Instant Plus Account offers a debit card whereas Lloyds TSB's basic bank account does not do so.

4.34. There was agreement among those providing evidence that the PCA was a 'gateway' to selling other financial products (although other products, including mortgages, can also be important as gateways). Lloyds TSB noted in its Group Strategic Plan 2000–2002 (see Appendix 5.1) that PCAs remained its key relationship product while Abbey National told us the PCA was a key vehicle for building customer relationships and driving product sales. Abbey National emphasized the frequency of contact with PCA customers, through branch visits, regular statements and telephone contact: it said that PCAs provided almost 100 contacts a year, much more than other products. One possible reason for the importance of PCAs as a gateway is that customers develop trust in their PCA provider and consequently have some preference for purchasing other products from that provider. Another possibility is that customers are unsure of where to go for information and advice about financial products and are thus receptive to suggestions from their PCA provider, for example at a financial review. Some individuals may prefer to avoid dealing with a large number of different providers of financial products, although there is also evidence of resistance to being dependent on a single provider (a 1999 study by Datamonitor quoted the results of a survey in which 70 per cent of respondents indicated that they would not buy all their financial products from one supplier, with the proportion being higher among socio-economic groups A and B and among older age groups). Cross-selling opportunities are likely to be profitable to PCA providers, for instance because selling and marketing costs are lower to PCA customers than to others. Abbey National said that PCAs provided richer information than other products: transactional data from PCAs assisted in targeting cross-selling efforts while PCAs also generated information for credit risk assessment.

4.35. Table 4.3 shows the extent to which Lloyds TSB PCA customers hold other Lloyds TSB products. It shows that Lloyds TSB's market share of other products is higher among its own PCA customers than among all customers and this is true also of the other main PCA providers, including Abbey National, Barclays, Halifax, HSBC and RBS/NatWest. Table 4.3 reflects a general pattern of cross-holding of personal banking products but, as pointed out by Lloyds TSB, does not demonstrate that cross-selling has been from PCAs to other products rather than vice versa. Table 4.3 also shows that Lloyds TSB's PCA customers hold a total of 2.2 accounts with Lloyds TSB while Abbey National told us that its PCA customers held a total of 2.7 accounts with Abbey National. The higher level of cross-holding by Abbey National's PCA customers may, however, reflect cross-selling from mortgages to PCAs.

TABLE 4.3 **Cross-holding of other financial products by Lloyds TSB PCA customers, December 2000**

	Customers with Lloyds TSB PCA			*All customers*
	Number of products held	*Number of Lloyds TSB products held*	*Lloyds TSB market share %*	*Lloyds TSB market share %*
Mortgages	0.4	0.1	25	9
Credit cards	1.1	0.3	27	14
Loans	0.3	0.1	33	12
Savings	0.9	0.3	33	10
Household insurance	0.8	0.2	25	6
Life assurance	0.7	0.1	14	4
Personal investments	0.5	0.1	20	5
Personal pensions	0.1	0.0	0	6
Total	4.8	1.2		

Source: CC calculations based on FRS data [*Details omitted. See note on page iv.*].

Note: Number of Lloyds TSB accounts and market share include Scottish Widows.

4.36. PCA services are currently delivered through a variety of means:

(a) over the counter in branches;

(b) ATMs (around 55 per cent of which are located at branches with the remainder at convenient locations such as supermarkets and stations) and other ‘hole-in-the-wall’ points for making deposits (usually located at branches);

(c) telephone service;

(d) Internet service;

(e) other electronic media: digital television and WAP phone;

(f) post offices; and

(g) cash-back facilities in supermarkets, convenience stores and garages.

Not all PCA services are accessible through all means, for instance cash withdrawal requires a physical presence and thus can only be effected over the counter, through ATMs or at post offices. As shown in Table 4.4, the availability of the different means of delivery differs by PCA product: all offer delivery via ATMs and most also offer delivery through branches, telephone and the Internet. Delivery via digital television and WAP phone is currently offered by relatively few PCAs but this is expected to increase.

4.37. In recent years there has been a trend away from counter service at branches. Over the ten years 1990 to 2000 the number of branches declined by about 30 per cent (see Table 4.2) while the number of ATMs increased by about 75 per cent.[1] The total number of bank and building society ATMs (30,400 at the end of 2000[2]) now far exceeds the total number of bank and building society branches. Telephone banking was introduced during the early 1990s and by 2000 registered users of telephone banking had increased to about 30 per cent of holders of all PCAs.[3] Internet banking was first introduced in 1997/98 and registered users were about 6 per cent of all PCAs in September 2000 with further rapid growth expected.

4.38. As well as the availability of different delivery methods, PCA products also differ from one another in some other respects:

(a) availability of cheques;

(b) availability of overdrafts;

(c) whether or not the account offers additional benefits such as free travel insurance (accounts offering additional benefits are known as ‘packaged accounts’). The customer usually pays a monthly fee for packaged accounts. Lloyds TSB said it had introduced packaged accounts in the first half of 1997 and that, by February 2001, they represented 19 per cent of its total accounts (including about 5 per cent of accounts where the monthly fee was waived because a sufficiently large credit balance was maintained throughout the month), compared with 5 per cent in December 1997; and

(d) whether or not the account offers automatic transfer of funds to and from a savings account (known as ‘account sweeping’) and whether or not funds in the PCA can be offset against the customer’s borrowings in a mortgage account with the same provider.

4.39. PCAs are characterized by an element of vertical integration in that providers sell directly to the customer but, for money transmission, themselves require access to networks of which the main ones are:

(a) APACS and its clearing companies (BACS, CCCC and CHAPS) which are responsible for exchanging automated payments (BACS and CHAPS) and clearing cheques (CCCC). The

[1]APACS.
[2]APACS.
[3]Lloyds TSB estimates.

APACS companies have a small number of members,[1] which do, however, provide agency services to other companies;

(b) Switch and VisaDebit which are debit card schemes, enabling PCA customers to make electronic payments to retailers; and

(c) LINK, which runs the interchange of information between ATMs. The LINK network, which covers more than 99 per cent of ATMs in the UK,[2] enables one bank's customers to use any ATM in the LINK network for making cash withdrawals and balance enquiries. It does not cover other ATM transactions.

4.40. The costs of the money transmission networks are paid by the members of the network but these costs are relatively small compared with the total costs of making a payment.[3] The bulk of the costs are incurred by banks in their infrastructure and back offices rather than by the networks themselves. For example, fees paid to LINK, reflecting the costs of switching and settlement, average 1p per transaction, while the charge for cash withdrawal at an ATM, reflecting the provision of ATMs, is typically 28p per transaction for branch-based ATMs and 40p for non-branch ATMs.[4] At a small proportion of ATMs the customer makes a direct payment to the ATM provider (typically 100p per transaction) and there is no interchange payment between LINK members.

Market shares

4.41. Table 4.4 shows PCAs offered by the main providers, including the delivery methods available and the services offered. Typically, providers offer a number of different PCAs, including a standard PCA, a basic bank account and in some cases one or more packaged accounts. Some banks have set up new banks which do not use their existing branch network: these include First Direct (HSBC), Smile (Co-operative Bank), cahoot (Abbey National) and Intelligent Finance (Halifax). Smile and cahoot are considered to be Internet banks as customers must open an account via the Internet.

4.42. Table 4.5 and Figure 4.1 show market shares, based on the number of accounts, over the years 1995 to 2000 using market research data (results are affected by sampling variation). The traditional banks still have a very large share of the PCA market; among the building societies and ex-building societies, Abbey National and Halifax have a share of around 5 per cent and Alliance & Leicester and Nationwide have around 3 per cent. On the basis of the market research data, Lloyds TSB's share is currently 22 per cent and would increase to 27 per cent after the merger. Appendix 4.2 considers market shares further.

4.43. Table 4.5 and Figure 4.1 suggest there has been relatively little change in market shares over this period: apart from the effects of the two mergers during 2000 (see paragraph 4.30), the main PCA providers gaining share were Halifax, Abbey National and HSBC (including First Direct). NatWest and Lloyds TSB lost market share over the period.

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[1]The members of CCCC are (apart from the Bank of England) : Abbey National, BoS, Barclays, Clydesdale, Co-operative Bank, Girobank (owned by Alliance & Leicester), HSBC, Lloyds TSB, NatWest, Nationwide, RBS. The members of BACS are these companies plus Coutts & Co (part of RBS Group), Halifax and Northern Rock.

[2]Lloyds TSB.

[3]Cruickshank report, paragraph 3.96.

[4]Based on default interchange fee information provided by Lloyds TSB.

TABLE 4.4 **PCA products offered by the main providers of PCAs**

Ultimate owner and bank	*Product name*	*Delivery methods*						*Services offered/type of account*						
		Branch	*Post Office*	*Tele-phone*	*Internet*	*Digital TV*	*WAP phone*	*Cheques*	*Over-drafts*	*Debit card*	*Pack-aged a/c*	*Switcher service*	*Account sweeping*	*Offset against mortgage*
Abbey National														
Abbey National	Bank account	•		•	•	•	•	•	•	•		•		
Abbey National	Instant Plus*	•		•	•	•	•			•				
Cahoot	Current account		•	•	•		•	•	•	•				
Cahoot	Current account†		•	•	•		•		•	•				
Alliance & Leicester														
Alliance & Leicester	Alliance	•	•	•	•			•	•	•				
Alliance & Leicester	Alliance Premier	•	•	•	•			•	•	•	•	•		
Alliance & Leicester	Basic banking account*	•	•	•	•					•				
BoS														
BoS	Chequeplus	•		•	•			•	•	•		•		
BoS	Direct current account	•		•	•			•	•	•		•		
BoS	Money Market Cheque	•		•	•			•		•		•		
BoS	Easycash*	•		•	•					•				
Barclays														
Barclays	Bank account	•	•	•	•			•	•	•				
Barclays	Additions	•	•	•	•			•	•	•	•			
Barclays	Cash card*	•	•	•	•									
Woolwich	Current account	•						•	•	•		•		
Woolwich	Open Plan	•		•	•	•	•	•	•	•	•	•	•	•
Woolwich	Current (basic)*	•												
Co-*operative Bank*														
Co-operative Bank	Current account	•	•	•	•			•	•	•		•		
Co-operative Bank	Cashminder*	•	•	•	•					•				
Smile	Current account		•		•			•	•	•		•	•	
HSBC														
HSBC	Bank account	•		•	•	•		•	•	•		•	•	
HSBC	Premier bank account	•		•	•	•		•	•	•	•	•		
HSBC	Basic bank account*	•		•	•	•							•	
First Direct	Bank account			•	•			•	•	•			•	
First Direct	Cheque			•	•			•	•	•				
Halifax														
Halifax	Current account	•		•	•		•	•	•	•		•	•	
Halifax	Cardcash*	•		•	•		•	•		•	•			
Intelligent Finance	Current account			•	•		•	•	•	•	•	•	•	•
Intelligent Finance	Current account (basic)*			•	•			•		•	•		•	•

Ultimate owner and bank	*Product name*	*Delivery methods*						*Services offered/type of account*						
		Branch	*Post Office*	*Tele-phone*	*Internet*	*Digital TV*	*WAP phone*	*Cheques*	*Over-drafts*	*Debit card*	*Pack-aged a/c*	*Switcher service*	*Account sweeping*	*Offset against mortgage*
Lloyds TSB														
Lloyds TSB	Classic	•	•	•	•			•	•	•		•		
Lloyds TSB	Select	•	•	•	•			•	•	•	•	•		
Lloyds TSB	Gold Service	•	•	•	•			•	•	•	•	•		
Lloyds TSB	Platinum current account	•	•	•	•			•	•	•	•	•		
Lloyds TSB	Bank account*		•	•										
NAB														
Clydesdale	Current account	•		•				•	•	•		•	•	
Clydesdale	Current Extra	•		•				•	•	•		•	•	
Clydesdale	Current Silver	•		•				•	•	•	•	•	•	
Clydesdale	Current Gold	•		•				•	•	•	•	•	•	
Clydesdale	Principal	•		•				•	•	•	•	•	•	
Clydesdale	Cashmaster*	•		•										
Yorkshire Bank	Paymaster	•		•				•	•	•		•	•	
Yorkshire Bank	Current account	•		•				•	•	•		•	•	
Yorkshire Bank	Premium current account	•		•				•	•	•	•	•	•	
Yorkshire Bank	Principal	•		•				•	•	•	•	•	•	
Yorkshire Bank	Readycash	•		•										
Nationwide														
Nationwide	FlexAccount	•		•	•			•	•	•				
Nationwide	FlexAccount (Basic)*	•		•	•					•				
RBS Group														
NatWest	Current account	•		•	•		•	•	•	•			•	
NatWest	Current Plus	•		•	•		•	•	•	•			•	
NatWest	Advantage Gold	•		•	•		•	•	•	•	•		•	
NatWest	Advantage Premier	•		•	•		•	•	•	•	•		•	
NatWest	Step*	•		•	•		•			•				
RBS	IPCA	•		•	•			•	•	•	•	•	•	
RBS	Royalties	•		•	•			•	•	•	•	•	•	
RBS	Royalties Gold	•		•	•			•	•	•	•	•	•	
RBS	Key*	•		•	•									

Source: Money£acts, May 2001.

