Banking and competition in the UK economy

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SMF Social Market Foundation

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Kindly supported by

FIRST PUBLISHED BY

The Social Market Foundation, May 2021
11 Tufton Street, London SW1P 3QB

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ACKNOWLEDGEMENTS

The SMF is grateful to Metro Bank for sponsoring this research. The Social Market Foundation retains full editorial independence with respect to its research.

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Before joining the SMF, he was Head of Macroeconomics and a Director at the economics consultancy Cebr, where he led much of the consultancy's thought leadership and public policy research.

Scott's expert insights are frequently sought after in publications including the Financial Times, the Guardian, the Times and the Daily Telegraph. Scott has appeared on BBC News, Sky News, Radio 4 and a range of other broadcast media.

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Aveek Bhattacharya joined the SMF as Chief Economist in September 2020. Prior to that, he was Senior Policy Analyst at the Institute of Alcohol Studies, researching and advocating for policies to reduce alcohol-related harm. He has also previously worked for OC&C Strategy Consultants, advising clients across a range of sectors including retail, consumer goods, software and services.

Aveek studied Philosophy, Politics and Economics at undergraduate level, and has Master's degrees in Politics (from the University of Oxford) and Social Policy Research (from the London School of Economics).

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Richard joined the SMF in August 2019 as senior researcher. Before joining he was a Senior Policy Advisor at the FSB (Federation of Small Businesses) with responsibility for a diverse range of small business policy issues including the small business regulatory environment, data and cyber security, crime and civil justice. Prior to the FSB, Richard was a Policy Officer at the Law Society of England and Wales. He has also held policy and research roles at Which? and the Small Business Research Centre (SBRC) at Kingston University.

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FOREWORD

Dan Frumkin
Chief Executive Officer, Metro Bank

I'd like to thank the Social Market Foundation for its work in this hugely important area.

The UK economy and society as a whole have just been through one of the most challenging periods in recent memory. The COVID-19 pandemic has impacted every community in the country and posed an unparalleled threat to many businesses. Sectors like hospitality, retail and travel have only survived thanks to unprecedented support from government and I am pleased to say the financial services sector has played an essential role in this too.

As we emerge from this pandemic, we must reflect on the conditions we need to ensure a recovery which can enable UK businesses to survive and thrive.

Looking back on the last year, I'm struck by how our community banking model helped us to serve our customers when they needed us most. Our commitment to this model meant that we kept stores open despite the challenges. You need to have a relationship with your customers to understand the pressures they are under and the solutions that will work for them. That's why, often in banking, biggest is rarely best.

We are pleased to partner with the SMF as they look at the state of competition in the UK. As their report identifies, sectors best serve their customers when competition thrives. It breeds innovation, drives down prices, and improves customer services and products.

In the banking sector, we've had far too little competition for far too long. And it shows.

Over the last decade we've been fortunate to see a host of new entrants driving product and customer innovation in the UK, but during that time the dominance of the Big Five banks has only gotten stronger. This structure means that banking customers often forgo better service, rates and product choice because of the lack of competition.

If we want to see real change, we need government and regulators to start a serious conversation about how we can encourage more current and business account customers to switch when they can get better value. We also need to challenge the continued dominance of the Big Five and the unintended consequences of burdensome regulation, such as the proposed capital requirements (MREL), which cements their market share by effectively penalising smaller players. As this report identifies, this is just one of the many challenges mid-tier banks face in delivering greater competition – and better services for consumers.

Over the next year, I want us to have more conversations about how we can create a banking sector that better serves the interests of UK customers and businesses and help us to deliver the best recovery possible.

FOREWORD

James Kirkup
Director, Social Market Foundation

This report goes to the heart of the Social Market Foundation's approach to economic policy and markets. Unlike many others, we are not interested in what ideology and dogma say markets should be and do. We are interested in how markets actually work in reality, especially for the people who use them day after day.

The market is still the best mechanism we have collectively devised to allocate resources, drive innovation and promote human wellbeing and happiness. When they work, markets are a win-win proposition: customers get goods and services, suppliers get revenue and investors (who are increasingly all of us, through pensions and savings) get a fair return. But if markets are the engine of prosperity, competition is the oil that keeps the engine working smoothly. Without competition between suppliers, consumers miss out on lower prices, better services and innovation.

That's not just a loss to them, it's a political problem, since unfair, unbalanced markets and poor consumer outcomes erode faith in the market economy. Too many people who preach about the virtues of the free market fail to take enough account of the fact that not all markets work freely and fairly: where big incumbents can dominate the market, consumers – who are also voters – are unlikely to get the prices and service they want. To people who feel ripped off and let down by suppliers, sermons on the virtues of the market will ring hollow.

So anyone who wants to get a better deal for those consumer-voters should pay more attention to competition. As this report shows, there isn't enough competition in many of the markets that define our day-to-day economic experiences. Sometimes that's because consumers don't shop around enough, but there are reasons for that: switching can seem complicated and even risky, and the benefits of doing so can be unclear in an opaque and over-complex marketplace. And sometimes competition is lacking because policy – perhaps unwittingly – favours established incumbents over the challengers who would like to take away their customers.

Such challenges are good for consumers. We've seen the effect of increased competition in the supermarket sector in recent years: new entrants have made incumbents work harder, squeeze prices and offer new services to keep and win customers. More competition has made the market work better for shoppers. That should be something all politicians want to see in other markets too.

I say "all politicians" quite deliberately. The SMF is a cross-party think-tank, and competition is a cross-party issue – or should be. Both the Left and Right should want more competition. People on the Left are sometimes worried about the power of big business: competition is a far more effective way to curb that power than crude state intervention. People on the Right sometimes worry that others don't share their faith in the wonders of the market: competition is the way to ensure that the market delivers tangible benefits to the public.

The timing of this report matters too. Britain is, we hope, emerging from the horrors of the pandemic and beginning not just an economic recovery but the search for a new economic model. The pandemic and our exit from the European Union raise some big questions about the sort of economy we want, about how our markets should work, and who they should work for.

I'm convinced that, when we look behind the political theatre and cultural clashes between our big parties, there is a quiet consensus emerging in British politics about that new economic model. Strip away the rhetoric and our leaders largely agree that the state should neither control nor withdraw from the market, but instead act as referee able to command the confidence of all participants. More competition would not just deliver better outcomes for consumers, it would help define Britain's economic role in the decades ahead. This report shows how to deliver it.

EXECUTIVE SUMMARY

This Social Market Foundation (SMF) report explores the state of competition in the UK economy, and the extent to which supposedly competitive markets are delivering good outcomes for customers. The report focuses particularly on the state of competition in the retail banking sector, from the perspective of households and SME business customers. The report sets out a range of policy recommendations for enhancing competition in the banking sector and the UK economy more broadly.

The report argues that greater rates of competition in markets can drive improved customer outcomes, both in terms of price and service quality. Done right, a renewed focus on competition policy in the UK could be a powerful lever for reducing the cost of living, enhancing customer service and driving up rates of innovation as businesses have to strive harder to retain and attract customers. In the case of banking, greater rates of lending to business, and access to business support, products and services – driven by a more competitive and diverse banking sector – could support economic growth, jobs and regional "levelling up". For consumers, increased competition and customer engagement could help eliminate the sizeable "loyalty penalties" that exist in the personal current account, savings and mortgage markets – effectively making households billions of pounds a year better off.

The research presents updated analysis of industry concentration in UK consumer markets – refreshing analysis the SMF undertook in its 2017 report, *Concentration, Not Competition.* We focus on eight key consumer markets, reflecting their relative importance as components of spending, as well as data availability[i]:

- Automotives
- Groceries
- Broadband
- Mobile telephony
- Electricity
- Gas
- Personal current accounts
- Mortgages

The state of competition in the UK

- **Six of the eight markets listed above are moderately or highly concentrated in the latest available data,** with a small number of firms accounting for a significant share of the market.
- **However, there have been some encouraging trends over time, including since our publication of *Concentration, Not Competition.*** The groceries sector has continued to become notably less concentrated since 2017, with the rise of Aldi and Lidl. The energy market has also become substantially less concentrated

[i] *Concentration, Not Competition* also considered the marketed for fixed-line only telephony and personal loans. We do not include these markets here due to a lack of up-to-date, publicly available data.

since our 2017 report, as new entrants have reduced the market share of the large incumbents.

- **In contrast, the telecoms market, personal current account market and mortgage market have seen relatively little change in market concentration in recent years.** The personal current account market remains more concentrated than prior to the 2008 Global Financial Crisis and, despite new entrants to the sector, there has been little change to market concentration since the separation of Lloyds and TSB in 2013.
- **An important driver of the diverging trends in market concentration is differing levels of customer engagement.** Between 2015 and 2019, annual customer switching rates for both the electricity and gas markets increased markedly, from 12% to a record high of over 20%. In contrast, the number of customers switching personal current account each year languished at about 2% over this time period. While telecoms switching rates have improved since 2015, this has not been as marked as for energy.
- **The Coronavirus pandemic saw a decline in customer switching rates in the energy and personal current account markets in 2020, perhaps reflecting the number of pressures on households over the course of the year, which may have seen switching deprioritised.** While we think it likely that switching rates will recover as the pandemic draws to a close, this will still leave a backlog of customers that have suffered detriment from not switching provider.
- **Low switching rates in concentrated markets such as current accounts and telecoms suggest that levels of competition are weak, with firms subject to limited pressure to cut prices or improve product quality.** As we discuss in this report, there is evidence that greater levels of competition in sectors such as energy and groceries have translated into benefits for customers, both in terms of prices and improved customer service. Conversely, lack of competitive pressure in markets such as telecoms and banking is contributing to substantial loyalty penalties for customers, with businesses taking advantage of customer inertia to charge excessively.

  Banking-related loyalty penalties account for over half (56%) of the £3.4bn aggregate penalty estimated by Citizens Advice. This includes customers overpaying for mortgages and receiving reduced interest on savings.
- **Evidence suggests that the rise of price comparison websites (PCWs) may be a key driver of increased customer engagement and switching in the energy market.** In 2019, 49% used a PCW to find their energy deal, a further 8% used an 'auto-scanning' service that notified them of new deals and 2% used an automatic switching service.[1] Technological and data-driven solutions appear to be playing a significant role in encouraging greater rates of switching and making it easier for consumers to identify better deals in the market.
- **In contrast, PCWs are less developed for current accounts and telecoms, in part reflecting the relative complexity of the products.** While the Open Banking initiative has the potential to improve consumer engagement its usage remains limited. Despite seeing an increase in users in 2020, it is still the case that just

3% of the UK's population are using Open Banking-enabled services. In contrast, the number of open banking service subscriptions in South Korea has surpassed 20 million, more than 70% of the nation's economically active population.

Competition and banking

- **There are a number of obstacles to smaller "challenger" banks gaining market share in the UK.** Given the business model inherent to banking, where the amount of money they can make depends on the amount of money they can lend out, big banks gain large advantages as a result of having more assets under their control.
- **Banking competition is also driven to a significant extent by data**. Having data on more and more varied types of customers increases the reliability of estimates of risk associated with lending. This gives larger banks another advantage over challenger brands.
- **Perceived risk of "something going wrong" can decrease customer willingness to switch bank – particularly to relatively new challenger brands.** Past SMF research has shown that more consumers would be resistant to taking out a bank account, loan or mortgage from a company established in the last three years than any other types of product or service. Almost two-fifths of consumers said they would not consider banking with a new entrant, and just under a third said they would not get a mortgage from one, compared to a quarter of consumers who would not consider trying a new phone or utility company.
- **Product complexity can make it more difficult for households and businesses to compare banking products.** For example, the use of cashback and rewards in addition to simple interest rates can make it difficult to compare personal current accounts. Business current accounts often have complex tariff structures, with a range of fees and charges. This is likely to contribute to a situation where current account customer switching rates are far lower than telecoms and energy switching rates.
- **While the mortgage market appears to be a relatively competitive part of the banking sector,** we note the existence of uncompetitive sub-sectors in which consumer detriment is significant. This includes "mortgage prisoners" for whom re-mortgaging is difficult or impossible – e.g. due to being in negative equity or failing to meet affordability requirements.

  In addition, we note evidence that the intermediary market often struggles to provide consumers with the most cost-effective mortgages. The Financial Conduct Authority's 2019 mortgage market report estimated that in 2015/16, 30% of consumers could have found a cheaper mortgage with the same essential features (for example duration of fixed introductory rate).
- **Government-backed lending schemes brought in during the financial crisis - the Coronavirus Business Interruption Loan Scheme (CBILS) and Bounce Back Loan Scheme (BBLS) – have seen business lending increasingly concentrated**

in the hands of large incumbent banks. Challenger and specialist banks' share of total gross lending to SMEs fell to 31% in 2020 from 48% in the previous year.

