

ADVISER

RISK IMPLICATIONS OF THE CMA RETAIL BANKING MARKET INVESTIGATION

BACKGROUND

In November 2014, the Competition and Markets Authority (CMA) announced its decision to launch a thorough investigation into the personal current account (PCA) and small to medium-sized enterprise (SME) retail banking markets. This was motivated by concerns that:

- Shopping around and switching levels were low.
- Comparisons were difficult, particularly for overdraft customers.
- There were significant barriers to entry and growth for smaller banks.
- There had been limited change in the market shares held by the four largest banks.

The CMA consulted with retail banks of varying sizes throughout the investigation and sought specialist input from regulators, government departments, academics, consultants, and the FinTech sector.

The CMA published its final report in August 2016. The report defines the areas it feels are not competitive enough and sets out the remedies it is enforcing to change the market for the better.

“Effective competition in retail banking is critically important for individual bank customers, small and medium-sized businesses, and the wider economy.”¹

Alex Chisholm, CMA Chief Executive

THE PROBLEMS

The CMA identified key problems that were inhibiting competition in PCA and SME retail banking:

- Personal and business current accounts were found to have charging structures that were difficult to interpret, including variations depending on how they were used. This was particularly evident for overdrafts.
- Personal and business current account customers lack trigger points to review the market.
- Although the Current Account Switching Service (CASS) has made it easier for customers to switch current accounts, awareness and confidence in the service remains low.

- More than half of new start-up businesses open a business current account with their personal account provider. A total of 90% of small businesses get their business loans from their main bank with little or no shopping around.

Given these problems, the CMA concluded that many personal and small business current account customers must struggle to see value in dedicating time to ensuring they are getting the right product for them. In turn, this makes it difficult for smaller banks to attract new customers, slowing their expansion and restricting competition.

THE REMEDIES

The CMA has set out a package of remedies based on the following three foundation measures:

- An open banking standard.
- Service quality information.
- Customer prompts.

While the CMA accepts its package of measures are ambitious and retail banks will incur significant implementation costs, it clearly states its belief that the benefits to customers will be more than proportionate.

¹Alex Chisholm on the role of competition in banking markets, available at: <https://www.gov.uk/government/speeches/alex-chisholm-on-the-role-of-competition-in-banking-markets>, accessed 15 December 2016.

What are Application Programming Interfaces (APIs)?

APIs enable different pieces of computer software to exchange information behind the scenes in a structured and consistent format. Open (or public) APIs are interfaces that enable third-party software developers to access certain functions and features of proprietary software.

Open APIs in action

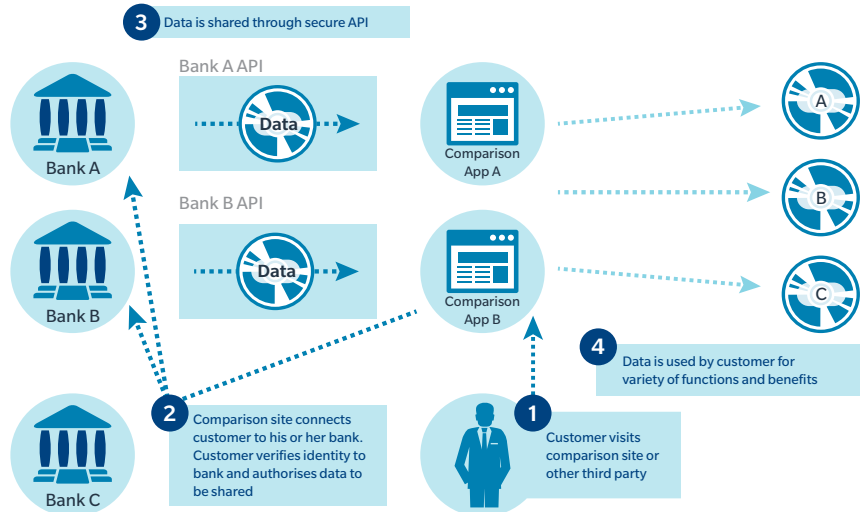
- Amazon publicly offers a product API, which enables third parties to advertise Amazon products on their own websites.
- Facebook publicly offers a login API, which enables third parties to give their customers the option to login using their Facebook credentials.

AN OPEN BANKING STANDARD

The introduction of an open banking standard is aimed at fast-forwarding technological improvements in the retail banking market to improve customers' ability to compare accounts and providers. The CMA is requiring the largest banks in Great Britain and Northern Ireland² to work towards a standard way of releasing customer data to third parties. It has chosen to do this on the basis that third parties could use this to provide information and comparison services that are personalised to each customer (see FIGURE 1). The largest banks must work together to create a standard format for their APIs.