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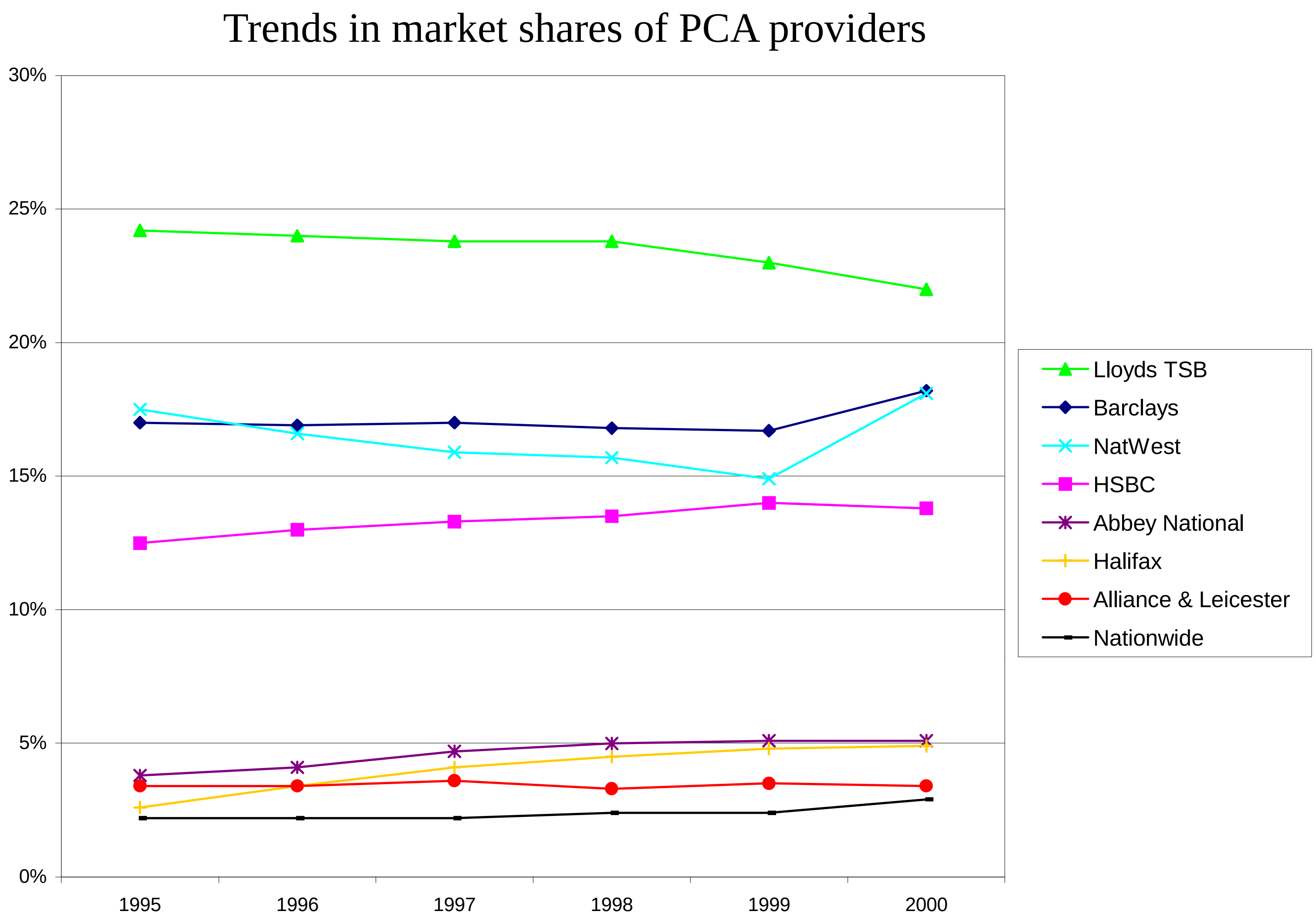
*Basic bank account.
†Current account with no chequebook.
Note: All PCAs shown offer automated transactions and cash withdrawal from ATMs.

FIGURE 4.1



Source: FRS.

TABLE 4.5 **Trend in PCA market share and concentration, Great Britain, 1995 to 2000**

per cent

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*Notional post-merger*
Barclays*	17.0	16.9	17.0	16.8	16.7	18.2	18.2
HSBC	12.5	13.0	13.3	13.5	14.0	13.8	13.8
Lloyds TSB	24.2	24.0	23.8	23.8	23.0	22.0	27.1
NatWest†	17.5	16.6	15.9	15.7	14.9	18.1	18.1
BoS	2.4	2.3	2.1	2.1	2.0	2.1	2.1
NAB	4.9	4.8	4.1	3.8	4.0	3.7	3.7
RBS	3.9	3.7	3.5	3.9	3.9	-	-
Abbey National	3.8	4.1	4.7	5.0	5.1	5.1	-
Alliance & Leicester	3.4	3.4	3.6	3.3	3.5	3.4	3.4
Halifax	2.6	3.4	4.1	4.5	4.8	4.9	4.9
Nationwide	2.2	2.2	2.2	2.4	2.4	2.9	2.9
Others	5.6	5.6	5.7	5.2	5.7	5.8	11.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total: big four	71.2	70.5	70.0	69.8	68.6	72.1	77.2
Total: all traditional	82.4	81.3	79.7	79.6	78.5	77.9	83.0
HHI (number)	1,424	1,397	1,380	1,377	1,332	1,424	1,649

Source: FRS [*Details omitted. See note on page iv*].

*2000 figures include Woolwich.
†2000 figures are for RBS Group.
Note: Market shares reflect shares of all banks and joint ventures within the group (eg RBS share includes Virgin). Because of sampling variation, market shares may not be accurate to the one decimal place shown.

4.44. Table 4.5 suggests that the increase in Abbey National's market share has fallen off in recent years. Table 4.6 shows Abbey National's own data on the change in its number of PCAs. This shows that the number of its PCAs has continued to increase but that there was indeed some reduction in its net rate of new account opening from about the middle of 1999. However, since the autumn of 2000 its rate of account opening has improved.

TABLE 4.6 **Growth in number of Abbey National PCAs**

'000 accounts

	Stock at start period	*Openings*	*Closures*	*Net openings*	*Stock at end period*
Annual data 1996 to 2000					
1996					
1997					
1998					
1999					
2000					
Quarterly data 1999 to 2001					
Quarter 1 1999		*Figures omitted. See note on page iv.*			
Quarter 2 1999					
Quarter 3 1999					
Quarter 4 1999					
Quarter 1 2000					
Quarter 2 2000					
Quarter 3 2000					
Quarter 4 2000					
Quarter 1 2001					

Source: Abbey National.

Note: Account transfers are excluded.

4.45. We considered the extent to which Lloyds TSB and Abbey National may compete particularly closely with one another in the PCA market. There is some evidence that the two companies compete for the same customers: their customers profiles are similar and their branch networks overlap (see Appendix 4.1). However, there is no particular similarity in products: Lloyds offers packaged PCAs, as also do Barclays and NatWest, but Abbey National does not do so. There is no similarity in regional strengths, rather the reverse (see Appendix 4.1). We also noted that around 19 per cent of customers switching to Abbey National are from Lloyds TSB, which is slightly less than Lloyds TSB's overall market share, suggesting the two are not closer competitors than would be expected from their market share.

Barriers to entry

4.46. There are a number of requirements for entry into the PCA market:

(a) a banking licence from the FSA;

(b) access to APACS schemes (required for the entrant's customers to transact with customers of other banks) and a debit card scheme;

(c) access to some of the means of delivering PCA services to customers (an entrant may not necessarily need access to all the delivery means listed in paragraph 4.36);

(d) the ability to bring new products to potential customers' attention (including development of successful brands);

(e) appropriate infrastructure and skills to process transactions and deal with PCA customers; and

(f) information regarding the credit risks posed by potential customers (this is required if overdrafts are to be offered).

4.47. In considering barriers to entry our concern is with factors that can deter entry even when the incumbent providers are earning profits in excess of the cost of capital. We consider each of the above requirements in turn and then go on to consider another factor—switching barriers—considered relevant to entry and expansion by a number of those providing evidence.

Obtaining licence

4.48. The FSA would require an entrant seeking a banking licence to demonstrate its financial probity and capital adequacy, and that it had appropriate staff in place (for instance, in relation to compliance and risk management), robust IT systems and well-designed credit and risk management processes.

4.49. The Cruickshank report pointed to the existence of unnecessary regulatory barriers to entry, including an informal requirement that new entrants must be linked to an established bank; informal restrictions on who can own a bank (the report suggested that concerns would be raised about ownership by venture capitalists); and the FSA policy of setting higher minimum capital ratios (see paragraph 4.8) for new entrants than incumbents. In its published response (available on the FSA's web site) the FSA made the following points:

(a) Many authorizations had not been linked to existing banks even though in the FSA's view there might be a strong business case for a new entrant to link up in some way, at least initially, with an established bank.

(b) In order to provide adequate protection to depositors, especially retail depositors, it was a reasonable approach for the FSA to state that it was more difficult to be satisfied that a new bank would be run with appropriate prudence if there was no track record in a similar business to refer to. In future, however, the FSA intended to be more flexible in dealing with new entrants and to use a wider range of more sharply focused tools: for example, rather than refuse authorization to an entrant, the FSA might limit the number of customers or the amount of deposits that could be taken during an initial period.

(c) Owners of banks had to meet the 'fit and proper' criteria which applied both to entrants and to incumbents. The criteria, and FSA guidance on them, were fully transparent and, under the new legislation, FSA decisions could be appealed to an independent tribunal.

(d) Although there was no hard and fast rule, the FSA would tend to set entrants a higher than average minimum capital ratio as experience had shown they were riskier. Entrants' minimum capital ratios would, however, tend to decline as they established a track record. (The FSA accepted that in the past minimum capital ratios had not declined as quickly as they might have done.)

4.50. In relation to PCA entry it may also be noted that there are a number of authorized banks which do not provide PCAs. The need for a banking licence would not be a barrier to entry by those banks.

Access to payments networks

4.51. An entrant can gain direct access to APACS through full membership or indirect access by an agency agreement. Until recently full membership was subject to minimum volume requirements but in March 2001 APACS agreed to drop minimum volume requirements in the three clearing companies. Nevertheless full membership tends to be expensive for small members (there is an entry fee and BACS cost per transaction declines with the volume of transactions while CCCC and CHAPS members have to pay a 2 per cent minimum share of central costs). Lloyds TSB told us that there was strong competition between full APACS members to provide indirect access, a view that receives some support in the Cruickshank report (which referred to a general view, shared by suppliers and customers, that price competition for some business is very intense). However, it may be difficult, post-entry, to take advantage of this competition as there may be high costs of switching between agents (for example, changing agent usually implies changing sort code and hence all cheque books have to be replaced): this would emphasize the importance of securing a good deal at the time of entry. The Cruickshank report also referred to a very wide range of prices charged for indirect access and to a lack of negotiation on certain aspects of service. Lloyds TSB attributed the wide range of prices to low volume agency contracts with foreign banks, where the price reflected relationship factors.

4.52. A PCA entrant wanting to issue debit cards will have to join one of the two main debit card schemes, Switch and Visa. As with APACS, there is an irrecoverable entry fee and entrants must be approved by the relevant boards and committees, which are composed of existing members ie the incumbent banks. As noted in paragraph 4.19, the Government has announced that payments schemes will be regulated and this may be expected to make entry easier.

Delivery of services to customers

4.53. Paragraph 4.36 listed seven means of delivering PCA services to customers. Of these the last five (telephone, Internet, other electronic media, the Post Office and supermarket cashback) would appear to involve no special problem for entrants, although some investment is no doubt required. The second one (ATMs) is also now easy for entrants to access by joining LINK (as noted in paragraph 4.39, nearly all ATMs are connected to the LINK network). Thus, an entrant can offer access, for cash withdrawals and balance enquiries (but not other services which are not covered by LINK), to nearly all ATMs and does not require its own ATM network. Furthermore, from 1 January 2001, LINK interchange fees (the fees paid to the ATM owner for making a cash withdrawal or balance inquiry) are the same for issuer-only members of LINK as for other (ATM-owning) members, so that entrants without their own ATM infrastructure are no longer at a competitive disadvantage. This compares with the situation in January 1999, shown in the Cruickshank report, where the fee paid by an issuer-only member of LINK was almost double that paid by a large ATM-owning member.