Policy recommendations

To enhance competition in the UK economy more broadly

- **Government should establish the position of Minister for Competition and Consumers, to ensure competition and consumers are prioritised across government and considered as part of the policy-making process in all relevant departments and agencies.** Further, building on the CMA's publication of a "state of competition in the UK economy report" last year, the Government should ensure this is updated annually and presented to Parliament.
- **A presumption in favour of competition should be introduced into takeover and mergers policy, with policymakers erring on the side of caution by not permitting mergers.** Given the inherent uncertainties associated with establishing the likelihood and scale of harms to consumers following mergers and acquisitions, our preference is for the "theories of harm" framework to be replaced with a new "presumption in favour of competition" – under which the CMA would be expected to prevent mergers in the most concentrated consumer markets – energy, groceries, banking and telecommunications – unless it could be demonstrated that there was a strong chance of the merger leading to significantly improved outcomes for UK consumers (for example, lower prices, better service quality and higher levels of product innovation) while not undermining competition.

To enhance competition in the banking sector

- **Government procurement should be used as a lever for creating greater competitive pressure in the banking sector.** The Government should place a requirement on "Government Banking" and all departments and state agencies to actively manage the bank accounts they have under their authority to ensure both value for money and support government competition objectives for the sector, where prudent to do so.

  Further, the Government should ensure that future lending support schemes, such as CBILS and BBLS during the COVID-19 crisis, can support competition in banking. This includes ensuring that challenger banks are involved in governmental and Bank of England discussions, at an early stage, with respect to such policies.
- **The FCA should require banks to "prompt" their current account customers to renew their consent for continuing to bank with their current bank (or banks) and create an artificial "prompt point" to stimulate switching, or at least consider switching.** Regulators and banks should also build more transparency into the switching process, through a code of best practice and a public reporting system ranking the performance of the banks against it. A disengaged customer database should be created, to make it easier to focus policy interventions on customers that have not switched current accounts [or consented to continue with their current bank] in over three years.

- **The Financial Services Compensation Scheme (FSCS) should provide enhanced rates of deposit protection for challenger banks**, to encourage greater levels of account switching, and reduce the perceived risk of using a challenger bank.

  We would expect any differential in deposit protection to be temporary, as part of a broader range of measures aimed at encouraging customer confidence in switching bank and engaging more with the market. **Further ahead, policymakers should explore more substantial reforms to deposit protection in the UK, replacing the "pay as you go" Financial Services Compensation Scheme with something akin to the "pre-funded" Federal Deposit Insurance Corporation in the US.**

- **The regulator should introduce a transition period requirement for all customers whose mortgage policy expires before they move onto the full SVR.** This transition period should be time limited and involve a cap on the number of basis-points that an interest rate paid by the customer can increase for that period. This would give consumers more time to re-mortgage and reduce the "financial shock" when transitioning to an SVR.

- **The FCA should bring coherence to its regulatory treatment of smaller businesses by recognising that, in many ways, they are akin to consumers when engaging in the use of financial products, the competition framework and the economic regulators.** The newly aligned approach should acknowledge that in many ways the smallest businesses should (subject to any exceptions, which must be based upon a strong rationale) be treated as akin to consumers for regulatory purposes.

- **The Bank of England's PRA should expedite the introduction of the so-called Basel IV rules to put a "floor" under the capital reserves of the banks that utilise the IRB models for risk modelling and identifying their reserve requirements and reduce the advantage that the IRB approach gives to bigger banks.**

  The Bank should also take the opportunity offered by its ongoing review of MREL to ensure regulations do not excessively disadvantage mid-tier banks, by making them more transparent and predictable and minimising 'cliff-edges'.

  Further ahead, the PRA should examine the extent to which barriers to entry and growth could be reduced further – for example through reductions to capital requirements – while at the same time maintaining stability of the banking system.

- **Regulators should trim back some of the unnecessary regulatory barriers that make switching more onerous for SME customers, in particular**. This means making the current Anti-Money Laundering (AML) rules more risk-based and proportionate, while the regulator should encourage banks to utilise the latest technology to reduce the bureaucracy associated with AML compliance further.

CHAPTER ONE – INTRODUCTION

Decades on from the privatisation of markets such as telecoms, energy and transportation, and the deregulation of sectors such as banking – questions loom large over the extent to which the UK's prevailing economic model is delivering good outcomes for customers.

Despite the opening of markets and increased choice, consumer engagement is often limited. Customer switching rates are low in banking and telecoms, despite attempts by regulators to encourage households to shop around, meaning that there is little in the way of genuine competition. This in turn has led to markets in which high "loyalty penalties" are pervasive, with companies taking advantage of consumer inertia to charge excessively or offer relatively poor customer service. A report by Citizens Advice found that loyalty penalties were leading to UK households overpaying by about £3.4 billion per annum. This included £800 million in excessive mortgage costs, over £1 billion in lost interest on savings, £750 million in home insurance costs and close to £700 million in telecoms charges.[2]

This situation has led to questions over the extent to which competition has improved outcomes in markets – both in terms of prices charged and measures of quality such as customer service. Recent years have seen the attitudes of regulators and politicians shift markedly; the policy debate has moved from one focused on encouraging consumer switching and the entry of new "challenger" firms into markets, to one in which there is more scepticism towards market-driven approaches.

Given high rates of consumer inertia to switching, and the persistence of issues such as the loyalty penalty, policymakers are increasingly using regulator intervention to protect consumers, rather than using competition in relative isolation to improve outcomes. For example, Ofgem introduced an energy price cap in 2019 to prevent customer overcharging and, in April 2020, the Financial Conduct Authority (FCA) introduced new rules to make the costs of bank overdrafts clearer and easier to compare. This included only allowing banks to charge overdraft users a simple annual rate of interest, without additional fees and charges.[3] The FCA has also been exploring the case for a Single Easy Access Rate (SEAR) for savings, to make it easier for consumers to compare products and "allow longstanding consumers to benefit from firms competing more on the SEAR than they do on current rates for these consumers".[4]

While we welcome regulator interventions to protect vulnerable consumers and curtail business models that take advantage of customer inertia, it is crucial that policymakers do not lose sight of the benefits that enhancing competition can bring to most sectors of the economy. As we argue in this report, done right, enhancing competition can be a powerful tool for reducing prices, improving customer service and driving innovation – particularly when balanced with effective regulation to curtail potential exploitation of customers. Indeed, recent developments in the energy market have shown how competition and regulation can work well in tandem.

In this SMF report, we explore the case for a renewed focus on competition policy in the UK. We examine the latest data on the state of competition in markets and the

evidence on the links between competition and customer outcomes. As we show, data support the view that levels of competition have important implications for price and non-price outcomes for customers. Enhanced competition policy could be a powerful lever for reducing the cost of living, enhancing customer service and driving up rates of innovation as businesses have to strive harder to retain and attract customers.

In the case of banking, greater rates of lending to business, and access to business support – driven by a more competitive and diverse banking sector – could support economic growth and regional "levelling up". For consumers, increased competition and customer engagement could help eliminate the sizeable "loyalty penalties" that exist in the personal current account, savings and mortgage markets – effectively making households billions of pounds a year better off.

We focus particularly on the banking sector and the extent to which enhanced competition has the potential to improve outcomes for both households and business customers – and conversely how a lack of competition is leading to detriment. Lastly, the report concludes with a series of policy recommendations.

The structure of the report is as follows:

- **Chapter two** – explores the state of competition in the UK, and the links between competition and customer outcomes.
- **Chapter three** – homes in on competition in the banking sector.
- **Chapter four** – sets out policy recommendations, informed by the preceding analysis.

CHAPTER TWO – THE STATE OF COMPETITION IN THE UK

In our 2017 report, *Concentration, Not Competition*[5], the Social Market Foundation provided new, detailed analysis of some of the most important consumer markets in the UK – banking, energy, telecommunications, groceries and transport. In particular, in one of the first economy-wide studies of its kind, we analysed the extent to which consumer markets in the UK were becoming more or less *concentrated* – dominated by a handful of large businesses.

The study showed that many key consumer markets were *concentrated*, with a small number of companies accounting for the overwhelming majority of the market. Not only were markets such as energy, banking and telecommunications found to be concentrated, but they were also found to be relatively *uncompetitive* – with very little pressure on large incumbents to cut prices or deliver higher quality services.

A key feature of these markets is a high degree of consumer inertia, with low rates of customer switching between suppliers. Low switching rates limit the extent to which market forces place downward pressure on prices and upward pressure on service quality, as companies know that they have a large pool of sticky customers that can be relied on as a source of income even in the event of price hikes and service deterioration.

Building on our past analysis, in this chapter we present updated estimates of competition in consumer markets in the UK. Have things changed for better or worse since our 2017 report? We focus on eight key consumer markets, reflecting their relative importance as components of household spending, as well as data availability[ii]:

- Automotives
- Groceries
- Broadband
- Mobile telephony
- Electricity
- Gas
- Personal current accounts
- Mortgages

How concentrated are consumer markets in the UK?

There are numerous ways of measuring the extent to which consumer markets are concentrated. In this research, we consider three separate measures of market concentration, which are based on the relative market share of different industries in the UK:

[ii] *Concentration, Not Competition* also considered the marketed for fixed-line only telephony and personal loans. We do not include these markets here due to a lack of up-to-date, publicly available data.

- **The Herfindahl-Hirschman Index (HHI) -** calculated as the sum of the square of company market shares. A HHI score of 10,000 relates to a perfect monopoly where one firm controls the entire market. Using the HHI, we can classify markets into three types:
    a) **Un-concentrated markets** – those with a HHI below 1,000.
    b) **Moderately concentrated markets** – HHI between 1,000 and 2,000.
    c) **Highly concentrated markets** – HHI above 2,000.
- **The CR1 ratio** – the market share of the largest firm within a consumer market.
- **The CR4 ratio** – the market share of the four largest firms within a consumer market.

Unlike the CR1 and CR4 ratios, the Herfindahl-Hirschman Index considers the relative size of the market shares of different industries. For example, a consumer market with four firms each holding 25% market share will have a lower HHI score than an industry where one of the four firms has a market share of 50%. The CR4 ratio does not take into account such variations – its score would be 100% in both instances. In this sense, the HHI can be seen as a broader and more complete measure of the extent to which a consumer market is concentrated.

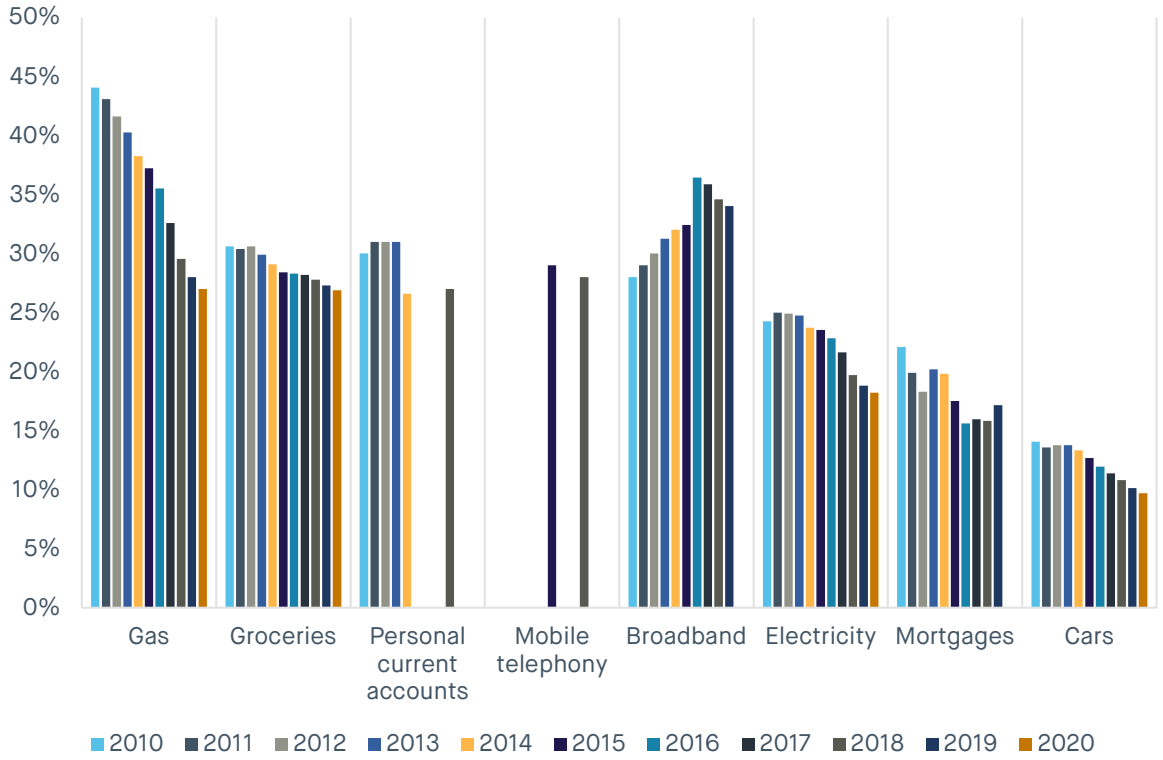
The charts below present updated estimates of CR1, CR4 and HHI ratios across the eight consumer markets we focused on. Details of data sources used for these calculations can be found in the appendix of this report.