This is so that if a banking customer has multiple accounts with multiple providers, software providers are able to easily unite data from all of these sources in one application as it is in the same format.

FIGURE 1
APIs: The Process for the Customer



App designers can design apps to work with individual bank APIs

Source: gov.uk (HM Treasury Consultation)

This data can then be used to produce services that benefit banking customers, including:

- Easy authorisation of transfers between accounts to avoid overdraft charges or to benefit from better interest rates elsewhere.
- Comparison services that require little or no data entry and are tailored to each customer's own banking patterns.
- Forecasting of cash flow to ensure banking customers avoid overdraft charges and manage their money effectively.
- Combine SMEs' transaction histories to allow lenders other than their main bank to reliably assess their creditworthiness.

SERVICE QUALITY INFORMATION

The CMA is mandating that all banks² release core indicators of service quality based on customers' willingness to recommend their services to friends, family, or colleagues. The CMA expects banks to begin publishing these core indicators by Q3 2018. Data must be collected annually and published every six months, including through their APIs for use in comparison services.

The CMA has also recommended that the Financial Conduct Authority (FCA) requires PCA and business current account (BCA) providers to publish additional service quality indicators that reveal more about the service they offer on their various lending products and delivery channels. Examples of these include:

- Interruptions to, and unavailability of, services.
- Performance of call centres.
- Availability of (services in) branches.
- Complaints handling.

There is a possibility that, at the FCA's discretion, these additional service quality indicators may be extended further to include metrics such as the number of bank employees that hold a relevant qualification and statistics on cyber security breaches.

² Royal Bank of Scotland Group (RBSG), Lloyds Banking Group (LBG), Barclays, HSBCG, Nationwide, Santander, Danske, Bank of Ireland (BoI), and Allied Irish Banks Group (AIBG).

CUSTOMER PROMPTS

The CMA has raised concerns that, unlike financial products such as insurance that have a natural break at renewal, bank accounts have no significant prompts that might encourage banking customers to shop around.

To ensure that customers are encouraged to review their banking arrangements, the CMA has ordered all banks³ to introduce occasional reminders (“prompts”). The CMA has enlisted the help of the FCA in conducting research into the prompts that are most effective in encouraging positive behaviour among banking customers. The FCA will then work with banks to ensure these prompts are implemented. This work is expected to commence by Q1 2017.

OTHER REMEDIES

- Increasing the scope of services offered by the Current Account Switching Service (CASS) to make switching even easier.
- Requiring banks to alert customers when they go into an unarranged overdraft, inform them of a “grace period” to avoid recurring charges, and set a ceiling on unarranged overdraft charges. The FCA is tasked with conducting research to ensure these measures are effective and looking into the effectiveness of current account opening processes in communicating the costs and benefits of overdrafts.
- A package of measures for SMEs, including requiring banks to improve the information available to them.

³ Subject to *de minimis* threshold.

THE IMPLICATIONS

The immediate concern for banks will be ensuring they put plans in place to comply with the orders and undertakings issued by the CMA in line with expectations. The retail banking market has been engaged throughout the investigation, so although many of the remedies will not come as a surprise, it is still important to carefully interpret what needs to be done and by when.

The CMA has also issued recommendations to be followed up by the FCA, HM Treasury, and the Department for Business, Energy and Industrial Strategy. This means banks must be ready to coordinate work on different customer-facing initiatives with multiple government departments and regulators.

Many of the banks involved in the investigation raised concerns about the implementation plan for the CMA's remedies. A key concern was that the deadlines imposed were too tight, particularly given that banks are being asked to release sensitive customer data to third parties while being expected to maintain its security at all times. There is a risk that if banks perceive the deadlines as tight, they may be exposed to cyber and data risks if they feel compelled to proceed at speed.

HOW MARSH CAN HELP

Marsh's Financial Institutions Practice can support the largest banks as they work towards implementing the open banking standard and other remedies. These banks must assess the impact of sharing their data with third parties as part of the open banking standard and manage the risks accordingly. Marsh can ensure that cyber, data, and third-party administration exposures arising from the implementation of this investigation are covered through your insurance programme.

In the same vein, third parties (app developers and other FinTech companies, for example) that choose to process banking data must manage the resulting liabilities. Marsh works with FinTech companies to help them manage the risks relating to technology and the management of financial data as a third party.

While the open banking standard focuses on the largest banks, smaller retail banks should be preparing for a more open and competitive future. The remedies should create opportunities for challenger and start-up banks to expand. Our Financial Institutions Practice is on hand to support these banks as they grow.

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