4.54. The remaining means of delivery is through local branches. As shown in Table 4.2, the big four banks and, to a lesser extent, the building societies and ex-building societies have large, albeit declining, networks of branches. Table 4.7 shows that branches remain important to customers: it was suggested to us that this was more for the ability to discuss problems in person than for the ability to make branch-based transactions. Only about 3 per cent of the PCA market is held by non-branch based suppliers.

TABLE 4.7 **Reasons for opening a PCA**

	% quoting
Convenient branch location	27
Family/friend/employer holds account/works there	18
Recommended	18
Hold other products there	12
Reputation/image	8
Availability of ATM	6
Services available on account	6
Attractive overdraft package	5
Attractive interest in credit	5
Offers direct banking	5
Offers incentives/vouchers/cash	3
Quality of advice	3
Lower charges	3
Opening hours/weekend opening	3
Have good/wide range of products	2
Ethical stance	1

Source: FRS.

4.55. The following main points were made to us qualifying the importance of branches to new entrants:

(a) Branches are no longer an essential means of delivering PCA services: cash can be withdrawn through LINK ATMs; cash and cheques can be paid in through post offices and cheques also paid in via the postal service. There are a number of separately branded telephone and Internet banks that have been started by existing banks (see paragraph 4.41). The current market share of these non-branch banks in the PCA market is about 3 per cent, although likely to increase in future.

(b) Some entrants may have their own branches as a result of operating non-banking businesses. Supermarket chains have entered some other retail banking markets, though not the PCA market, through joint ventures with existing banks (see paragraph 4.30). Among the reasons given by supermarkets, with an existing presence in banking markets, for not entering the PCA market were difficulties with switching accounts between providers; need for an established reputation in financial services; and the at best marginal financial case for providing PCAs.

(c) An entrant might make an agency agreement with an existing branch-based bank. Lloyds TSB told us that it currently acted as an agency for Citibank and Investec Bank, whose customers could make deposits at branches of Lloyds TSB without being charged by Lloyds TSB. In practice such an agreement might offer little advantage over the Post Office and be subject to difficulties over fair treatment of the entrant's customers relative to those of the agent bank.

4.56. For an entrant starting from scratch there would be significant sunk costs in establishing a branch network: even though premises can be rented they have to be adapted for use as a bank and there is also the need to invest in systems infrastructure and training of skilled staff. More importantly, economies of scale at branch level represent a difficulty for entrants. It would be very difficult for an entrant to match the branch networks of existing providers cost-effectively since at the outset the costs would have to be spread over a smaller number of customers. Moreover, other factors, including marketing costs and switching barriers (discussed below) would deter entrants from entering on a large scale.

Marketing

4.57. Any new entrant to the PCA market would need to spend on marketing in order to bring new products to potential customers' attention. In most cases this would involve developing or extending to PCAs a brand with a national reputation. Lloyds TSB argued that much less marketing expenditure was required where the potential entrant had already developed its brand and entry into the PCA market merely involved extending the brand; Virgin in PCAs, and Sainsbury and Tesco in savings, were quoted as examples of brand extension (we noted above that all entered through joint ventures with existing banks). Advertising and other marketing expenditure is often thought of as a potential barrier to entry since such expenditure is a sunk cost that cannot be recovered if entry generates strong price competition and the entrant subsequently wishes to exit.

4.58. In addition, Table 4.8 suggests that entrants have to spend more on advertising, for a given PCA market share, than traditional banks, potentially putting entrants at a disadvantage. It is difficult to separate PCA from other advertising expenditure by PCA providers and Table 4.8 therefore shows estimates of all advertising by the group as well as that specific to PCAs. Lloyds TSB argued that the figures for advertising specific to current accounts in Table 4.8 did not take account of its own advertising for online current accounts or that by others such as Barclays and that, generally, it was appropriate to attribute general brand spend to current accounts. Nevertheless, it seems that even a long-standing new brand such as First Direct has to spend heavily relative to traditional banks (although Lloyds TSB pointed out that, as a non-branch-based provider, First Direct benefits from not having to spend on branches). Table 4.8 covers only advertising expenditure and excludes, for example, marketing expenditure incurred by branches, which will be greater for branch-based than non-branch-based providers.

TABLE 4.8 **Comparison of advertising expenditure with market share for PCA providers, 2000**

	Advertising expenditure £m		*Advertising expenditure % of total*		*PCA market share*
	All	*Specific to current account*	*All*	*Specific to current account*	
Traditional banks					
Barclays	26	0.3	8	1	17
HSBC	14	0.0	5	0	12
Lloyds TSB	32	0.2	10	1	22
NatWest	34	1.0	11	4	14
BoS	13	0.1	4	0	2
RBS	27	0.7	9	3	4
Building societies and ex-building societies					
Abbey National	22	0.8	7	3	5
Alliance & Leicester	26	0.9	8	4	3
Halifax	26	0.4	8	2	5
Nationwide	19	2.9	6	12	3
Woolwich	14	0.0	4	0	1
Others					
Cahoot	10	4.8	3	20	0
First Direct	11	2.7	4	12	2
First-e	0	0.3	0	1	0
Intelligent Finance	11	7.0	4	30	0
Smile	3	0.5	1	2	0
Others	25	0.9	8	4	11
Total: all providers	313	23.5			

Source: Abbey National's analysis of advertising expenditure (based on A C Nielsen MMS), and FRS market shares.

Note: Advertising expenditure and market shares are by brand: figures for NatWest and RBS are shown separately as are Barclays and Woolwich, and HSBC and First Direct. Consequently market shares differ from those in Tables 4.1 and 4.5. Lloyds TSB pointed out that the figure for its advertising expenditure included advertising by parts of the Lloyds TSB group other than the banking business, eg by Scottish Widows.

4.59. Although the need for marketing expenditure may appear to create a barrier to entry, it seems noteworthy that some existing suppliers have launched separately branded banks for non-branch-based supply (see paragraph 4.41). This suggests there may be advantages to a new brand which at least potentially an entrant could take advantage of.

Other

4.60. The last two entry requirements mentioned above were infrastructure/skills and information for credit checks. The evidence suggested that neither of these was likely to be a major entry barrier. On the first, we received evidence in particular from Professor Llewellyn that there was increasing outsourcing of back office work. So far, there seem few examples of outsourcing in PCAs: the only one quoted to us was Woolwich outsourcing in 2000 the handling of its Open Plan applications to Ventura, a subsidiary of Next plc. The theoretical ability to outsource complex and costly operations and infrastructure appears to be a factor making entry easier than in the past although any outsourcing proposals must be discussed with the FSA (in its role as banking supervisor) and the tax-exempt status of banking may raise the cost of outsourcing (as the bank cannot offset VAT paid to contractors against its own VAT payments). There do not appear to be undue difficulties in obtaining information for credit scoring and a large number of companies are already involved in the personal loans and/or credit cards markets, which also require such information. An entrant starting from scratch would need to recruit staff skilled in credit assessment.

Switching barriers

4.61. Abbey National and others drew our attention to factors that discouraged customers from switching their PCAs to another supplier. The existence of such switching barriers may have a number of effects. It may give existing providers some market power over their existing customers, enabling prices to be increased to the 'back book'. It may on the other hand also lead to stronger competition and lower prices for new customers, both switchers and first-time customers such as students.

4.62. Switching barriers may also raise the costs of entry and expansion: entrants will tend to incur large sunk costs of customer acquisition (generous terms have to be offered to attract customers and costs are incurred in providing a switcher service to deal with originators of direct debits and others). Furthermore, by constraining the rate of expansion, a low rate of switching makes it more difficult to take advantage of economies of scale. In this context PCA entrants face both a low rate of switching and a low natural rate of account opening and closure compared with some other products such as mortgages (a mortgage attaches to a property and thus is redeemed whenever the customer moves house).

4.63. The main barriers to switching that were identified in evidence included:

(a) consumer fears regarding their credit status—consumers may see advantage in having a long-term banking relationship when seeking credit;

(b) consumer fears regarding disruption to other banking or financial relationships, such as a mortgage or SME business account, that may be linked to the current account banking relationship; and

(c) delays and costs associated with switching accounts, in particular regarding transfer of direct debits and other automated transactions to the new account. Recently these have been addressed by some providers setting up special units to do the transfer work on behalf of consumers: as shown in Table 4.4, both Lloyds TSB and Abbey National have such units.

Additionally we note that the consumer may spend time and incur costs in seeking information about PCAs. Unlike mortgages and savings, information on PCA charges and terms is not readily available in 'best buy' tables in newspapers, although it is probably becoming easier to obtain than in the past as a result of increased access to the Internet. However, many consumers may not bother to compare terms: research for the Cruickshank report suggests that 60 per cent of new PCA holders in the last five years actively considered only one provider.

4.64. When a customer wishes to switch PCA provider, the Banking Code (see paragraph 4.11) requires the outgoing bank to cooperate with the incoming bank and provide it with information on the customer's regular payments. The incoming bank then contacts the originators of the automated transactions on behalf of the consumer and asks them to make the relevant changes. The code does not include a timescale but there is a separate agreement that information should be provided within ten working days. Abbey National told the House of Commons Treasury Committee, which was conducting an inquiry into 'Banking and the Consumer', that in the last four months of 2000 it had found that NatWest was taking an average of 24 working days to provide account information and Lloyds TSB 18 working days. In May 2001 Intelligent Finance reported that the big four banks were taking an average of between 11 and 13 days to provide the information and that their average performance had deteriorated since the beginning of 2001. Abbey National, whose switching service was established in

May 2000, told us that there were frequently delays beyond its control in obtaining the necessary action from originators of direct debits, such as utility companies, and that the process of transferring accounts could take as long as six weeks to complete. Lloyds TSB announced in the course of our inquiry that from 1 July 2001 it would send a list of direct debits and standing orders to a customer's new bank within three working days of receiving the customer's authority and account details. If it failed to do so, it would pay the customer £50.

4.65. The members of BACS are committed to introducing an automated system for switching customers' direct debits by the end of 2001. Under the new scheme the incoming bank will advise the direct debit originator of the switch of bank: this will be done electronically by BACS members but agency banks will continue to send paper advice unless they choose to join the automated scheme. Abbey National told us that delays caused by third party originators would remain.

4.66. The House of Commons Treasury Committee commented in its report, published in March 2001, that the major banks' efforts to ease the transfer of PCAs in the 12 months since the Cruickshank report—which recommended that standards of service be set for switching—had been disappointingly slow and called on them to do very much better in the next 12 months. Once the computerized system came into force the committee expected the banks to commit themselves to a shorter deadline than ten working days for the provision of account details: the time limit should be specified in the Banking Code and there should be penalties and/or a liability to pay compensation in the event of non-compliance.

4.67. The available evidence suggests the rate of PCA switching is very low. A DTI survey of switching across nine products showed only 6 per cent of respondents having switched PCA in the previous five years (see Table 4.9). This is the lowest of the products shown in Table 4.9 although PCA customers also showed the greatest contentment with their existing supplier. The FRS market research data suggest a switching rate of only just over 1 per cent a year (see Table 4.10). It is possible that these figures understate the extent of switching as the figures may not capture occasions when consumers open a secondary account and gradually move their transactions over. Table 4.10 indicates significant net opening of secondary accounts: it shows a net PCA opening rate of 3.5 per cent for 1995 to 1997 and 3.0 per cent for 1998 to 2000 (although our own survey results (see Appendix 4.2) suggest a slightly higher rate of 3.8 per cent for 1998 to 2000) which is more than the 1.8 per cent accounted for, on average, by customers opening their first-ever account. Table 4.10 does not show any increase over time in the rate of switching; recent and forthcoming changes (including the BACS automated switching system) may be expected to increase the switching rate, although it remains to be seen to what extent.

4.68. Lloyds TSB said that the main reason for lower levels of switching in PCAs than in other markets such as mortgages related to the expected level of financial gain from switching: for a mortgage this was many times that of a PCA. Professor Llewellyn suggested that, since customers perceived that PCAs were provided by banks free of charge, they saw no price advantage in switching (see paragraph 6.163).

4.69. The DTI's researchers also carried out qualitative research and commented, in general, on the difference between consumer responses to the quantitative and the qualitative elements. They noted that in quantitative research consumers appeared to rationalize their reasons for not switching, often emphasizing their satisfaction with current suppliers even when inertia and concerns about potential difficulties in switching were present, while the qualitative work (depth interviews and focus groups) indicated that consumers' experiences were not always as positive.

4.70. The evidence also suggests that the reason for switching a PCA often relates to dissatisfaction with the level of service offered by the current supplier (see Table 4.11).