While six of the eight markets are moderately or highly concentrated in the latest available data, on the HHI measure, there have been some encouraging trends over time, including since our publication of *Concentration, Not Competition*. For example, the groceries sector has continued to become less concentrated since 2017, with the rise of Aldi and Lidl.

The energy market has also become substantially less concentrated since our 2017 report, as new entrants have reduced the market share of the large incumbents. In 2017, the CR4 ratio for gas stood at 63.4%. In 2020, it stood at just 58.3%. A decade ago, this ratio stood at over 80%, meaning the retail energy sector has been through a period of significant change in market structure.

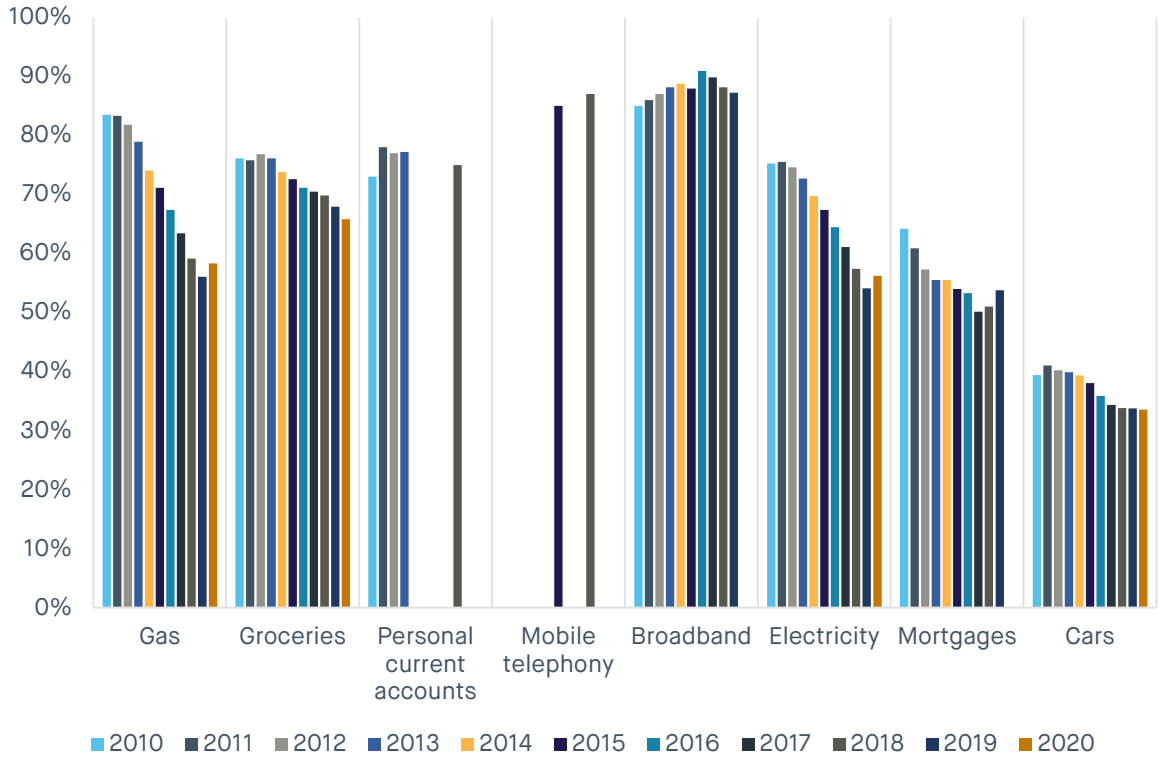
In contrast, the telecoms market, personal current account market and mortgage market have seen relatively little change in market concentration in recent years, as shown in Figure 4. The personal current account market remains more concentrated than prior to the Global Financial Crisis and, despite new entrants to the sector, there has been little change to market concentration since the separation of Lloyds and TSB in 2013.

Figure 1: CR1 ratios over time



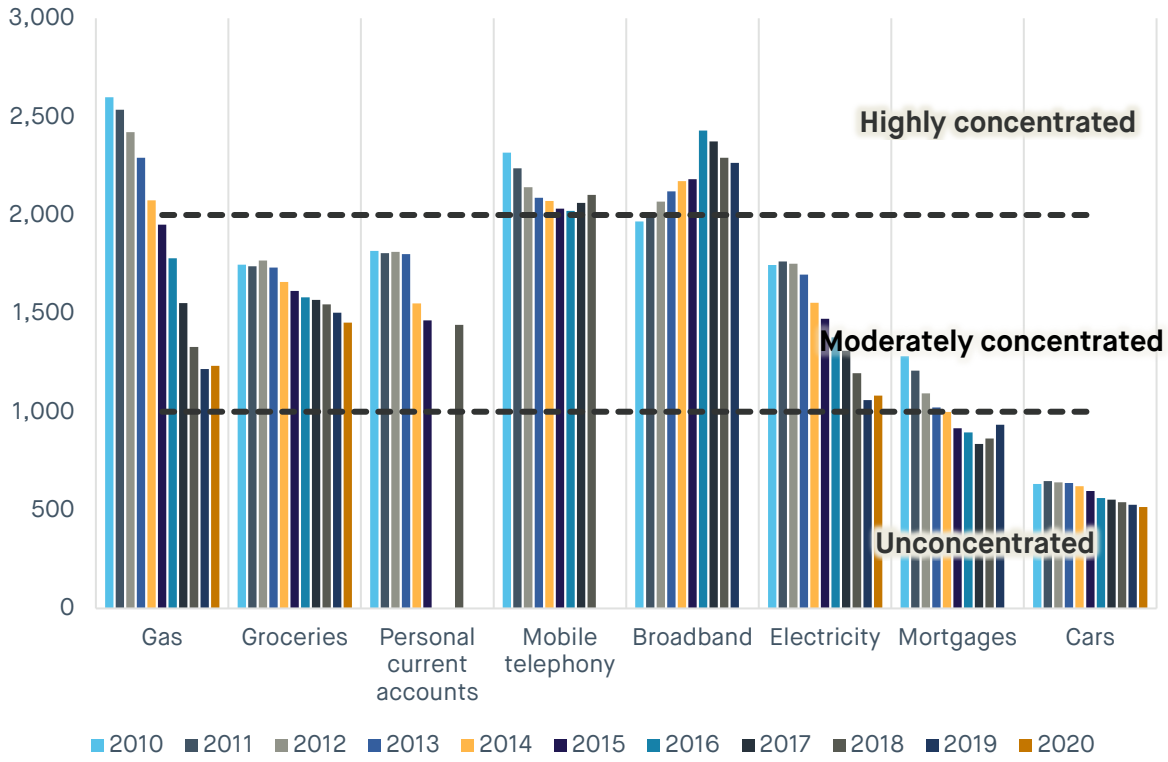
Source: SMF analysis. More information on data sources in report appendix.

Figure 2: CR4 ratios over time



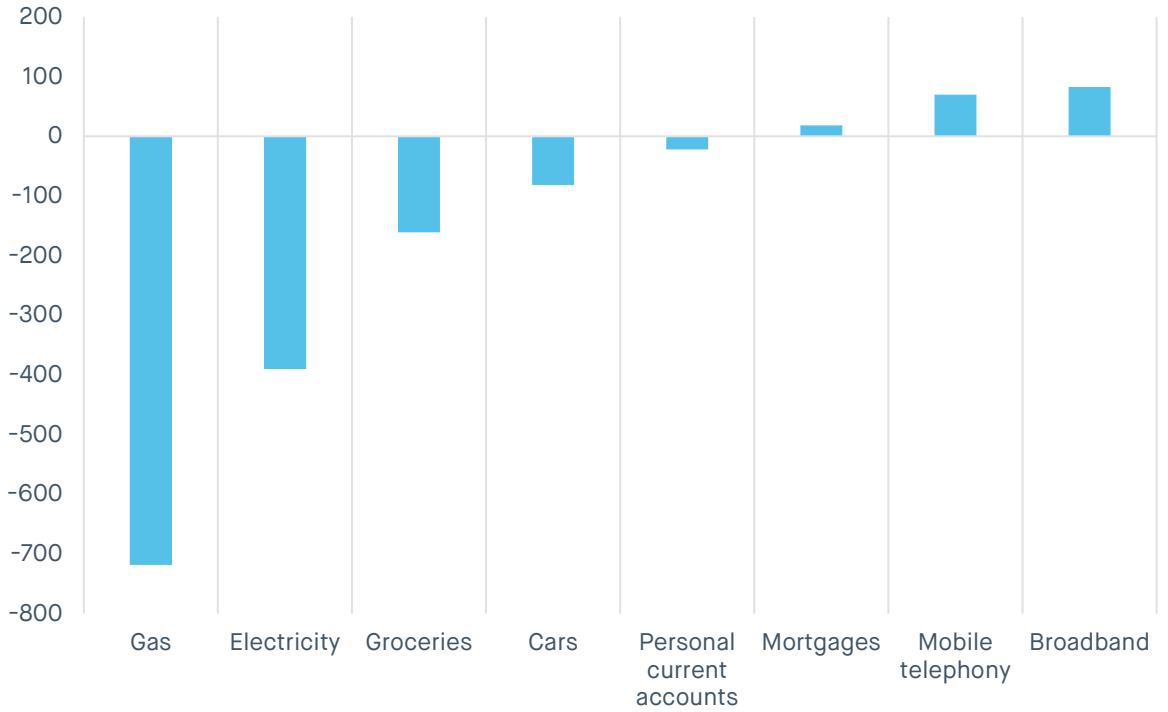
Source: SMF analysis. More information on data sources in report appendix.

Figure 3: HHI ratios over time



Source: SMF analysis. More information on data sources in report appendix.

Figure 4: Change in HHI ratio since 2015



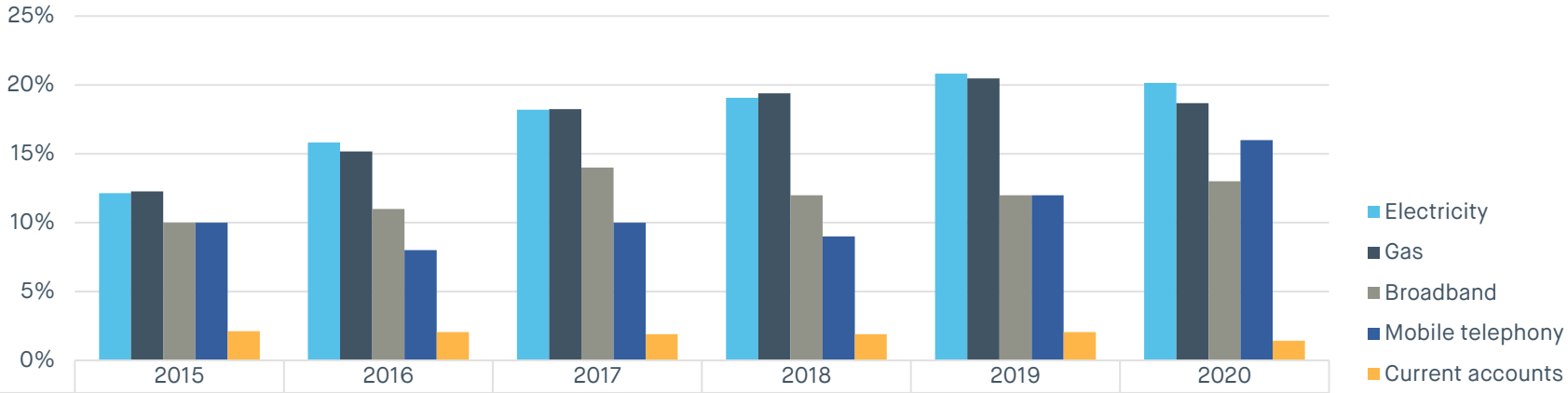
Source: SMF analysis. HHI data go up to 2020 for gas, electricity, groceries and automotive. Mortgage and broadband data go up to 2019. Personal current account and mobile telephony data go up to 2018. More information on data sources in report appendix.