TABLE 4.9 **Results from DTI survey: switching suppliers**

per cent

	PCAs	*Mortgages*	*Gas*	*Electricity*	*Telephone*	*Home insurance*	*Car insurance*
Percentage in previous five years							
Switched	6	12	37	26	11	30	53
Considered switching	15	32	15	13	18	23	21
Not switched or considered it	79	56	48	61	71	47	26

	PCAs	*Mortgages*	*Gas*	*Electricity*	*Telephone*	*Mobile phones*	*Insurance*
Position regarding current supplier							
Happy to stay	88	68	83	83	79	77	66
Plan to switch	2	10	6	5	6	7	3
Too much hassle to switch	10	13	8	9	12	12	5
Other answers/don't know	0	9	3	3	3	4	26

	*Banks**	*Mortgages*	*Energy*		*Telephone*	*Mobile phones*	*Insurance*
Whether would change if simple and free to do so							
Yes, definitely	10	22	16		16	14	18
Yes, possibly	22	27	28		26	29	35
No	62	47	51		53	49	43
Don't know	6	4	5		5	8	4

Source: DTI.

*These results cover both current and deposit accounts.

Note: A representative sample of household decision-makers in Great Britain was surveyed. The nine products covered were: PCAs, savings accounts, mortgages, gas, electricity, fixed-line telephones, mobile phones, home insurance and car insurance. Not all results were quoted for all products in the DTI summary. The results understated the percentage of telephone switchers.

TABLE 4.10 **Estimated rate of switching and annual growth rate of PCAs, Great Britain**

'000

	1995	*1996*	*1997*	*1998*	*1999*	*2000*
PCAs opened						
Switched from other supplier	477	486	591	584	492	594
First ever main PCA	735	834	801	806	733	661
New secondary PCAs	542	558	609	528	536	678
Other new PCAs*	688	663	617	675	646	635
Total PCAs opened	2,442	2,541	2,618	2,593	2,407	2,568
Total PCAs closed	1,016	1,057	1,123	1,192	1,168	1,321
Net PCA openings	1,426	1,484	1,495	1,401	1,239	1,247
Total stock of PCAs	40,856	41,557	42,142	41,990	43,212	46,299
Rate of switching (%)†	1.2	1.2	1.4	1.4	1.1	1.3
Rate of first account opening (%)	1.8	2.0	1.9	1.9	1.7	1.4
Rate of growth (%)‡	3.5	3.6	3.5	3.3	2.9	2.7

Source: FRS data [*Details omitted. See note on page iv.*].

*Including internal switches, PCA re-entrants.

†Number switched from other supplier as percentage of total PCA stock.

‡Number of net openings as percentage of total PCA stock.

Note: Change in stock does not agree with net openings because of sampling variation.

TABLE 4.11 **Reasons for switching PCA**

	%
Unhelpful/impolite/rude staff	20
Better account elsewhere	18
Account charges too high	18
Transaction errors	17
Poor advice	8
Not enough branches	7
Unjustified/incorrect charges	7
Refused overdraft	3
Refused other product	2
Do not need account any more	7

Source: FRS regular surveys of those switching in the last 12 months carried out between September 1998 and September 2000. [*Details omitted. See note on page iv.*]

Entry history

4.71. The larger building societies entered the PCA market in the late 1980s and early 1990s. Apart from those shown in Table 4.4, the building societies and ex-building societies currently offering PCAs are Chelsea Building Society, Cumberland Building Society, Leeds and Holbeck Building Society, Northern Rock and the Norwich and Peterborough Society.[1] None of these has a market share as large as 1 per cent. Other independent entrants to the PCA market that are still in the market[2] include:

(a) Citibank, owned by Citigroup, a large US bank, which first entered the PCA market in the early 1990s;

(b) First-e, an Internet start-up bank subject to French regulatory control. First-e's current account does not offer overdrafts or a cheque guarantee card;

(c) more specialized PCA providers: Brown Shipley, Fleming Premier Banking (which started offering PCAs in 1998 and is now owned by J P Morgan Chase, which has agreed to sell it to Abbey National), Hoare & Co (which started offering PCAs in 1995), Laiki Bank; and

(d) Britannic Money plc, which offers current account facilities combined with a mortgage account.

Other new brands include cahoot, First Direct, Intelligent Finance, Smile and Virgin (which offers a combined mortgage and current account in a joint venture with RBS Group). However, these brands are controlled or materially influenced by existing competitors and are not therefore entrants in the usual sense.

4.72. A number of new brands are non-branch based. These include First Direct which was launched in 1989, but whose customers are able to deposit cash and cheques via HSBC branches, and which now has about 2 per cent of PCA customers. First Direct told us that it took until 1995 to turn into profit but this was primarily because it continued to follow a high growth, high investment strategy. Its continued investment in these marketing and acquisition costs masked the fact that the underlying current account holders were already profitable. First Direct published pre-tax profits of £50 million and £39 million in 1999 and 2000 respectively. Other non-branch-based brands which were launched more recently are estimated to have a combined share of less than 1 per cent and may not currently be profitable. Abbey National said that cahoot, which currently has some [✂] PCA customers, was expected to reach breakeven by the end of 2003. We were told that results of stand-alone Internet banks in the USA had been disappointing.

4.73. No significant competitors have exited from the market in recent years other than through mergers and acquisitions. Smaller players exiting in the last six years include Airdrie Savings Bank, Beneficial Bank, Britannia and Western Trust.[3]

Prices and competition

4.74. The main features of PCA pricing are as follows:

(a) There are no transaction charges to the customer for the main money transmission services (withdrawing cash, writing cheques, paying in cash and cheques, automated transactions, use of debit card). There is usually a charge for stopping cheques, bankers drafts and making same day payments. Abbey National no longer charges for stopped cheques and bankers drafts (although it has introduced a new charge for paying bills over the counter in order, it told us, to encourage its customers to use alternative payment methods such as ATMs and deposit points).

(b) Interest is usually paid on credit balances although in most cases the rate is very low.

(c) Interest is charged on authorized overdrafts. In some cases the amount is reduced by the application of an interest-free buffer of typically £10 to £50, but some providers currently charge a monthly fee for authorized overdrafts.

[1]*Money£acts*, April 2001. Accounts have been included only if they offer standing orders, direct debits and at least a cash card.
[2]*Money£acts*, April 2001.
[3]Based on PCA providers in *Money£acts*, January 1995.

(d) There are penalty interest rates for exceeding authorized overdraft limits (although in most cases these are not applied within the buffer zone) and penalty charges for returned cheques.

(e) A monthly service charge is usually levied on packaged accounts.

Table 4.12 summarizes the main charges in May 2001. Barclays and Lloyds TSB at present charge monthly overdraft fees but have announced that these will be discontinued later in the year. The traditional banks charge an overdraft rate of 18 to 19 per cent and pay an interest rate of 0.1 per cent on balances up to £5,000 although these rates are improved for some packaged accounts. The building society and ex-building societies shown charge lower overdraft rates (10 to 12 per cent) and Halifax and Nationwide also offer better interest rates on credit balances (4.0 and 1.0 per cent respectively, subject to conditions in the case of Halifax). Most non-branch-based banks also offer attractive interest rates on both authorized overdrafts and credit balances. Interest rates on unauthorized overdrafts are typically 27 to 34 per cent (see Appendix 4.3).

4.75. Most banks offer much more favourable terms on overdrafts to students and in some cases also to recent graduates. For example, Lloyds TSB's student account offers an interest-free overdraft up to £1,500 for years 1 to 3 of study and £2,000 for years 4 and 5 of study and its graduate account a £2,000 interest-free overdraft for up to two years after graduation. Students may also be offered incentives: Lloyds TSB offers a £40 cash incentive to students who are existing customers or relatives of existing customers.

4.76. Some providers offer incentives to non-student customers:

(a) A number of banks offer interest-free overdrafts to switchers. Abbey National offers an interest-free overdraft up to £5,000 for one year and Lloyds TSB told us that it generally offers switching customers a one-year interest-free overdraft up to the lesser of one-half monthly net salary and £1,000.

(b) Alliance & Leicester offers a £50 cash incentive to new customers if three consecutive salary payments (minimum £500) are made in the first six months after the account is opened. Alliance & Leicester also offers a free packaged account, with annual travel insurance (household income of £20,000 a year and a monthly credit to the account of £1,000 is required).

(c) First Direct offers a £15 cash incentive to new customers.

(d) Citibank offers a free flight with British Airways.

4.77. Trends in weighted average quoted and actual overdraft rates are illustrated in Figure 4.2 and compared with base rate. The actual average overdraft rate is substantially below the quoted rate (which reflects the authorized rates shown in Table 4.12) despite rates for unauthorized overdrafts being substantially higher (see Appendix 4.3). This appears to reflect a number of factors including:

(a) the effect of interest-free overdrafts to students;

(b) the effect of other special offers including those to switchers;

(c) the effect of interest-free overdraft buffers and lower rates on packaged accounts;

(d) the possible effect of a minority of personal customers with large overdrafts and specially negotiated low rates; and

(e) the inclusion of sole traders (part of the household sector under standard EC definitions) whose business accounts may have large overdrafts and lower rates.

The Bank of England said that it was reviewing the data, which it published for the first time in March 2001, in response to its own concern about possible reporting inconsistency and queries raised (including ours). Lloyds TSB told us its weighted average external overdraft rate for 2000 was 13.2 per cent which compares with 10.5 per cent shown by the Bank of England data for the market as a whole. Abbey National told us that its rate for February 2001 was 12.5 per cent and this compares with 10.6 per cent for the market as a whole in that month in the Bank of England data.