Trends in customer engagement and switching

An important driver of the diverging trends between electricity, gas and banking with respect to market concentration is differing levels of customer engagement. Between 2015 and 2019, annual customer switching rates for both the electricity and gas markets increased markedly, from 12% to a record high of over 20%. In contrast, the number of customers switching personal current account each year languished at about 2% over this time period. While telecoms switching rates have improved since 2015, this has not been as marked as for energy.

The Coronavirus pandemic saw a decline in customer switching rates in the energy and personal current account markets in 2020, perhaps reflecting the number of pressures on households over the course of the year, which may have seen switching deprioritised. While we think it likely that switching rates will recover as the pandemic draws to a close, this will still leave a backlog of customers that have suffered detriment from not switching provider.

Figure 5: Annual switching rates between suppliers



	2015	2016	2017	2018	2019	2020
Electricity	12.1%	15.8%	18.2%	19.1%	20.8%	20.2%
Gas	12.3%	15.2%	18.3%	19.4%	20.5%	18.7%
Broadband	10.0%	11.0%	14.0%	12.0%	12.0%	13.0%
Mobile telephony	10.0%	8.0%	10.0%	9.0%	12.0%	16.0%
Current accounts	2.1%	2.1%	1.9%	1.9%	2.0%	1.4%

Source: SMF analysis. More information on data sources in report appendix.

Is competition delivering? And is a lack of competition creating problems?

Ultimately, we do not care about competition for competition's sake. We care about it because of the evidence that enhanced competition can improve the customer experience of markets – both in terms of price and non-price outcomes.

Price outcomes

A number of recent studies have explored the links between market concentration, competition and pricing – particularly in the US, where business concentration and profit margins have increased across most industries in the past 20 years. This is in contrast to Europe where there has not been such a ubiquitous increase in market concentration.[6]

It has been argued that increased market concentration in the US has led to higher prices faced by consumers. Twenty years ago, access to the internet was cheaper in the US than in Europe. In 2018, however, the average monthly cost of broadband in the States was twice as high as in France or Germany. Air transportation is another industry in which the US has fallen behind, with its aviation industry becoming more concentrated. In Europe, in contrast, the growth of low-cost carriers has driven competition up and prices down.[7]

Some of these trends may reflect a competition regime that is too lenient in permitting mergers between companies, to the detriment of competition. A paper by Kwoka Jr (2012) examined 48 mergers in the US, concluding that most mergers resulted in price increases.[8]

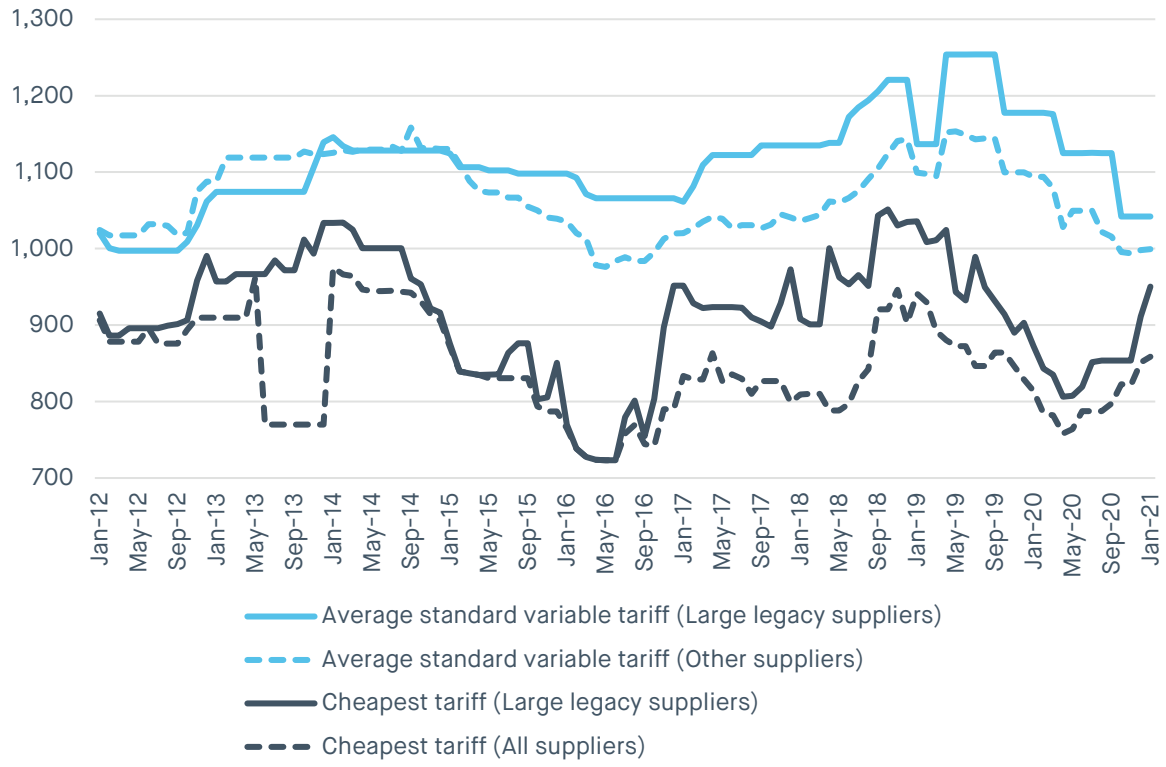
A European Central Bank paper looking at food prices in the Euro area found that increased retail market concentration was associated with higher price levels across a range of products.[9] This aligns with the recent UK experience, where increased competition and decreased market concentration in the groceries sector has been beneficial to consumer outcomes. The expanding presence of German discount chains Aldi and Lidl has contributed to a supermarket price war, to the benefit of British consumers.[10]

In the UK energy market too, competition appears to be delivering, with most new entrants offering cheaper fixed and variable tariffs than the "Big Six" incumbents – as shown in the chart below. When consumers engage with the market, and switch to "challenger" brands, they are likely to realise financial savings. And customer engagement is increasing; switching rates reached a record high in 2019, with around half (49%) of customers either switching supplier, changing tariff or comparing tariffs – up from 41% in 2019.[11]

Having said that, it is still the case that around half of UK energy customers have either never switched supplier or only switched once, highlighting a significant cohort that is not benefiting from increased choice in the market.[12] While the recent introduction of an energy price cap protects such customers from particularly excessive pricing, they still face higher energy costs than more engaged customers and indeed their inertia may be leading to some degree of cross-subsidy – with engaged customers

enjoying lower prices on fixed tariffs than would be the case if firms did not have a large customer base of disengaged variable tariff users. The potential for such cross-subsidies to take place is particularly concerning given that disengaged consumers are more likely to be on lower incomes, older and less educated[13] – meaning that there are important distributional implications.

Figure 6: Average annual energy tariffs, £



Source: Ofgem

Lack of consumer engagement also leads to detrimental price outcomes in the telecoms and banking sectors.

Citizens Advice has estimated that the loyalty penalty for mortgages leads to consumers overpaying on housing costs by about £800 million, due to being on poor value variable rate mortgages rather than switching to better value fixed rate mortgages.

On the HHI measure of industry concentration the mortgage market is relatively unconcentrated and the sector has been described as "ultra-competitive".[14] However, as we noted in *Concentration, Not Competition,* it is important to note the existence of sub-markets where competition is lacking and consumer detriment pervasive. With respect to the mortgage market, there may be two such sub-sectors that are worthy of further policy intervention. Firstly, the sub-sector of relatively disengaged consumers that, as we noted earlier, are more likely to be on lower incomes. Secondly, so-called "mortgage prisoners" who are unable to switch provider, or who have access to limited options – such as those in negative equity or who struggle to meet affordability criteria needed to remortgage. It has been estimated

that, as of January 2020, there were some 250,000 household categorised as mortgage prisoners.[15]

In addition to the loyalty penalty for mortgages, Citizens Advice also estimated a £1.1 billion penalty on cash savings from customers not switching to products offering more attractive interest rates. This means that banking-related loyalty penalties account for over half (56%) of the £3.4 billion aggregate penalty estimated by Citizens Advice. In the next chapter of this report, we discuss competition and price outcomes in the banking sector in more detail.

Loyalty penalties in the mobile and broadband sectors are estimated to lead to consumers overpaying by close to £700 million. The SMF has previously argued that policymakers have paid insufficient attention to consumer detriment in the telecoms market, arising from low rates of customer engagement and in turn limited competitive pressure.[16]

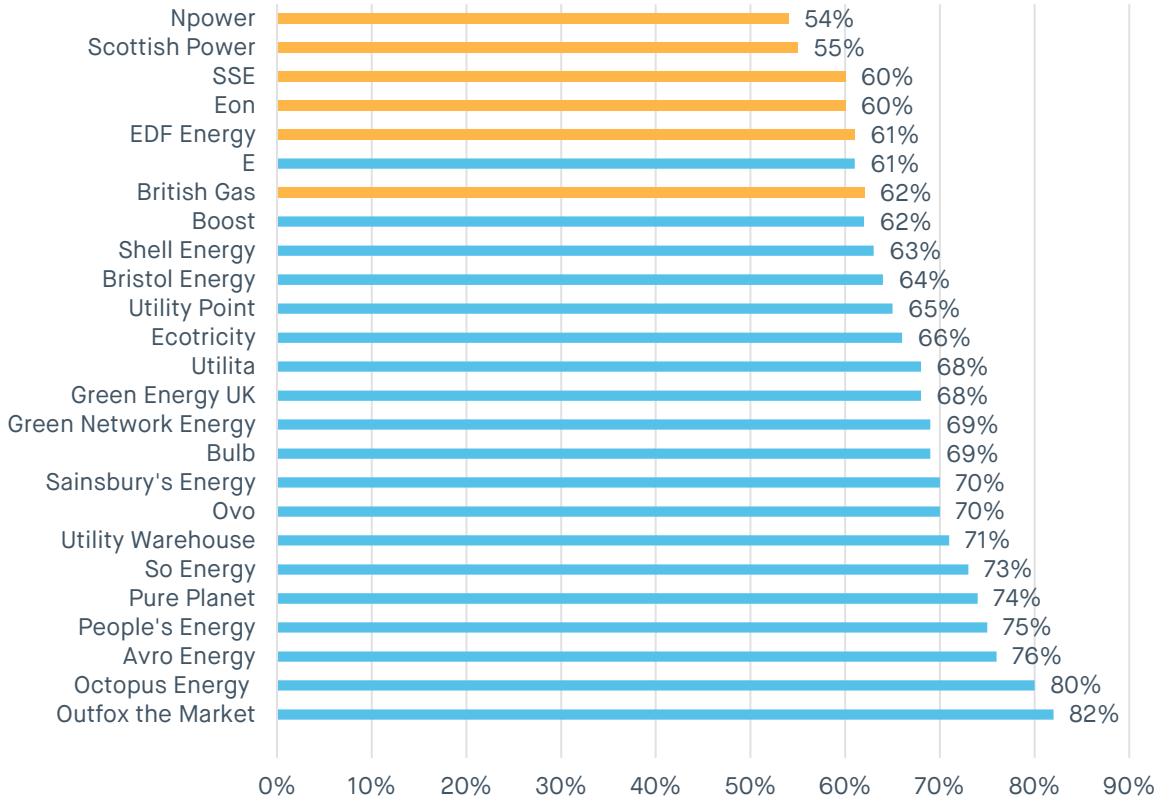
Non-Price outcomes

Competitive pressure in markets also has important implications for non-price outcomes, such as customer service, product quality and choice.

There is evidence that greater rates of competition can be beneficial to customer service quality. In the UK energy market, for example, the "Big Six" large incumbents languish at the bottom of customer service rankings, as the chart below illustrates. There is a less clear-cut picture in the banking sector, with some challenger brands ranking poorly on customer service, though it is perhaps notable that four of the top five banks for customer service are challenger brands (First Direct is owned by HSBC, one of the "Big Five" banks in the UK).