TABLE 4.12 **Charges and interest rates on PCAs**

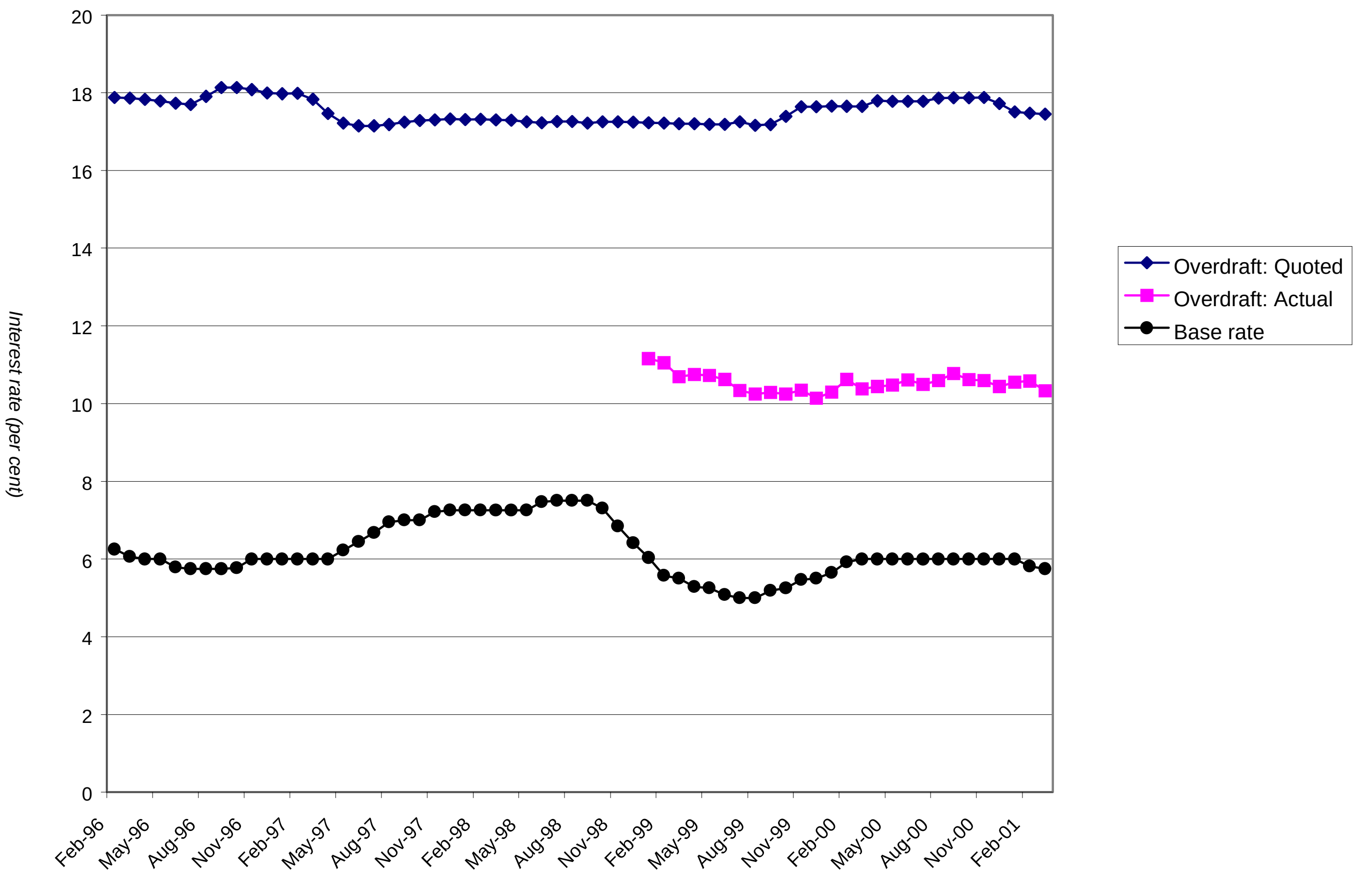
Ultimate owner and bank	*Product name*	*Service charge £ per month*	*Credit interest £1–£5,000 %*	*Credit interest £5,001+ %*	*Overdraft interest %*	*Overdraft fee £ per month*
Abbey National						
Abbey National	Bank account	None	0.10*	0.10*	9.90†	None
Cahoot	Current account	None	4.90	5.40	6.40–8.00‡	0–15.60‡
Cahoot	Current account§	None	6.00	6.40	6.40–8.00‡	0–15.60‡
Alliance & Leicester						
Alliance & Leicester	Alliance	None	0.25	0.25	12.00	None
Alliance & Leicester	Alliance Premier	None	0.25	0.25	9.90	None
BoS						
BoS	Chequeplus	None	0.10	0.25	18.00	None
BoS	Direct current account	None	0.10	0.10	13.25	None
Barclays						
Barclays	Bank account	None	0.10	0.10	18.80	5.00
Barclays	Additions	6.00	0.10	0.10	18.80	None
Woolwich	Current account	None	0.10	0.10	11.00	3.50
Woolwich	Open Plan	None	1.50	1.50	11.00	3.50
Co-operative Bank						
Co-operative Bank	Current account	None	0.00	0.00	19.56	8.00
Smile	Current account	None	4.25	4.25	9.90	None
HSBC						
HSBC	Bank account	None	0.10	0.10	18.30	None
HSBC	Premier bank account¶	None	0.10	0.25	12.60	None
First Direct	Cheque account	None	0.10	0.10	15.90	None
First Direct	Bank account	None	1.49¤	4.41	12.90	None
Halifax						
Halifax	Current account	None	4.00#	4.00#	10.00	None
Intelligent Finance	Current account	None	4.65	4.65	10.50	None
Lloyds TSB						
Lloyds TSB	Classic	None	0.10	0.10	18.60	5.00
Lloyds TSB	Select	4.00	0.10	0.10	18.60	5.00
Lloyds TSB	Gold Service	8.00**	0.10	0.10	16.50	None
Lloyds TSB	Platinum Current	12.00††	0.10	0.10	13.25	None
NAB						
Clydesdale	Current account	None	0.00	0.00	Negotiable	3.00
Clydesdale	Current extra	None	0.10	0.10	19.56	8.50
Clydesdale	Current silver	4.50	2.50‡‡	2.50	12.15	None
Clydesdale	Current gold§§	6.25	3.50	3.50	9.90	None
Clydesdale	Principal¶¶	7.92	4.50	4.50	7.76	None
Yorkshire Bank	Paymaster	None	0.00	0.00	18.60	6.00
Yorkshire Bank	Current	None	0.25	0.25	18.86	None
Yorkshire Bank	Premium current account¶¶	10.00	3.00	3.00	9.91	None
Yorkshire Bank	Principal¶¶	7.92	4.50	4.50	7.71	None
Nationwide						
Nationwide	FlexAccount	None	1.00	1.00	9.90	None
RBS/NatWest						
NatWest	Current account	None	0.00	0.00	18.38	None
NatWest	Current Plus	None	0.10	0.10	18.38	None
NatWest	Advantage Gold	6.00	0.25	0.25	16.06	None
NatWest	Advantage Premier	12.50	0.50	1.50	9.37	None
RBS	IPCA	None	0.10	0.10	19.50¤¤	None
RBS	Royalties	5.00	0.40	0.40	13.20¤¤	None
RBS	Royalties Gold	9.00	0.70	1.25	10.6¤¤	None

Source: *Money£acts*, May 2001.

*Rate increased to 0.20 if salary or £500 paid into account each month for one year.
†No interest charged to switchers for one year on overdrafts up to £5,000.
‡Low risk rates. Lowest overdraft interest rate applies when highest fee is paid.
§Current account with no cheque book.
¶Requires minimum of £30,000 savings with HSBC.
¤2.96 per cent paid on balances over £2,500.
#Rates require £1,000 per month to be credited to account; otherwise 4 per cent paid only on balances over £500.
**Waived if balance in excess of £1,000 for whole month.
††Waived if balance in excess of £3,500 for whole month.
‡‡0.1 per cent paid on balances up to £500.
§§Minimum income required of £25,000, or £40,000 for joint account.
¶¶Minimum income required of £35,000, or £50,000 for joint account.
¤¤Lower rates for overdrafts of over £1,000.
Note: Excludes basic bank accounts. All interest rates quoted in this chapter and its appendices are gross of tax.

FIGURE 4.2

Weighted average overdraft rates



Source: Bank of England.

Note: Quoted rates apply to authorized overdrafts and are weighted by outstanding overdrafts at the end of the month. If there are tiered rates a band of less than £1,000 is used. Actual interest rates are computed from interest received and average daily balances during the month.

4.78. The PCA pricing structure means that PCA providers gain income primarily from credit balances and overdraft interest and fees but incur direct costs primarily according to the number of transactions, except for debit card transactions where costs are recovered from retailers via interchange fees to merchant acquirers (merchant acquirers carry out card transactions for retailers). This implies cross-subsidization between accounts. Accounts with larger than average credit balances (or fewer than the average number of transactions) and overdrawn accounts will tend to subsidize other accounts. In its Group Strategic Plan 2000–2002, Lloyds TSB estimated that only [✄] per cent of its personal customers were profitable on a fully-absorbed basis (this analysis takes into account not only PCAs but all personal products held). Lloyds TSB's further analysis for the month of February 2001 showed that, at any one time and including all relevant costs, [✄] per cent of PCA customers were profitable, taking account of other products held by those customers, and [✄] per cent were profitable taking account of PCA business alone.

4.79. Competition may be on standards and quality of service as well as on price. Table 4.7 (reasons for opening a PCA) and Table 4.11 (reasons for switching PCA) suggest that relevant aspects of service include branch location, staff helpfulness to customers, avoidance of errors, availability of different delivery channels, quality of advice, opening hours and range of products available.

4.80. Firms also compete to develop and introduce innovations. In the context of the UK market, we would identify two aspects of innovation:

(a) development of new products and processes, which may, of course, take place anywhere in the world; and

(b) introduction and use by firms of new products and processes.

The most significant innovations in recent years appear to have been the introduction of banking via telephone, Internet, WAP phone and digital television and also the introduction of packaged and offset accounts. The Cruickshank report noted that the UK was relatively advanced in the development and introduction of some new delivery channels, in particular telephone and interactive television banking, but also noted that it was lagging some other countries in the widespread introduction of important innovations (such as Internet banking and smart cards).

Savings accounts

4.81. We define personal savings accounts as deposit-holding accounts that do not offer money transmission facilities (and thus are not classified as PCAs). A savings account may be operated in conjunction with a PCA but Table 4.4 shows that only a minority of PCA providers offer automatic transfer of funds between a PCA and a savings account (account sweeping).

4.82. Substitutes for savings accounts may include PCAs (in the absence of account sweeping, customers' willingness to transfer money between PCAs and savings accounts may depend on the interest rate differential between them) and flexible mortgages (see paragraph 4.93).

4.83. The terms and conditions of savings accounts differ significantly:

(a) Delivery may be via one or more of branches, ATMs, post, telephone and Internet.

(b) Branch-based accounts may or may not be based on a passbook which is updated for each deposit, withdrawal and interest payment at the branch (building societies traditionally offered passbooks to their customers).

(c) Methods of deposit and withdrawal may include cash, cheque and automated transaction via BACS.

(d) The number of transactions per month may be limited and/or there may be a minimum withdrawal amount.

(e) A notice period (frequently 30, 60 or 90 days) may be required for withdrawals although in these cases an earlier withdrawal with loss of interest is usually possible.

(*f*) Interest rates are usually variable (at the bank's discretion) but may be fixed for the life of the product (this is usually referred to as a bond). A few accounts are available with interest rates linked to base rate.

Market shares

4.84. There are a large number of providers of savings accounts: *Money£acts* (May 2001) lists 120, of which 60 are building societies (we note that not all of the 120 are independent: for example, Cheltenham & Gloucester and Lloyds TSB Scotland are listed separately). Table 4.13 shows the market shares of the largest providers by number of accounts. Over the period 1995 to 2000, the largest ex-building societies, including Abbey National, lost market share while those gaining market share included Nationwide, two of the traditional banks (HSBC and Barclays) and the smaller providers. Abbey National remains the second largest provider and Lloyds TSB (including Cheltenham & Gloucester) is the fifth largest. Between 1995 and 2000, the four-firm concentration ratio declined from 56 to 52 per cent but as a result of the merger it would increase to 62 per cent. Similarly, the HHI declined from about 1,000 to about 900 but as a result of the merger would increase to about 1,160.

TABLE 4.13 **Trend in personal savings market share and HHI, Great Britain, 1995 to 2000**

per cent

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*Notional post-merger*
Barclays*	4.2	4.0	4.1	4.7	5.0	10.4	10.4
HSBC	3.0	3.3	3.1	3.5	3.9	4.9	4.9
Lloyds TSB	9.9	9.9	9.7	10.0	10.0	10.0	22.9
NatWest†	3.4	3.2	2.8	2.9	3.1	5.8	5.8
Abbey National	16.5	16.1	15.2	14.5	14.1	12.9	
Alliance & Leicester	5.1	5.6	5.2	4.4	4.6	3.9	3.9
Halifax	21.4	20.4	21.3	19.4	19.0	17.8	17.8
Nationwide	8.1	8.4	9.1	10.0	10.4	10.6	10.6
Woolwich	5.4	5.5	5.5	5.0	4.5		
Others	23.0	23.6	24.0	25.6	25.4	23.7	23.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total: big four banks	20.5	20.4	19.7	21.1	22.0	31.1	44.0
Four-firm concentration ratio	55.9	54.8	55.3	53.9	53.5	51.7	61.7
HHI (number)	1,011	968	986	913	902	906	1,164

Source: FRS [*Details omitted. See note on page iv.*].

*2000 figures include Woolwich.
†2000 figures are for RBS Group.
Note: Market shares reflect shares of all banks and joint ventures within the group (eg NatWest 2000 share includes Virgin). Because of sampling variation, market shares may not be accurate to the one decimal place shown.

4.85. Table 4.14 shows alternative estimates of Lloyds TSB and Abbey National's market share based on value of deposits rather than number of accounts. On this basis both companies' market shares are somewhat lower, perhaps reflecting a smaller share of the highest value accounts.

TABLE 4.14 **Value of personal savings deposits, UK, 1995 to 2000**

£ billion

	1996	*1997*	*1998*	*1999*	*2000*	*Notional post-merger*
Value of end-year balances						
Total for all providers	388.0	393.8	414.4	435.4	462.2	
Lloyds TSB	31.2	33.0	35.3	35.1	38.8	
Abbey National	41.9	43.3	44.0	43.9	43.6	
						per cent
Shares of total						
Lloyds TSB	8.0	8.4	8.5	8.1	8.4	17.8
Abbey National	10.8	11.0	10.6	10.1	9.4	

Source: Bank of England, Lloyds TSB and Abbey National.

Entry and switching

4.86. The potential barriers to entry are similar to some of those affecting PCAs and include the need for a banking licence and the possible advantages (in supplying some customers) of brand recognition and a branch network. Entry into savings accounts is easier than into PCAs since there is less need for money transmission skills, infrastructure and access to payments schemes. Information on savings account rates is more readily available, for example in newspapers, than that on PCAs and the switching barriers identified in paragraph 4.63 are much less relevant to savings accounts than PCAs. Nevertheless consumer purchasing behaviour is affected by inertia, with many consumers apparently being reluctant to move their money to accounts offering better interest rates. Research for the Cruickshank report found that 68 per cent of respondents had not actively considered any other suppliers when selecting their main savings accounts and also that savings accounts were held for a long time—a median of 9.9 years.

4.87. Entrants in the last ten years have included a number of insurance companies: Prudential (which offers savings accounts both through Prudential Banking and through its Internet bank, Egg), Standard Life, Norwich Union, Direct Line Insurance and Scottish Widows (now part of Lloyds TSB). Other entrants have included foreign banks, such as Citibank, Capital One Bank and MBNA, and retailers—Sainsbury and Tesco have joint ventures with BoS and RBS Group respectively. The most successful entrant, as measured by number of accounts, is Prudential: FRS data show a market share of 1.3 per cent in 2000, reflecting rapid advance in 1999 and 2000 when Prudential took 6.9 per cent and 4.9 per cent of new accounts respectively.

Prices and competition

4.88. A wide variety of interest rates are paid on savings accounts. For example, at the beginning of May 2000 Abbey National's passbook-based Instant Saver account paid an interest rate of 0.25 per cent on balances up to £2,5000 (and 0.5 per cent on balances between £2,500 and £5,000, rising in steps to 1.4 per cent on balances of over £25,000) whereas its eSaver account paid an interest rate of 6.2 per cent on all balances of £2,000 and over.[1] Differences in interest rates to some extent reflect differences in terms and conditions: higher interest rates tend to be paid by accounts with access restrictions (for example, no branch access) or those with implicit or explicit restrictions on the number of transactions. Branch-based accounts tend to be more expensive to operate and thus tend to offer lower interest rates. However, there are also significant differences in interest rates between accounts with very similar terms and conditions.

4.89. Interest rates on savings accounts are usually variable but discretionary (in most cases not linked to base rate or to market interest rates). Information on interest rate changes is made available at branches and through selected newspapers, helplines and web sites but customers are not necessarily informed by letter when rates are changed. There has been a tendency for the attractiveness of discretionary interest rates on particular accounts to fall off over time, leaving a 'back book' of holders of that account on relatively poor rates while differently named accounts are introduced to attract new customers. The Banking Code now requires interest rates on 'superseded' accounts (those that are no longer open to new customers or not actively promoted) to be kept at the same level as interest rates on similar accounts, or alternatively customers on the superseded account to be transferred to the new account. Where there is no similar new account available, the code requires the customer to be informed about the superseded account and to be helped to switch to another account. The Banking Code also requires banks and building societies to send information on all their savings accounts to their customers at least once a year.

4.90. Lloyds TSB told us in April 2001 that its overall margin on savings accounts declined substantially throughout 2000. For the previous two years Lloyds TSB branch staff had been asked to identify customers with poor-paying accounts and encourage them to upgrade. Nearly 90 per cent of the balances on Lloyds TSB accounts would not now be improved by upgrading to another account. [

Details omitted. See note on page iv.

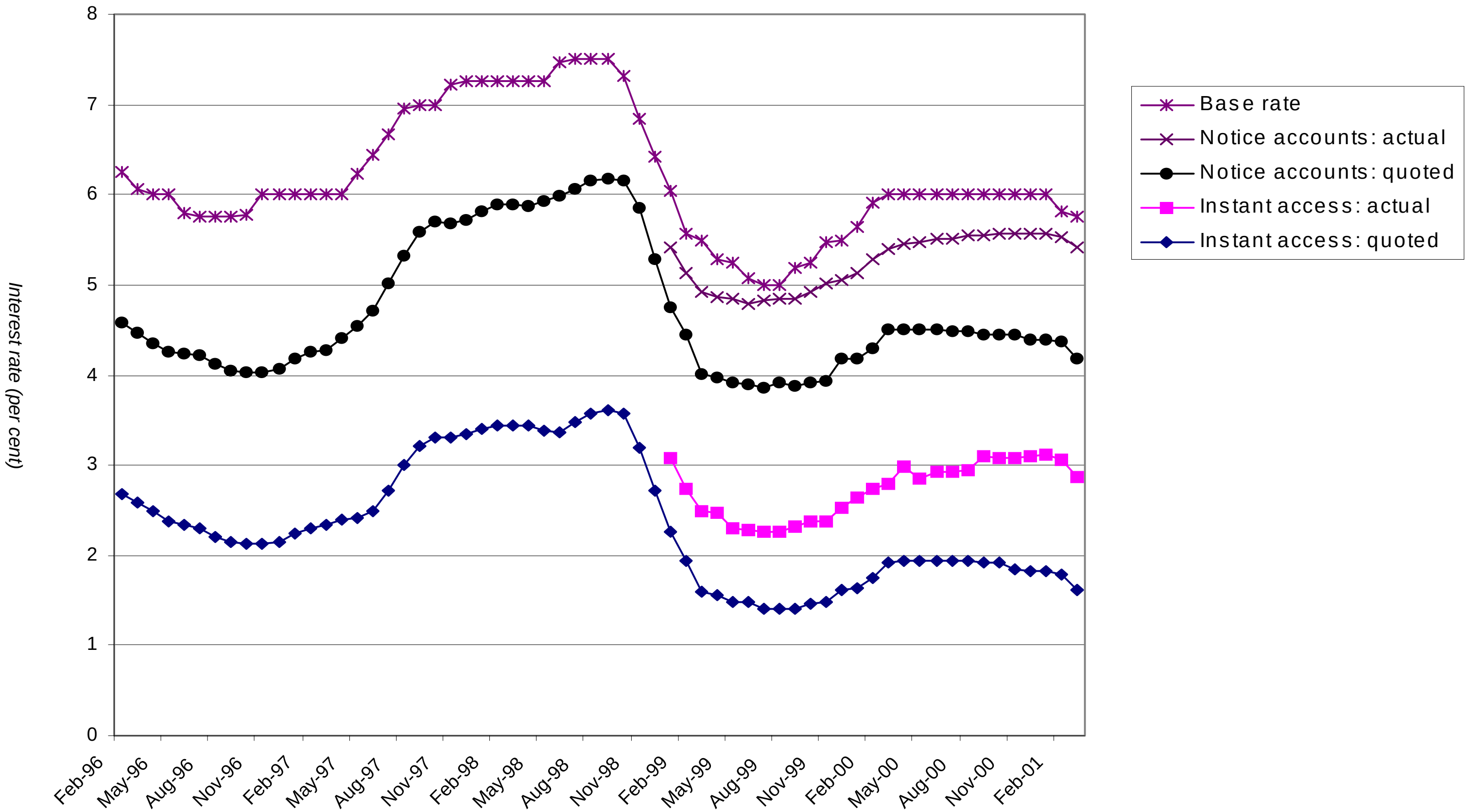
]

4.91. Figure 4.3 shows weighted average interest rates on savings accounts over time. Average actual rates (for which data are available since January 1999), which reflect all accounts including postal

[1] *Money£acts*, May 2001. The eSaver rate includes a 1 per cent bonus for the first six months.

FIGURE 4.3

Weighted average interest rates on savings accounts



Source: Bank of England.

Note: Quoted instant access rates apply to a balance of £1,000 and quoted notice accounts apply to balances of £10,000 in a 90-day notice account. Quoted rates reflect actively marketed branch-based accounts only and are weighted by outstanding deposits at the end of the month. Actual interest rates are computed from interest paid and average daily balances during the month for all notice and instant access accounts respectively.

and telephone accounts, are higher than quoted rates which reflect only branch-based accounts. Interest rates have moved broadly in line with base rate.

Mortgages

4.92. A mortgage is a loan secured on a property. In this section we are concerned with mortgages held by the personal sector, that is, loans secured on residential properties. At the end of 2000 there were about 11.2 million UK mortgages,[1] which represents about 45 per cent of the total number of UK households.

4.93. The products currently on offer may differ in a number of respects:

(a) Monthly payments may be calculated on a repayment basis (level payments covering both interest and repayment of principal) or an interest-only basis (which leaves the borrower with the responsibility of providing the funds to repay the mortgage at the end of the term).

(b) Interest rates may be fully variable (at the lender's discretion) or fixed for a period, usually one to five years, after which they revert to a variable rate. In some cases the variable rate is linked to base rate: the CAT standard is for mortgage rates to be no more than 2 per cent above base rate. Interest rates may also be capped for a period.

(c) Some mortgages are flexible in that they allow the borrower to make overpayments and under-payments and to have payments holidays and in some cases loans (subject to possible limits on the total value of the loan): the mortgage account may then be used instead of a savings account or an unsecured loan. This may be attractive to some consumers as mortgage interest rates tend to be more favourable (higher than on savings accounts and lower than on unsecured loans). There are also mortgage accounts offering the facilities of a PCA.

4.94. Unlike PCAs and savings accounts, mortgages are marketed both directly to consumers and through intermediaries (who may receive commission), of which there are about 10,500 who have agreed to abide by the Mortgage Code.[2] In the first six months of 2000, about 40 per cent of total mortgage lending was through intermediaries, with 49 per cent through lenders' branch networks, 8 per cent through telephone/postal/Internet means and 3 per cent other.[3] Table 4.15 suggests that financial advisers are the most important type of intermediary followed by estate agents.

TABLE 4.15 **Method of first approach to mortgagors, 2000**

	%
Financial adviser	25
Estate agent	7
Insurance company	2
Solicitor	2
Mortgage company/broker	1
Employer	1
Total: intermediaries	38
Total: direct approach	56

Source: CML annual housing finance survey.

Note: Remaining percentage either 'Don't know' or 'Don't know/someone else arranged it'.

4.95. Most lenders supply mortgages through more than one channel (see Table 4.16). 86 per cent of lenders supply through intermediaries and 79 per cent have a branch network.

[1]CML.
[2]Mortgage Code Compliance Board figures for April 2000.
[3]CML survey of lenders carried out in November 2000.

TABLE 4.16 **Distribution channels used by lenders, 30 June 2000**

per cent

	All lenders	*Lenders with branch network*
Branch network	79	-
Telephone	57	47
Postal	43	33
Internet	23	17
Intermediary	86	70
Other	7	4
No others	-	9

Source: CML.

Note: The table shows the percentage of lenders supplying mortgages through each channel, not the percentage of customers using each channel.

Market shares

4.96. As with savings accounts, there are a large number of providers of mortgages: *Money£acts* (May 2001) lists 113 (not all of these are independent: for example, Cheltenham & Gloucester and Lloyds TSB Scotland are listed separately). Table 4.17 shows estimated market share by number of accounts. Abbey National is currently the second largest provider and Lloyds TSB the third largest: their combined share of 22.6 per cent is slightly more than that of the Halifax (20 per cent). The effect of the merger would be to increase the four-firm concentration ratio from 51 to 58 per cent and the HHI from about 860 to about 1,110.

TABLE 4.17 **Trend in residential mortgage market share and HHI, Great Britain, 1995 to 2000**

per cent

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*Notional post-merger*
Barclays*	3.1	3.0	3.0	2.9	3.3	7.7	7.7
HSBC	1.9	1.8	2.0	2.1	2.1	2.4	2.4
Lloyds TSB	8.0	9.0	9.1	9.0	8.9	9.4	22.6
NatWest†	2.8	3.1	3.1	2.9	2.9	4.3	4.3
Abbey National	15.5	14.6	14.2	13.6	12.9	13.2	
Alliance & Leicester	4.5	4.6	4.6	4.2	4.3	4.2	4.2
Halifax	23.2	23.1	22.9	21.8	21.4	20.0	20.0
Nationwide	8.0	7.7	7.8	8.4	8.1	8.1	8.1
Woolwich	4.9	5.0	4.9	4.9	4.8		
Others	28.1	28.1	28.4	30.2	31.3	30.7	30.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total: big four banks	15.8	16.9	17.2	16.9	17.2	23.8	37.0
Four-firm concentration ratio	54.7	54.4	54.0	52.8	51.3	50.7	58.4
HHI (number)	999	990	968	909	871	861	1,109

Source: FRS [*Details omitted. See note on page iv.*].

*2000 figures include Woolwich.
†2000 figures are for RBS Group.
Note: Market shares reflect shares of all banks and joint ventures within the group (eg NatWest 2000 share includes Virgin). Because of sampling variation, market shares may not be accurate to the one decimal place shown.

4.97. Alternative estimates of market share based on value of balances (see Table 4.18) are similar.

TABLE 4.18 **Value of residential mortgages, UK, 1996 to 2000**

£ billion

	1996	*1997*	*1998*	*1999*	*2000*	*Notional post-merger*
Value of end-year balances						
Total for all providers	409.6	431.6	456.7	494.4	534.5	
Lloyds TSB	36.8	39.4	43.4	46.2	51.4	
Abbey National	57.6	58.3	59.7	61.8	64.7	
						per cent
Shares of total						
Lloyds TSB	9.0	9.1	9.5	9.3	9.6	21.7
Abbey National	14.1	13.5	13.1	12.5	12.1	

Source: Bank of England, Lloyds TSB and Abbey National.

Entry and switching

4.98. As with the savings market, the need for brand recognition and a branch network may be a deterrent to entry. However, the importance of intermediaries in marketing mortgages to house buyers may reduce the significance of these factors.

4.99. Consumers potentially incur costs when switching mortgages: these include valuation fees and legal fees and also, in some cases, fees charged by lenders for redeeming a mortgage (the CAT standard states there should be no such fees). In addition, dislike of hassle and general inertia may be factors discouraging switching. Nevertheless monthly mortgage payments are an important cost for many consumers and there appears to be a higher level of switching than in some other personal banking markets. The DTI survey suggested that around 12 per cent of consumers had switched mortgage in the previous five years (see Table 4.9). Data on the rate of remortgaging (see Table 4.19) suggests the annual rate has increased rapidly over time to reach 7 per cent of the value of all mortgages outstanding in 2000. This increase has continued in the first three months of 2001 (which show a 23 per cent increase on the comparable period of 2000). The remortgaging data in Table 4.19 suggest a higher level of switching than the DTI survey data: one possible reason for this is that the largest mortgages are more likely to be switched. In 2000 remortgaging accounted for about 28 per cent of all mortgage advances and this increased to 34 per cent in the first three months of 2001.