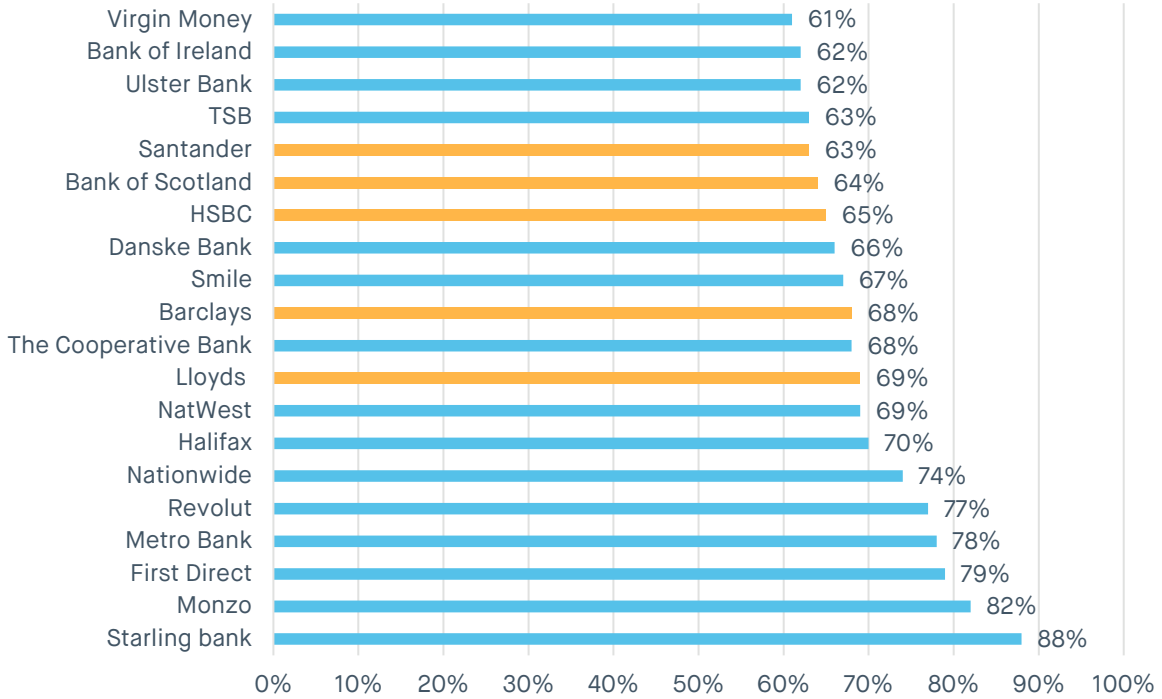
More generally, levels of competition in a market can in the longer-term impact service and product quality through innovation – with competitive pressure incentivising firms to innovate to maintain or expand market share. A 2018 IMF paper found that higher industry markups led to reduced investment and innovation rates in the long-run. More concentrated industries saw a more negative relationship between markups and investment and innovation.[17]

Figure 7: Which? customer scores for energy. "Big Six" energy firms in yellow bars.



Source: Which?

Figure 8: Which? customer scores for retail banks. "Big Five" banks in yellow bars.



Source: Which?

Summary

This chapter presents updated analysis on the state of competition in key consumer markets in the UK. Compared with our 2017 report on market concentration and competition, we note a number of positive trends. In sectors such as groceries and energy, the market share of the largest incumbents has continued to decrease, with competition driving improved consumer outcomes.

However, we remain concerned about a continued lack of competitive pressure in the telecoms sector and banking – the latter being the focus of this report. While switching rates for telecoms have improved in recent years, the improvement has been less marked than for energy. In banking, current account switching rates remain extremely low at about 2% per year. While the mortgage market is both unconcentrated and on the whole competitive, we are concerned about the uncompetitive sub-sectors of mortgage prisoners and disengaged (and disproportionately vulnerable) customers.

Lack of customer engagement and limited competitive pressure in the banking sector mean that it accounts for a majority of the £3.4 billion loyalty penalty faced by UK households. But what can be done to improve competition in the banking sector? What are the barriers to greater customer engagement and increased competitive pressures? It is to these questions that we turn in the remainder of this report. In addition to competition in consumer banking, the next chapter also explores the business banking sector – focusing particularly on the banking experience of small and medium-sized enterprises (SMEs).[iii]

[iii] We do not explore business current accounts in our analysis of market concentration in this chapter due to a lack of available data.

CHAPTER THREE – BANKING MARKET ISSUES

The previous chapter showed that market concentration in the banking sector has seen relatively little change in recent years. This contrasts with sectors such as energy and groceries, which have become more competitive and less concentrated – to the benefit of customers.

In this chapter, we explore some of the possible causes of market concentration in the banking sector, in an effort to identify the issues that policymakers should address in order to create a better functioning banking market. Some of these issues are shared with other markets, such as energy, and so there may be opportunities to learn from what regulators have done to encourage competition elsewhere, while others are specific to banking. Some are common across different banking services as a whole, while others are particular to mortgages, current accounts, consumer or business banking.

This chapter discusses four types of issue. First, the structural and regulatory obstacles that thwart the growth of smaller 'challenger' banks. Second, the relative disengagement of consumers and businesses from the market, and their reluctance to switch banks. Third, some of the distinctive features of the mortgage market – the role of intermediaries and the problem of "mortgage prisoners". Fourth, salient problems in the business banking market, where phenomena such as "lock in" effects limit the scope of competition, the concentrated nature of the business banking market contributes to the persistence of an SME "finance gap" and SME's engaging in the market for financial services products suffer from financial detriment, in-part because the banking sector is not as competitive as it might be and their vulnerabilities, when acting as consumers, is not fully recognised by the financial services regulatory framework.

Scale and incumbency advantages

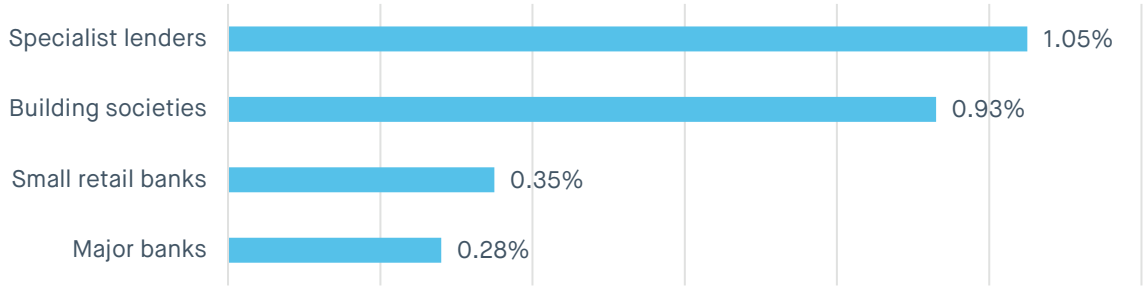
In many markets, larger and more established firms have advantages over smaller and more recent entrants. However, the nature of banking, and the way that the sector is regulated, means that the competitive edge for larger incumbents is greater than in many other markets. As in other industries, there are economies of scale, with fixed costs such as human resources, finance and IT systems accounting for a smaller share of total costs for larger banks. But given the business model inherent to banking, where the amount of money they can make depends, for example, on the amount of money they can both bring-in and lend out, big banks gain an even larger advantage as a result of having more assets under their control. Banking competition is also driven to a significant extent by data. Banks that more precisely estimate the level of risk associated with lending to a particular customer should be more profitable. Having data on more and more varied types of customers increases the reliability of these estimates. Thus, larger banks with a bigger client base have a further potential boost in terms their profitability.

As well as these efficiency and profitability benefits from being a large, established bank, there are also advantages in terms of appeal to consumers. Especially for a service like banking, where people may be particularly risk-averse, the familiarity and

confidence that they get from a recognised brand may be more significant. By contrast, the potential downsides of banking with a lesser-known name may seem particularly acute.

These structural advantages are reflected in the less generous interest rates offered by larger banks on deposits; customer inertia means lower interest rates can be offered without this leading to switching to banks offering more attractive rates. Figure 9 compares the interest rate on 'on demand' deposits (cash in personal current accounts, business current accounts or instant access savings) between different types of lender. Returns are lowest for major banks, at 0.28% on average, slightly higher for small retail banks (0.35%) and closer to 1% for building societies and specialist lenders.

Figure 9: Average customer interest rate on 'on demand' deposits



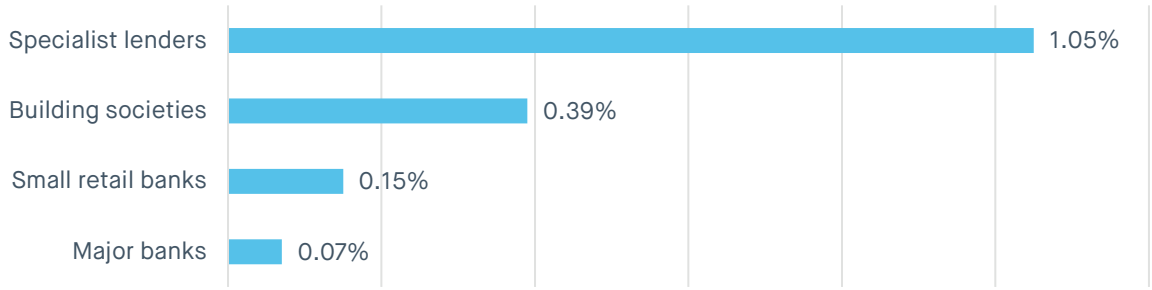
Source: Financial Conduct Authority (2018), "Strategic Review of Retail Banking Business Models: Final Report"

The issue is particularly acute for SME business accounts, where 85% of the more than four million business current accounts (BCA) open in Great Britain are held with the "Big Five" banking groups,[18] [iv] and interest rates on SME BCA balances are lower than for other retail deposits.

Figure 10 shows the spread between the interest paid out on SME BCA balances by different categories of financial institution. The average interest paid by major banks was estimated by the FCA to be around 0.07%. This compares unfavourably with that paid by smaller banks, who paid approximately 0.15% in interest on deposit balances, with building societies paying 0.39% and specialist lenders 1.05%. Between the typical interest rate paid by larger banks and that paid by specialist lenders (that pay the highest interest rate on SME balances) the FCA identified a "spread" of 98 basis points.

[iv] At the end of 2018, according to UK Finance, there was £203.4 billion in deposits in SME accounts in the UK. Nearly 60% of the £204.4 billion was in "immediate-access accounts" and the remainder in "notice accounts" Source: https://www.ukfinance.org.uk/system/files/SME-Update-Q4-Press-copy-final.pdf

Figure 10: Average interest rate on SME BCA deposits



Source: Financial Conduct Authority (2018), "Strategic Review of Retail Banking Business Models: Final Report"

Bank regulation and incumbent advantage

Beyond customer inertia, it has also been suggested that regulation favours large banks over smaller ones. Last year, a report from the All-Party Parliamentary Group on Challenger Banks and Building Societies concluded that regulatory "unintentional consequences...combined to disadvantage smaller players", reflecting "an institutional bias towards major banks which was stifling competition".[19]

Again, economies of scale contribute: large banks can spread compliance costs across a larger base. The bigger issue, though, is capital requirements – the amount of money that banks are required to set aside as a buffer in case risky assets such as loans or mortgages fail. Larger banks, with more assets, can find it easier to meet these capital requirements. Moreover, capital requirements appear to vary between banks whose assets are evaluated using the Prudential Regulatory Authority's standardised approach, and those that are accredited to use their own internal ratings. For example, in 2018 when CYBG, which owns Clydesdale Bank, Yorkshire Bank and Virgin Money, shifted to an internal ratings based approach, its risk-weighted mortgage assets dropped by £4.5 billion, reducing its minimum capital requirements.[20] The accreditation can be a long, cumbersome and resource-intensive process. It also favours institutions with a strong existing record of modelling risk behind them. Both of these factors mean that newer and less established banks face significant initial disadvantages relative to incumbents.

In recent months, attention has focused on the implications for competition of the Bank of England's minimum requirement for own funds and eligible liabilities (MREL).[21] A bank's MREL represents the minimum equity and eligible debt that it must set aside in case the institution itself fails in order to limit the costs borne by depositors, the financial system and taxpayers. Having published its initial MREL policy in 2016, and updated it in 2018, in December 2020 the Bank of England launched a consultation on reforming the scheme.[22]

Challenger banks have highlighted a number of ways in which they are disadvantaged by MREL as it currently operates. The threshold above which MREL requirements kick in is relatively low compared to other countries. In the UK, banks with a balance sheet of £15-25 billion are included, whereas in the European Banking Union it only applies as a matter of course to banks with over €100 billion (although regulators have

discretion to extend the requirements to smaller banks). In the US, requirements equivalent to MREL only apply to "Global Systemically Important Banks", though there are other private resolution strategies in place in case of failure.[23] Moreover, that threshold is seen as something of a "cliff-edge". Banks have complained that it is not always clear when they are close to triggering MREL requirements and that the sharp difference between being covered by MREL and not can very suddenly increase capital requirements.