TABLE 4.19 **Remortgaging compared with mortgages outstanding, 1996 to 2000**

£ billion

	1997	*1998*	*1999*	*2000*
Mortgages outstanding (start of year)	409.6	431.6	456.7	494.4
Remortgages in year	12.9	23.0	27.8	34.0
Remortgages (%)	3.1	5.3	6.1	6.9

Source: Bank of England; CML.

Note: Remortgaging total is approximate. Remortgaging in 1997 seems to have been low: 1995 and 1996 totals were higher.

4.100. The clearing banks entered the mortgage market in the 1970s: Lloyds TSB and Barclays subsequently increased their market share by acquiring former building societies. More recent entrants to mortgage lending are in many cases similar to entrants into the savings market. They include Prudential (both through Prudential Banking and Egg), Standard Life, Norwich Union (which, however, does not sell directly, only through intermediaries), Direct Line, Legal and General and Scottish Widows (now part of Lloyds TSB). Sainsbury has entered the mortgage market but Tesco has not done so. The most successful entrant according to FRS figures was Standard Life which obtained 1.3 per cent of new accounts in 1999 and 2.0 per cent in 2000.

Prices and competition

4.101. It was noted above (paragraph 4.61) that the existence of switching barriers and costs may lead to strong competition for new customers, both switchers and first-time customers, but to higher prices for existing customers. This pattern is seen clearly in the mortgage market: lenders routinely make special offers available to new borrowers that are not available to their existing borrowers (except when moving home, when inertia and concerns about hassle are not relevant). In addition switchers' valuation fees and legal costs may be paid by the incoming lender.

4.102. Such special offers take the form of attractive fixed rates or reductions on the lender's standard variable rate for a period (usually one to five years). During the period of the special offer (and occasionally beyond), redemption penalties are usually imposed on borrowers redeeming the mortgage for reasons other than moving house.

4.103. Within the last 12 months some lenders, in particular HSBC and more recently Nationwide, have reduced rates to existing borrowers while cutting back on special offers to new customers. Some other lenders, including Halifax and Abbey National, have also offered reduced rates to existing customers but only if the customer makes a request. Abbey National told us it was in the process of writing to all customers to offer them a financial review.

4.104. Figure 4.4 shows trends in the weighted average interest rate on mortgages compared with base rate. The average standard variable rate paid by most existing customers has been well above the average rate paid by new borrowers on a variable rate. The average variable rate to new borrowers has in recent months been similar to base rate. Data on the average rate paid by all borrowers (including both new and existing borrowers and those on fixed as well as variable rates) is available since January 1999. During this period the spread between the average mortgage rate and base rate has declined slightly: this appears to be the result of the increase in remortgaging which has meant a higher proportion of borrowers are on the relatively low rate for new borrowers and a lower proportion are on the relatively high standard variable rate.

Other personal financial services markets

Other personal loans

4.105. This market includes unsecured loans and also loans secured on personal assets other than residential property (principally vehicles). Table 4.1 suggests that Lloyds TSB has about 12 per cent and Abbey National about 6 per cent of the total market. On the basis of end-year balances, Lloyds TSB's share was about 13 per cent and Abbey National's share was 8 per cent. The market as a whole is not concentrated.

4.106. Unsecured loans are usually sold direct to customers either at bank branches or by telephone, post and Internet. Competitors include other traditional banks, some building societies and newer banks and other lenders, including the Automobile Association, Marks & Spencer, Prudential, Sainsbury and Tesco.

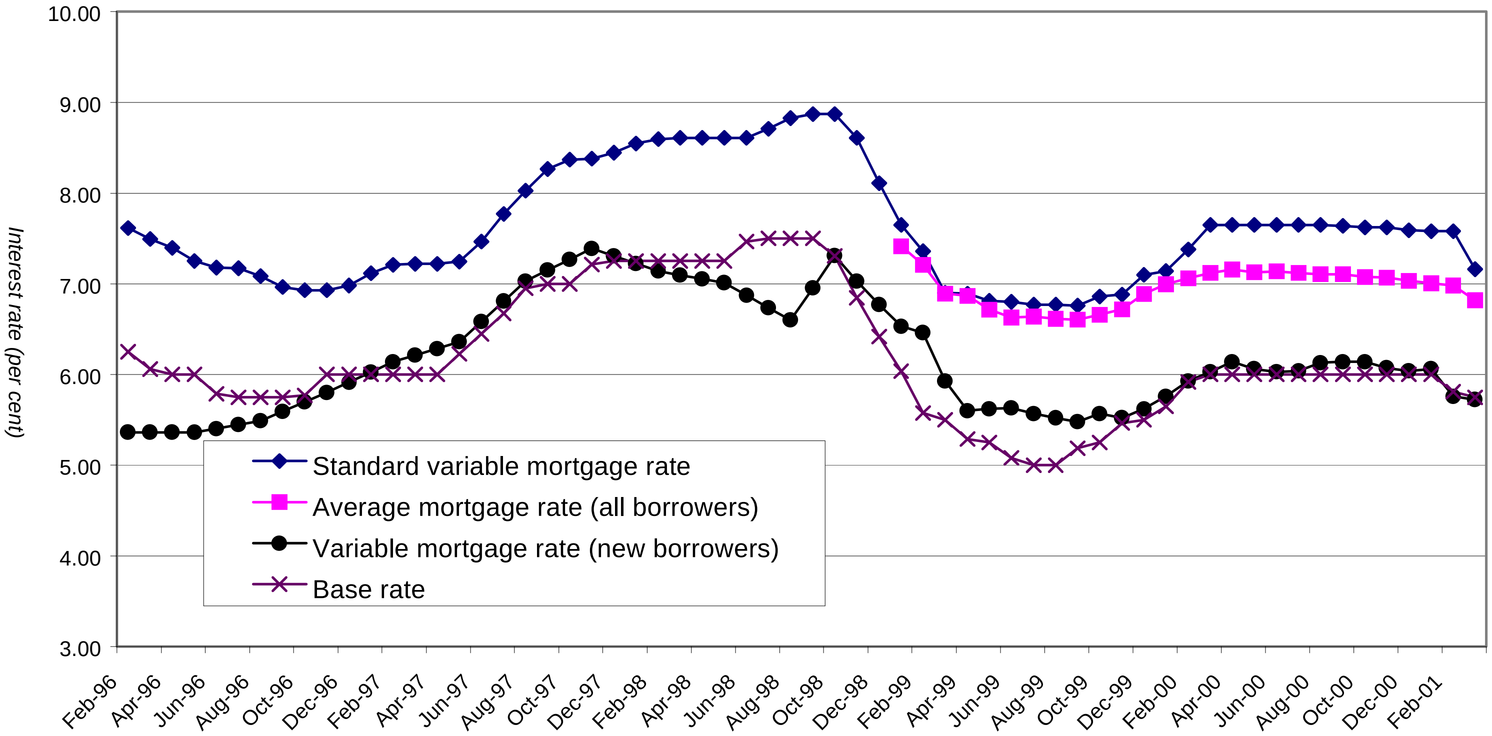
4.107. Secured car loans are usually sold by car dealers to their customers. The car manufacturers have a major role in providing such loans for new and used car sales by their own dealers. Lloyds TSB (through Lloyds UDT and Chartered Trust) and Abbey National (through First National) are the largest independent providers of point-of-sale loans (ie providers that are independent of the car manufacturers). We were told by Abbey National that the next largest independent providers were GE Capital and BoS (through Capital Bank). We were also told that this market segment was very competitive and the other traditional banks had recently exited, presumably because of losses. We note that it would be relatively easy for them to re-enter if it was profitable to do so and that secured point-of-sale loans face competition from unsecured loans.

Credit cards

4.108. Credit cards are used by personal customers both as a source of finance and a means of payment to retailers (retailers receive the amount paid by the customer less charges levied by the card issuer and their own merchant acquirer but are able to surcharge the customer for using a credit card—in practice few retailers do this).

FIGURE 4.4

Weighted average interest rates on mortgages



Source: Bank of England, CML.

Note: Standard variable rates are computed by the Bank of England on the basis of rates to existing borrowers weighted by the existing mortgage book. Average rates are computed by the Bank of England from interest received and average daily balances during the month and reflect rates paid by all borrowers. Variable mortgage rates to new borrowers are computed by CML.

4.109. Table 4.1 suggests that Lloyds TSB's share of the number of credit cards in 2000 was about 14 per cent; Lloyds TSB was the third largest credit card provider after Barclays and RBS Group. Abbey National had a share of only about 2 per cent of the number of cards in 2000. On the basis of end-year balances, both companies' shares were lower: Lloyds TSB's share was 9 per cent and Abbey National's share 1 per cent. The lower share of end-year balances than number of accounts may reflect a number of factors including a higher than average proportion of inactive accounts and a concentration of customers with below-average credit outstanding balances.

4.110. During the course of our inquiry, Abbey National sold its credit card business to MBNA. MBNA will continue to market an Abbey National branded card and, as part of the deal, will pay fees to Abbey National on the basis of issuance and usage of Abbey National branded cards.

4.111. The share of credit card accounts held by the traditional banks has declined from 82 per cent in 1995 to about 70 per cent in 2000 (this figure includes the shares of Sainsbury's Bank (1.1 per cent) which is a joint venture with BoS, and the banking arm of Tesco (2.1 per cent) which is a joint venture with RBS Group). Similarly, the share of the big four has declined from 73 to 61 per cent over these five years. New entrants have been more successful in the credit card market than in other personal banking markets: the most successful on FRS figures are MBNA (5.6 per cent of the number of accounts in 2000 before its acquisition of Abbey National's credit card business); HFC Group, which issues the Goldfish card, (4.9 per cent); and Capital One (3.2 per cent). All these are US-owned.

4.112. The majority of credit cards offer an interest-free period and charge interest after that period has expired. Most credit card issuers now offer very low interest rates on balance transfers to encourage switching by those customers who do not pay their bills in full. Average credit card interest rates have declined from 17.9 per cent in January 1999 to 15.2 per cent in March 2001[1] despite little change in the base rate over this period. This decline reflects both offers to switchers and declines in quoted rates. Few credit card issuers now charge annual fees.

Insurance and investment products (including pensions)

4.113. Lloyds TSB and Abbey National make sales of insurance and investment products both through their branches and through intermediaries. Some of these products may be cross-sold from banking products, for example household insurance from mortgages. The markets are not concentrated and the combined market share of Lloyds TSB and Abbey National is about 12 per cent in life assurance and less than 10 per cent in other products.

SME markets

4.114. In this section, we consider banking products marketed to SMEs. Small SMEs may use personal banking products (for example, PCAs) for business purposes: such use is included in the personal market concerned.

4.115. As noted above (paragraph 4.18), the CC is currently investigating the supply of banking services to SMEs. The CC has made public statements concerning this inquiry on 8 November 2000 (issues letter), 6 March 2001 (provisional conclusions statement) and 21 March 2001 (hypothetical remedies statement). Extracts from these statements are shown in Appendix 4.4.

4.116. There is no widely accepted definition of an SME. Table 4.20 shows the definitions used by DTI and the European Commission and in the Companies Act 1985. In its provisional conclusions statement the CC Group carrying out the SME monopoly inquiry defined SMEs as those enterprises having annual turnover up to £25 million. This is broadly similar to the definition used by the European Commission at the exchange rates between the pound and the euro prevailing in 1999 and 2000. We have used the same definition.

[1]Weighted average actual interest rates calculated by the Bank of England.

TABLE 4.20 **Definitions of SMEs**

Source	*Criteria used*	*Classification of SME*		
		Micro	*Small*	*Medium*
DTI	Number of employees	0–9	0–49	50–249
European Commission*	Number of employees	Max 10	Max 50	Max 250
	Turnover	N/A	Max €7m	Max €40m
	Balance sheet	N/A	Max €5m	Max €27m
	Independence criteria†	N/A	25%	25%
Companies Act 1985‡	Number of employees		Max 50	Max 250
	Turnover		Max £2.8m	Max £11.2m
	Balance sheet		Max £1.4m	Max £5.6m

Source: DTI and European Commission.

*Both the employee and the independence criteria must be satisfied and either the turnover or the balance sheet total criteria. Using the average £:€ exchange rate in 1999 and 2000, the turnover ceilings for small and medium firms are £4.4 million and £25.3 million respectively and the balance sheet ceilings are £3.2 million (small) and £17.1 million (medium).

†Refers to the maximum percentage that may be owned by one enterprise, or jointly owned by several enterprises, not satisfying the same criteria.

‡Has to meet two of the three criteria in any year.

Note: N/A = Not applicable.

Products and market definition

4.117. The banking products supplied to SMEs are broadly similar to those supplied to personal customers: current accounts, deposit accounts, secured lending and unsecured lending all play a role. Differences include the following:

(a) Current account SME customers usually have access to a relationship manager who provides advice and support; in most cases, relationship managers are regionally rather than branch based.

(b) Credit cards play a lesser role in the SME sector.

(c) As in the personal sector, loans may be secured on property (commercial mortgages) and vehicles, but they may also be secured on other business assets such as plant and equipment.

(d) SMEs have additional sources of finance in factoring and invoice discounting. Factors purchase the sales invoices of SMEs and obtain income by collecting debts from the SMEs' customers: as a result, SMEs obtain cash earlier (a source of finance) and are saved the trouble of administering the sales ledger and collecting debts. Invoice discounting is similar but does not include administration of the sales ledger.

(e) For some SMEs, especially in retailing, access to bank branches is very important for depositing cash.

SME banking products, like personal banking products, may be delivered through one or more channels comprising branches, telephone, post and Internet.

4.118. The CC provisional conclusions statement identified four relevant markets:

(a) a liquidity management services market that includes business current accounts together with short-term bank business deposit accounts and overdraft facilities when provided in conjunction with business current accounts;

(b) a market for general purpose business loans supplied by banks or other lenders to SMEs;

(c) a market for other types of business loans to SMEs which can be segmented into, inter alia, invoice discounting and factoring, hire purchase, leasing and other asset finance including commercial mortgages; and

(d) other business deposit accounts held by SMEs.

4.119. It also stated that there were separate geographical markets (in England and Wales; Northern Ireland; and Scotland) for the markets of liquidity management services and general purpose business loans, but that the markets for other types of business loans and other business deposit accounts were UK-wide. Lloyds TSB does not offer liquidity management services and general purpose business loans to SMEs in Northern Ireland and, as for PCAs, we concentrate on Great Britain. In the circumstances of this inquiry, we have not found it necessary to carry out a separate assessment of the England and Wales market from that in Scotland.

Market shares

4.120. Lloyds TSB provides a full range of banking products to SMEs. Abbey National provides some of the products mentioned above:

(a) It markets a current account to sole traders and two-person partnerships: Abbey National told us this would be extended to limited companies in September 2001 (with a pilot starting in June 2001). This account does not at present provide overdrafts or branch access: transactions can be made via Abbey National ATMs as well as by post, telephone and Internet. (Abbey National also offers, on a trial basis for a very small number of customers, access through post offices.)

(b) It markets a short-term no-notice deposit account to all SMEs.

(c) It provides factoring and invoice discounting to SMEs.

(d) It provides a variety of asset financing products to SMEs both directly and indirectly (through intermediaries and also through dealers, manufacturers and brokers which supply vehicles and equipment to SMEs).

Abbey National introduced current and deposit accounts in 1997 as a diversification from personal banking products. Its services in factoring, invoice discounting and asset financing are provided through First National (see paragraph 3.40), a finance house which it acquired in 1995.

4.121. Table 4.21 shows market shares based on market research of the proportion of SMEs (with annual turnover up to £1 million) for which each operator is the main business bank. The share of the big four in Great Britain is about 85 per cent and the share of all traditional banks is over 90 per cent. The traditional banks' share of SME accounts is higher than their share of PCAs, reflecting the lesser impact of building societies and former building societies in SME markets. Lloyds TSB's share among SMEs with turnover up to £1 million is about 20 per cent but its share of the market for larger SMEs is lower as is its share of total income from SMEs. Abbey National's share of accounts among SMEs with turnover up to £1 million is about 1 per cent. As Abbey National's share is concentrated among the smallest SMEs, its share of income will be lower.

TABLE 4.21 **Main business bank of SMEs, 1997 to 2000, Great Britain**

				per cent
	1997	*1998*	*1999*	*2000*
SMEs with turnover up to £1m				
Barclays	21	21	21	21
HSBC	13	15	15	15
Lloyds TSB	18	18	19	19
NatWest*	26	25	23	29
RBS	6	6	6	
BoS	3	4	4	4
NAB	5	5	5	5
Abbey National	1	1	1	1
Alliance & Leicester	2	1	2	1
Co-operative Bank	1	2	2	1
Nationwide	†	†	1	1
Others	4	2	1	3
Total	100	100	100	100
Total: big four	78	79	78	84
Total: all traditional	92	94	93	93
HHI (number)	1,686	1,698	1,642	1,912

Source: City Research Associates data on number of accounts (supplied by Lloyds TSB).

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*2000 figures are for RBS/NatWest.
†Less than 0.5 per cent.

4.122. Abbey National has stated publicly its ambition to achieve a 5 per cent share of the number of business banking customers by 2005. [

Details omitted. See note on page iv.

]

4.123. We estimate that total net income earned from all SME banking in 1999 was about £7 billion and that Lloyds TSB's share was about 16 per cent and Abbey National's share less than 1 per cent.

Entry and switching

4.124. Barriers to entry into SME markets are in some respects similar to those affecting personal markets. As far as SME current accounts are concerned, all the requirements mentioned in paragraph 4.46 are relevant to SMEs. We note in addition the following points:

(a) Some SMEs need to make frequent deposits of cash and/or cheques at their bank and, for these SMEs, local branch access is likely to be of particular importance.

(b) The role of local post offices as alternatives to local branches is constrained to some extent by an exclusive agreement between the Post Office and Alliance & Leicester (arising out of Alliance & Leicester's acquisition of Girobank).

(c) The availability of overdrafts and/or loans is important to many SMEs and the offering of these products requires specialized skills, associated with credit risk assessment, which an entrant would need to have or obtain. (Lloyds TSB and others pointed out that this was not necessarily a significant barrier since relationship managers with these skills could be recruited from existing market participants.)

(d) Information for credit scoring of SMEs is less readily available than that for credit scoring of persons. This may represent a particular difficulty since entrants are at risk of acquiring the most risky customers (those rejected by existing suppliers will have most incentive to apply to new entrants).

4.125. Switching barriers (see paragraph 4.63) are as relevant to SME as to PCA customers. Inertia may be a less important factor for SMEs since, unlike personal customers, most pay transactions costs (see paragraph 4.130) and any potential benefit from switching is therefore more visible. On the other hand, SMEs are likely to attach more importance to a continuing relationship with their bank than do personal customers and this would discourage switching. Product comparisons are likely to be more difficult for SMEs because of the greater complexity of the products and the element of negotiation that affects prices (see paragraph 4.130).

4.126. The rate of current account switching is higher for SMEs than personal customers (the BMRB International survey for the CC monopoly inquiry suggested that 5.5 per cent of SMEs had switched bank in the last year and 12 per cent in the last three years while the Cruickshank report suggested annual switching of 3 to 4 per cent).

4.127. The rate of opening and closure of SMEs is such that the average life span of an SME is only about eight years. This potentially gives more opportunity for entrants to acquire new SMEs than personal customers without incurring the costs and difficulties associated with switching. However, around two-thirds of new SMEs open their first business account at the bank where the principals have their personal account: this puts entrants at a disadvantage compared with banks with a large share of the personal market.

4.128. Entry barriers are most significant in the short-term liquidity management market and the general purpose business loans market (which tend to be closely linked since SMEs look in the first instance to their main bank for a general purpose loan). Local branches and access to credit information are less important in the other markets identified in paragraph 4.118: with the products concerned (factoring, invoice discounting, asset financing, deposits with notice periods) there is no need for SMEs to deposit cash and cheques at a local branch, while the advances involved are secured on cash flow or assets.

4.129. There has been very little entry into the liquidity management and general purpose business loans markets: as noted above, the traditional banks retain over 90 per cent of SMEs' main business accounts. Apart from Abbey National (which offers current and short-term deposit accounts but not at present overdrafts or term loans), entrants have included Citibank (which was unsuccessful and exited); Fleming Premier Banking (currently owned by J P Morgan Chase but in the process of being sold to Abbey National); and Nationwide (whose 'BusinessInvestor' account offers a business cheque book but has no overdraft facility). Bank of Ireland and Bank of Cyprus have expanded beyond their original customer bases of Irish and Cypriot nationals: the Cruickshank report stated, however, that, whilst they were successful niche players, neither had made a significant impact on the market position of the big four. Alliance & Leicester, which entered the market through acquisition of Girobank (see paragraph 4.30), has recently expanded its products: during the second half of 2000 it launched a new current account aimed at smaller businesses (with turnover of less than £0.5 million) which it had not targeted before, and started to offer overdrafts and loans. Halifax does not at present have a business current account with full money transmission facilities. However, it has indicated that, if its merger with BoS proceeds, it will compete aggressively for SME business.

Prices

4.130. Most traditional banks, including Lloyds TSB, do not generally pay interest on credit balances in SME current accounts and they also levy transaction charges, which are summarized in Table 4.22. Interest rates on authorized overdrafts are in most cases subject to negotiation and not published, as are the terms for other products.

TABLE 4.22 **Published transmission charges on SME current accounts, 2000**

		Pence per transaction						*£ pa*	*Pence per £100*	
Company	*Account name*	*DD*	*S/O*	*Auto credit*	*Chq in*	*Chq out*	*Non-auto credit*	*Standing charges*	*Cash in*	*Cash out*
Branch-based										
Barclays	Small Business*	45	45	45	0	64	64	30	0	0
Barclays	Business†	35	35	15	25	54	75	0	50	57
HSBC	Small Business*	35	35	35	0	60	60	30	0	0
Lloyds TSB	Small Business‡	66	66	66	0	66	66	42	0	0
Lloyds TSB	Business Extra	42	59	15	27	59	70	30	50	50
NatWest	Small Business*	40	40	40	0	67	67	30	0	0
NatWest	Business†	40	40	22	28	67	95	69	49	57
Alliance & Leicester	Flat Fee Account*	0	0	0	0	0	0	120	0	0
BoS	Business Current	32	47	32	20	47	47	0	63	58
Co-operative Bank	Business	40	40	20	28	60	70	60	55	55
Nationwide	BusinessInvestor	0	0	0	0	200§	0	0	0	0
RBS	Business Current (England, Wales)	40	43	25	25	55	64		49	53
RBS	Business Current (Scotland)	31	45	27	19	46	46	0	61	59
Clydesdale	Current	21	47	32	20	47	47	0	61	61
Yorkshire Bank	Small Business*	37	37	37	53	15	37	36	25	25
Yorkshire Bank	Business Tariff†	35	35	20	75	28	75	0	50	50
Direct										
Abbey National¶	Business	0	0	0	50	50	0	0	0	0
Alliance & Leicester	Direct	65	65	65	0	65	65	0	65	43
Alliance & Leicester	Business Plus	40	25	25	13	60	0	0	50	43
BoS	Direct	0	0	0	0	40¤	0	0	N/A	N/A
Co-operative Bank	Business Direct#	17	17	0	0	23	0	36	0	0
Fleming Premier	Corporate**	50	50	50	50	50	50	0	0	0
Fleming Premier	Investment††	50	50	50	50	50	50	0	0	0
RBS	Direct	20	20	20	20	20	20	0	N/A	N/A

Source: *Business Money£acts*.

*Turnover under £100,000.
†Turnover over £100,000.
‡Not open to new customers. Continues to be available to existing customers. Criterion for opening was turnover under £100,000.
§First six transactions a month are free.
¶First 25 cheque withdrawals and first 25 cheque deposits a month are free; then each additional withdrawal/deposit costs 50p.
#Cheque withdrawals and automated debits cost 70p each if balance is less than £2,000; after £4,000 a month (ie 40 entries per month) of cash deposited, cash is charged at 75p per £100 deposited; after 200 cheques a month, each cheque deposited is charged at 20p.
¤First 100 cheques are free per month if credit balance is greater than £5,000.
**200 free entries per month then 50p per entry. If the balance of the account is less than £5,000 when the monthly statement is prepared, there is a charge of 50p for each transaction.
††20 free entries a month then 50p per entry.

4.131. Abbey National's Business Bank Account pays interest on credit balances as do some other providers of non-branch-based current accounts (including Co-operative Bank and Fleming Premier) and Nationwide's branch-based account. As shown in Table 4.22, Abbey National does not charge for automated transactions nor for the first 25 cheque withdrawals and cheque deposits per month.

4.132. Most banks do not charge start-up SMEs for transactions for an initial period: around 20 per cent of traditional banks' SME customers consequently benefit from free banking.[1] Some banks (including Barclays and HSBC) make similar offers to switchers, and SME customers considering switching accounts may be able to negotiate a similar deal with their existing bank. Lloyds TSB told us that, whilst it did not have a general offer of free SME banking to switchers, its account managers had discretion to offer concessions on charges.

[1]Provisional conclusions statement of CC SME monopoly inquiry.