Smaller banks also argue that they find it more burdensome to comply with MREL because they have less easy access to capital markets than larger banks, who have more established debt issuance programmes and are able to borrow in different currencies and not just pounds. Whereas large banks have been able to borrow at rates of 2.5% to fulfil their MREL requirements, the comparable figure is 4.5% for mid-tier banks. That difference is significant in cash terms, and is part of the reason challenger banks have claimed they could increase lending to consumers by £24 billion if MREL requirements were relaxed.[24] Reforms to MREL could therefore strengthen the relative position of mid-tier banks and enable them to compete more effectively with larger institutions.

Customer disengagement

As noted earlier, customer disengagement – the unwillingness of a significant proportion of customers to review their options and switch provider – is an obstacle to effective competition in many markets. Switching rates are considerably lower for business and personal current accounts than for other similar services – in 2019, only around 2% of current account holders changed provider.[25] That rate fell further as a result of the Coronavirus pandemic: in 2020, there were 705,000 current account switches, down almost a third from a million in the previous year.[26] A large proportion of consumers are inert: in 2014, 57% of personal current account holders had remained with the same bank for over a decade. Disengagement among business customers is similarly high. Data from BEIS (Table 1) shows how the proportion of SMEs across the economy switch bank account provider in a year tends to be low and that the trend in switching is flat, with little sign of growth in the year between 2016 and 2019.

Table 1: BCA Switching, 2016 and 2019

	2016	2019
Employer SME: switched	4%	3%
Employer SME: did not switch	95%	96%
Sole trader: switched	2%	2%
Sole trader: did not switch	97%	96%

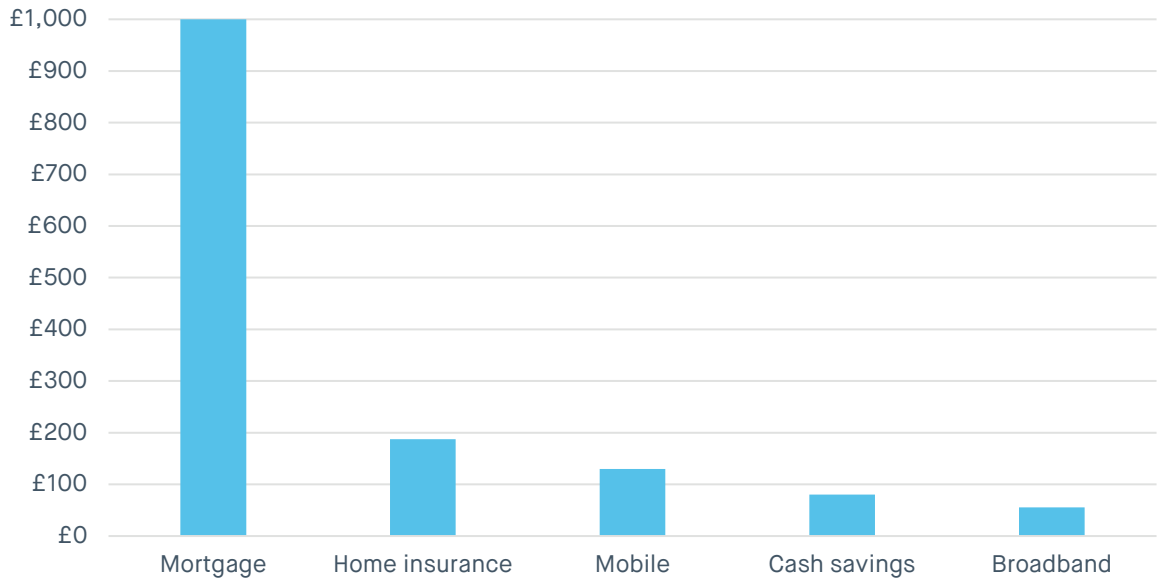
Source: BEIS Longitudinal Small Business Survey (2016) and (2018)

Indeed, even when nudged by policy, it can be difficult to get businesses to switch bank. Royal Bank of Scotland's (RBS's) Incentivised Switching Scheme, also known as the "Business Banking Switch", was launched in February 2019. The scheme offered incentives such as cash payments to encourage some RBS business customers to

switch provider, with the aim of reducing concentration in the BCA sector. Despite this, the scheme fell flat. By early 2020, just 23,000 business customers out of a pool of 220,000 had switched.[27] Due to low uptake, the Incentivised Switching Scheme has been extended to 30 June 2021, following agreement between RBS and HM Treasury.[28]

While aggregate switching rates are higher in the mortgage market, the costs of inertia are greater. The FCA estimates that around 10% of mortgage holders, some 800,000 consumers in total, do not switch at the end of their fixed-rate term, moving onto standard variable interest rate. That costs them on average £1,000 a year for the first two years, and £100 a year thereafter.[29] Of all the 'loyalty penalties' that have drawn the concern of Citizens Advice, this is the biggest, as the figure below shows.

Figure 11: Average overpayment due to 'loyalty penalty' (£/year)



Source: Citizens Advice (2020), "The loyalty penalty in essential markets: Two years since the super-complaint"; SMF analysis

Many of the barriers to switching banks – e.g. switching current account, savings account or mortgage - are similar to the barriers to switching other services like energy and telecoms. Customers may not appreciate the potential cost savings or benefits from changing provider. They may lack confidence in navigating the market. Researching alternatives and moving over can be time consuming and inconvenient, encouraging inertia.

Unclear benefits

However, many of the particular features of banking mean that it has higher barriers to engagement and switching. The benefits of switching bank may be less clear than for other products. In relation to personal current accounts, the 'free if in credit' model means that there are no 'headline prices' that indicate consumers are missing out on better deals elsewhere – particularly in a low interest rate environment where current accounts offer little positive return. On the contrary, most of the cost of current accounts is hidden in the shape of foregone interest and overdraft charges. That does not mean that there are not significant savings to be made from switching. The 2016

Competition and Markets Authority (CMA) retail banking market investigation found that 90% of consumers on standard or reward accounts would be financially better off from switching, and that the average gains were around £92 a year.[30] The potential gains are especially high for overdraft users, with those spending 8-14 days a month in overdraft saving around £180 a year.

The CMA has suggested that similar issues inhibit SME engagement with BCAs.[31] There is a view, prevalent among many smaller and medium-sized businesses that the gains from switching are not especially significant, and that the difference between alternative providers is marginal and therefore the return on the effort associated with switching is not substantial enough, if there is one at all. Moreover, businesses consider the costs associated with their BCA to be relatively small compared to many of the other costs SMEs face. Consequently, in such a context, switching is not seen as a high priority.

However, as is revealed later in this chapter, there are in-fact, considerable differences to be found between alternative BCA offerings. Perceptions, among business owners and managers that BCA products differ very little and any gains from opting for an alternative are likely to be marginal at best are not a reflection of the reality. Analysis by the FCA for example, suggests that there are considerable financial benefits for businesses, from choosing the right BCA.[32]

Challenges of engaging and competing for overdraft users

Overdraft users face particular difficulty in comparing accounts. Until recently, banks often failed to advertise overdraft terms prominently or to present them in a standardised manner. In the past couple of years, regulation of overdrafts, requiring banks to price and display overdrafts in a simpler way, with a single annual interest rate, appears to have improved things somewhat. However, overdrawn consumers are often unsure about whether they are able to switch accounts and what sort of overdraft facility they are likely to have when they move over. This is not a marginal issue – around 45% of account holders use an overdraft[33], and around one in eight are never in credit.[34]

There is a more fundamental problem with trying to engage some overdraft users with bank switching. The very factors that lead them to dip into their overdrafts mean they may be less willing and able to engage in the sort of financial planning that switching bank accounts assumes. Moreover, they may fall prey to a sort of 'optimism bias' that leads them to underestimate their reliance on credit, and so downplay the importance of their overdraft in choosing an account.

The absence of a natural 'break' to prompt switching

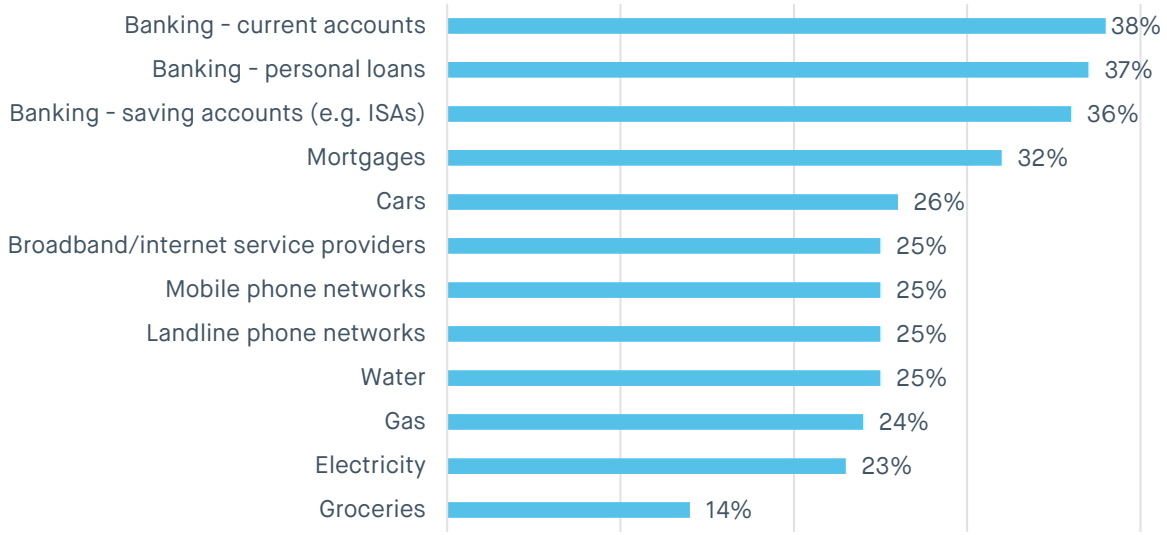
Another relatively distinctive feature of banking is that there is a lack of a natural 'break point', prompting customers to review their options and consider switching. Unlike energy and telecoms services, which are usually structured as contracts with a specified end date, banking relationships (at least for current accounts) tend to be more open ended. That is not true, however, for mortgages, which are typically fixed at a certain interest rate for given period of time, the end of which is often an occasion for re-mortgaging.

The lack of "prompting" is also a problem in the BCA market, as the CMA observed in its last market review into business banking.[35] The 2019 switching data highlighted earlier suggests that the position has not improved since the CMA last explored this problem in 2016.

Risk aversion

Risk aversion – which may be a more general barrier to switching any service, in the worry that the move may go wrong or the new provider will be worse – is a particular issue for banking. Figure 12 presents the results of a 2017 survey conducted by YouGov on behalf of the SMF. It shows that more consumers would be resistant to taking out a bank account, loan or mortgage from a company established in the last three years than any other types of product or service. Almost a two-fifths of consumers said they would not consider banking with a new entrant, and just under a third said they would not get a mortgage from one, compared to a quarter of consumers who would not consider trying a new phone or utility company.

Figure 12: Proportion of consumers that have not and would not consider purchasing a product/service from a company established in the last three years



Source: Corfe & Gicheva (2017), "Concentration not competition: the state of UK consumer markets", SMF.

That fear of the unknown clearly disadvantages newer, less recognisable challenger banks and favours more established firms. The Current Account Switching Service, introduced in 2013, has taken much of the risk out of switching for consumers, guaranteeing that switches are completed within a week without any financial detriment. However, a substantial minority of consumers are not adequately reassured by this facility. Despite advertising campaigns targeting younger and more financially vulnerable consumers, one in four people have not heard of the service,[36] and many of those aware of it lack confidence in it.[37]

Risk aversion is also an issue among businesses. The CMA has suggested that SMEs may be put off switching banks because they fear the possibility of losing crucial payment information and possible disruption to customer and supplier relationships.[38] Moreover, as with consumers, the CMA has found low awareness of the Current

Account Switching Service among businesses – half of SMEs that had not switched BCAs did not know the service was available. Of those that were aware, the majority knew little or nothing about the nature of the assistance. In the case of SMEs, the time and inconvenience associated with switching bank may be a further impediment to switching. In particular, the CMA has raised the length of the account opening process, in part as a consequence of the bureaucracy associated with rules such as anti-money laundering regulations, as an issue.[39]

Product complexity

Product complexity is another factor that can inhibit bank switching. Particularly in recent years, there has been a growth in reward personal current accounts that offer benefits like cashback, bonuses for particular types of spending or package accounts that bundle current accounts with other services like insurance. Between 2011 and 2016, there was a 19% increase in the number of different types of personal current account products on the market.[40] While these products can lure in customers to switch accounts, they may also make it hard to compare like-for-like and to assess the level of value on offer.

The BCA landscape is more complex than the PCA landscape. The central function of a BCA is straightforward enough. It is a safe place in which businesses can store their money and a secure mechanism for making and receiving payments. However, built around these basic functions are complicated by tariff structures.[41] Many banks initially offer a period of "free banking" but after its expiration, a myriad of charges and fees are levied. The exact nature of the tariffs varies by BCA. Some entail flat monthly fees, others might involve fees proportionate to the size of an individual transaction, or a fixed amount per transaction. Some accounts charge different fees for different volumes or patterns of transactions going through the account.[42] Ultimately, there are wide range of ways that BCA providers levy tariffs on SMEs with BCAs and the picture is a complex one.

Such complexity in tariff structures limits the transparency of BCAs as products and results in considerable difficulty understanding and comparing the costs associated with one account to alternatives. One consequence of such opacity is inertia, a less discriminating demand-side and a large disparity in BCA associated costs across the market. A phenomenon that has been observed by the FCA in an analysis of the cost differentials linked to different BCAs and customer demographics:[43]

> *"...For GB BCA providers, the difference between the highest and lowest monthly costs was over 100% for 15 of...17 customer profiles. For five of the profiles, the highest monthly cost was over three times as large as the lowest monthly cost. Similar results were found for the NI BCA providers and we noted that their monthly prices are generally higher than those of GB BCA providers".*

The comparability challenges that the frequently complex structure of BCA fees and charges generate for SMEs are compounded by the negligible interest rates paid on BCA balances (see Figure 10). For the larger incumbents in particular, the almost zero interest they pay on BCAs is an important element in their business model. For business customers the absence of clear, comparable interest rates negatively impacts the ability of SMEs to weigh-up the costs and benefits of alternatives.

In combination, the complex tariffs and negligible interest rates on deposit balances enable banks to make substantial revenues from each BCA customer. The FCA estimate that each BCA generates revenues in the region of £203, per year.[44] Around ten times higher than the revenues earned on PCAs.[45] Allied with scale, which the biggest incumbents have (i.e. the "Big Five", which serve around 85% of the BCA market between them) enables the latter to reap significant quantities of income from their BCA business.

"Lock-in"

Even for products that are not formally linked, some banking customers experience the problem of "lock-in" i.e. where using a bank for one product (such as a personal current account) can make people more likely to choose them for other products (such as a business account, personal loan or mortgage).

The scale of this issue in the consumer market should not be overstated – around a fifth of consumers have current accounts with different banks,[46] and most people do shop around mortgages. However, in a minority of cases "lock in" can help entrench the position of bigger incumbents.

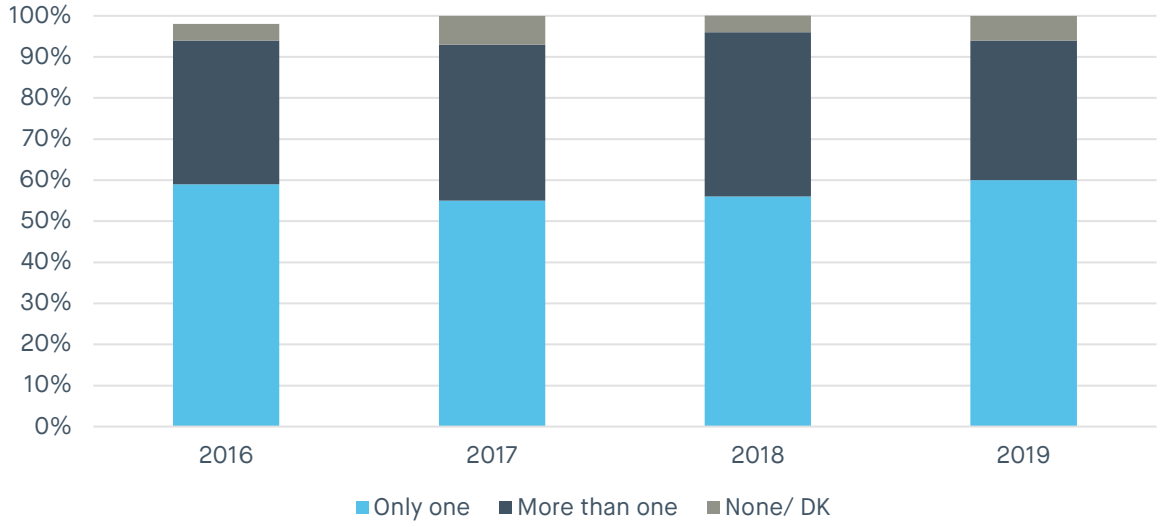
In business banking, "lock-in" effects are more common. Such dynamics are present across a range of business banking products. Indeed, the effect is so strong that it is evident at the very earliest stages of the entrepreneur's business activities. For example, the CMA identified a consistent relationship between consumer and business banking, with over half of entrepreneurs choosing the provider of their personal bank account for their start-up's business account.[47] Further, more than a third of start-ups appear to do so without searching the market for alternatives at all.[48] And, as noted earlier, when discussing general disengagement, 58% of start-up SMEs reported not comparing providers, while 23% said they only undertook the most cursory comparisons.[49]

The same CMA market study also discovered that a high proportion of businesses stay "loyal" to the bank providing their BCA, when it comes to accessing other business banking products. Research commissioned by the CMA found that:[50]

- Around nine in ten SMEs use their BCA provider for overdrafts, business loans and credit cards.
- More than two-thirds used their main bank for invoice discounting and factoring and more than three quarters for commercial mortgages.

British Business Bank data backs-up the CMA's findings. Its own survey data shows that among the businesses looking for loan finance, the majority of firms fail to look past one provider.

Figure 13: Number of finance providers considered by SMEs that sought finance in the preceding three years, 2016-19



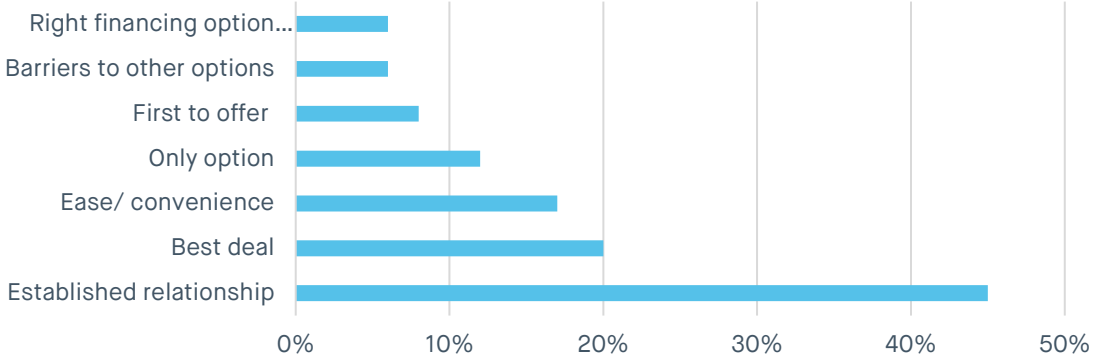
Source: British Business Bank (2019), Business Finance Survey: SMEs.

A primary motivation behind SMEs using their main BCA provider for loans and other current and future financing needs, is the advantages of an existing relationship with the provider of the finance. As explained by the CMA:[51]

> *"...there is a considerable amount of evidence that SMEs value the relationship with their bank and believe that loyalty to their main bank will help them obtain finance. In addition, an SME's main bank will have more information on its customers...to enable it to assess the risk of the SME defaulting. This information asymmetry between the main bank and other lenders enables the main bank to price credit more accurately, and...make lending decisions more quickly".*

Further evidence from the British Business Bank confirms the importance of the "close connection" between a business and the bank the former has their main relationship with. The "established relationship" was the most frequently reported reason (45% of respondents) as to why a business seeking external finance only approached one provider.

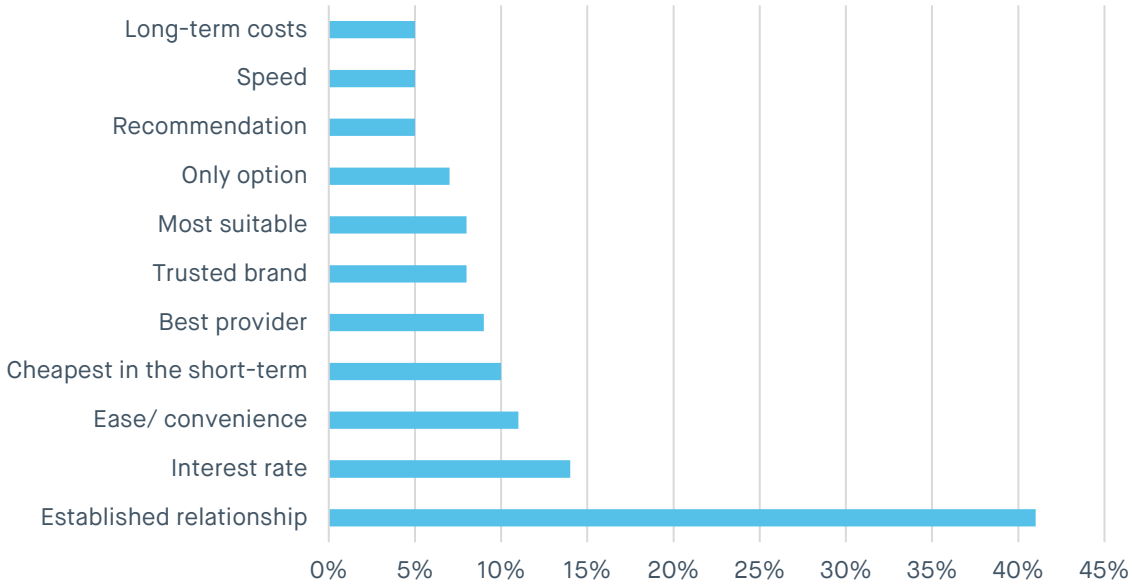
Figure 14: Reasons for approaching only one provider, 2019



Source: British Business Bank (2019) Business Finance Survey: SMEs.

The same British Business Bank survey found that the "existing relationship" was a key factor in the final decision about where to source financing from for many SMEs.

Figure 15: Reasons for choosing a particular provider, 2019



Source: British Business Bank (2019), Business Finance Survey: SMEs.

The British Business Bank data, presented in Figures 14 and 15, illustrates the importance of the existing relationship to an SME seeking external finance at different points in the "consumer journey" i.e. at the "search" stage and at the "decision" stage. This demonstrates the powerful "lock-in" effects that develop, once a bank (a "Big Five" bank in particular) has established a banking relationship with a business customer through a mechanism such as a PCA or BCA.

Technology and Price Comparison

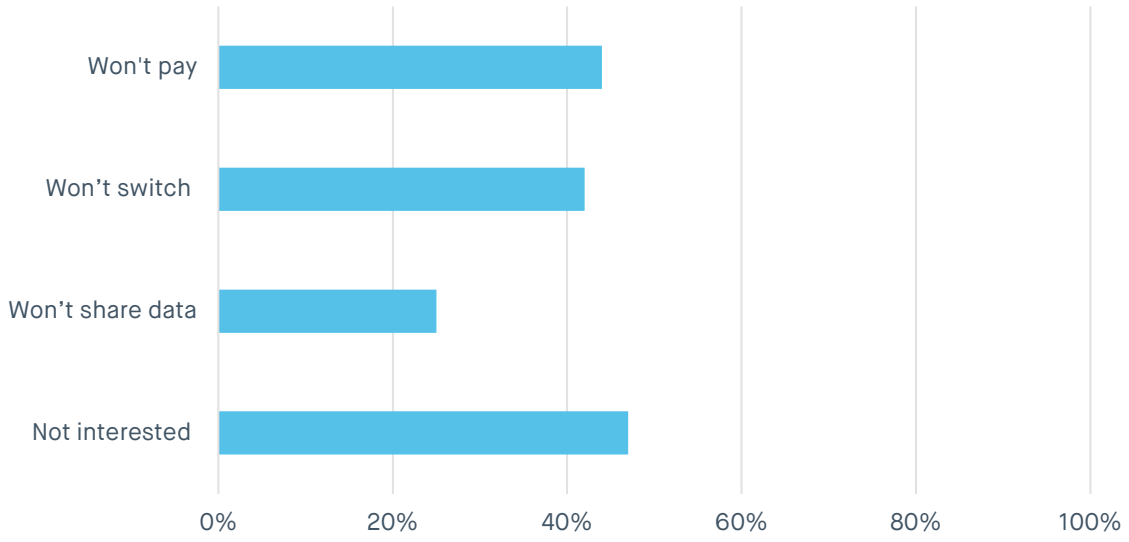
In markets like energy, where consumer engagement and switching have increased, there is evidence to suggest that the rise of price comparison websites (PCWs) have contributed to this trend. In 2019, 49% used a PCW to find their energy deal, a further 8% used an 'auto-scanning' service that notified them of new deals and 2% used an automatic switching service.[52] Technological and data-driven solutions appear to be playing a significant role in encouraging greater rates of switching and making it easier for consumers to identify better deals in the market.

In contrast, PCWs are less developed for current accounts and telecoms, in part reflecting the relative complexity of the products. While energy is a relatively homogenous product where price is the key variable, factors influencing the right current account for an individual depend on a wide range of factors – likely monthly deposits, overdraft usage, value placed on having access to physical branches, and so on. As the SMF has noted in previous research, increased use of bundling in telecoms – for example joint purchase of pay-TV, mobile telephony and broadband – is potentially making it harder for individuals to compare products.[53]

The Open Banking initiative, which allows consumers and businesses to access and share their financial information and transaction history in a single place, has generated a lot of enthusiasm – including from the SMF[54] – as a way to encourage engagement with the market and facilitate switching. Specifically, the expectation is that Open Banking will help people better understand their specific needs and requirements when shopping around, that sharing data with price comparison apps and websites could generate more personalised search results and that banks can better adjust their terms and offer based on an individual or firm's credit and transaction history. Initial levels of sign-up have been fairly strong, with over three million individuals and businesses active users of open banking-enabled products so far.[55] However, this falls far short of the rate of adoption in South Korea, where open banking services have 20 million subscribers, some 70% of the nation's economically active population.[56] Further, as we can see from aggregate switching rates and levels of concentration in the UK banking sector, excitement has not (yet at least) dramatically increased the competitiveness of the banking market.

Open Banking has potential to open-up the market for SME banking more widely and reduce some of the problems with the SME banking market.[57] It could help reduce the information asymmetry problems that exist between the lender and the borrower and those that exist between the incumbent financer and a potential competitor lender in the market.[58] Reducing some of the information asymmetries would reduce the strength of the "lock-in" effects that limit SMEs' de facto ability to "shop around" and find alternative sources of finance to the provider that they have an existing relationship with. However, there is still a long way to go to persuade large numbers of SME's to wholly embrace its potential.

Figure 16: SME attitudes towards Open Banking



Source: KPMG (2018), Is Open Banking Open for Business?

A survey of SMEs by KPMG found a large proportion of smaller firms have little interest in Open Banking (47%). Significant minorities of small businesses professed to be unwilling to pay for any Open Banking services (44%) and more than four in ten would

not "switch" their banking provider to take advantage of Open Banking services. A quarter of SMEs said they would not, under any circumstances, be willing to share their data with third parties. If these proportions persist, it leaves those looking to push ahead with providing Open Banking-based services on the market with about half of SMEs to target. This is a significant market, but smaller than those hoping it will transform SME banking might have hoped for.

Mortgage market issues

As well as these more general issues that apply to the banking market more broadly, there are certain issues specific to the mortgage market which affect its competitiveness. One major difference between mortgages and other services is that the majority of mortgages (three-quarters of the total) are taken out via an intermediary, usually a mortgage broker.[59] In many ways, this is good for consumer engagement and welfare – consumers are able to benefit from the experience and expertise of a specialist that is familiar with a range of products and can find one that suits their needs.

However, some concerns have been raised about the effectiveness of intermediaries. The Financial Conduct Authority's 2019 mortgage market report estimated that in 2015/16, 30% of consumers could have found a cheaper mortgage with the same essential features (for example duration of fixed introductory rate).[60] The cost of missing out on the best available offer can be substantial – the FCA estimates that these consumers are £550 worse off over the course of their introductory period. Lenders and intermediaries tend to play down these figures. It is sometimes argued that this sort of analysis fails to account for the fact that consumers may be willing to pay more for 'soft' factors, like a desire for speed or preference for a particular lender. However, the FCA's core finding remains despite adjusting for a range of sensitivities: new buyers, who might be expected to value speed more, do not pay more; cheaper mortgages are not driven by niche lender, nearby lenders or lenders with a better reputation for customer satisfaction. Lenders and intermediaries have also argued that things have changed in the five years since the period covered by the FCA's analysis, but such claims are only anecdotal.

It is possible that the intermediary market has issues because of its incentive structure. Intermediaries are generally paid procuration fees for each deal, which incentivises them to find mortgages for as many customers as possible. At the same time, that weakens their incentive to search extensively in order to maximise value for each individual customer. It should be emphasised that mortgage brokers are bound by certain ethical standards, which require them to act in their clients' best interests. However, it is possible that, at the margin, this may not always occur. Some intermediaries may also be hampered by the fact that not all mortgage products are distributed through intermediaries: the FCA found that excluding products only available direct from lender, the proportion of consumers that could improve on their actual deal fell from 30% to 20%.

A group of consumers that have attracted particular attention in recent years are 'mortgage prisoners' – a group we touched on the previous chapter, in relation to uncompetitive sub-sectors of the mortgage market. Mortgage prisoners are

consumers that are up-to-date with their existing mortgage payments, but unable to switch to a cheaper option because of changes in lending practices after the financial crisis – in particular, stricter affordability assessments. The Financial Conduct Authority estimates that there are around 250,000 people holding mortgages with inactive lenders or whose mortgages are held by firms not authorised to lend.[61] 170,000 of these people are up-to-date with their payments and are now eligible to switch following rule changes introduced in 2019, allowing lenders to assess affordability on the basis of a borrower's track record of keeping up with their payments. That leaves 80,000 still unable to switch. These consumers account for a relatively small share of the market, but are particularly disadvantaged by being unable to benefit from competition.

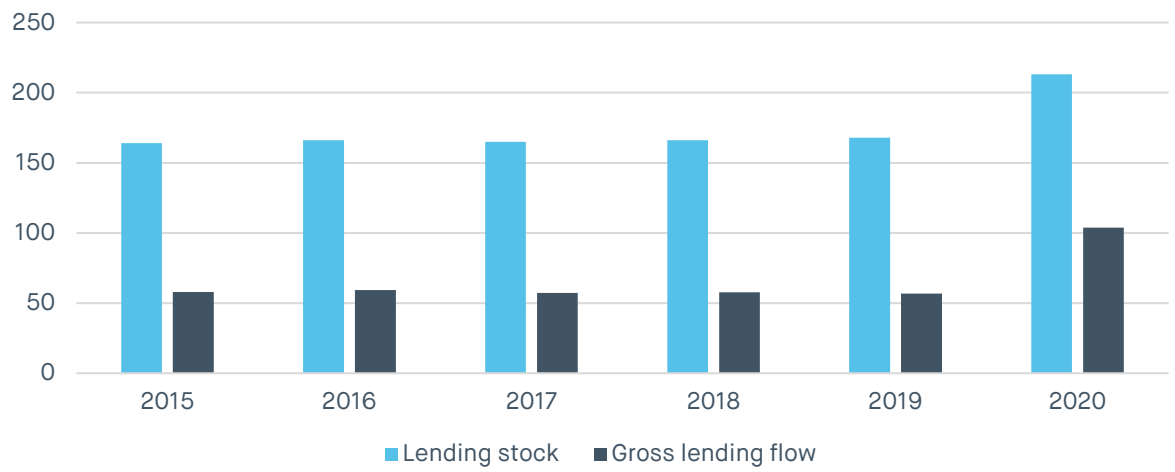
Business market issues

In addition to the competition issues in the BCA market described earlier in this report, there are also competition concerns in the external business finance market in general and the commercial loans part of that market in particular. Further, there are indications that the existing problems in the latter are likely to have been exacerbated by the COVID crisis and some of the business-related measures taken by the government, aimed at keeping many of the firms that have been negatively impacted by the virus and the public health measures implemented to tackle the virus solvent over the period of the crisis.

The COVID crisis and SME borrowing

COVID and its consequences have delivered a considerable "shock" to the economy in general and to the SME community in-particular.[62] To counter the potential long-term economic scarring that might otherwise occur, the Government has instituted a series of measures to help support the UK's SMEs through the economic turbulence. One result of the policy response has been a significant rise in the amount of external finance being sought by and provided to SMEs across the UK.[63] In 2020, for example, the British Business Bank has estimated that 45% of SMEs sought a loan, compared to 13% in 2019 and 2018.[64] A (more than) threefold increase in a year.

Figure 15: Flow and stock of external finance for SMEs, 2015 to 2020, £ billion



Source: British Business Bank (2021), Small Business Finance Markets 2020/21.

The chart above shows the quantum of external finance being supplied to UK SMEs in 2020 and how that compares to amount of finance supplied during the years 2015 to 2019. In 2015, for example, just under £58 billion in (gross) new external finance was provided to SMEs across the UK. In 2020 that rose to nearly £104 billion. The British Business Bank has noted that the COVID support schemes have driven the explosion in the use of external financing, with:[65]

> *"...the Bounce Bank Loan Scheme (BBLS) and the Coronavirus Business Interruption Loan Scheme (CBILS) providing around 55% of total bank lending".*

The principal schemes have been the Coronavirus Business Interruption Loan Scheme (CBILS),[66] Bounce Back Loan Scheme (BBLS).[67] More recently, the Recovery Loan Scheme has been instituted - which is the successor to both CBILS and BBLS.[68]

However, utilisation of the schemes so far, has been largely through the "Big Five" banks, which dominate the SME banking market:[69]

> *"Challenger and specialist banks have so far provided a significantly smaller proportion of loans made under these schemes compared to the Big 5 banks. At the end of December 2020, the total value of BBLS and CBILS facilities drawn down from UK banks was £56.7bn. Of this, challenger and specialist banks comprised £6.9bn (12%) while the Big 5 banks provided £49.8bn...".*

Consequently, the crisis and the various schemes have helped create a situation, where:[70]

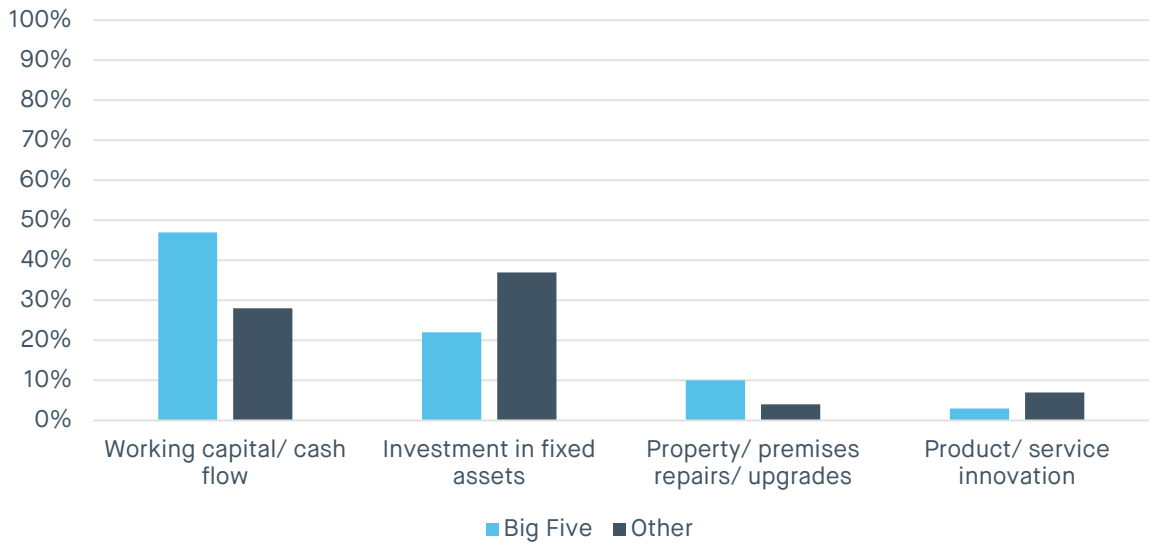
> *"...challenger and specialist banks' share of total gross lending [to SMEs] fell to 31% in 2020 from 48% in the previous year, the lowest on record. This reversed the post-financial crisis trend which had seen the challenger and specialist banks go from providing a third of gross bank lending in 2013 to around a half in 2017-2019...".*

The emergency economic measures were demonstrably needed to help keep the economy "afloat" during the unprecedented circumstances of 2020 and early 2021. Nevertheless, the necessity of such measures should not blind policymakers to some of the potential negative longer-term consequences of the schemes, as the economy returns to something more like normal. As the data showing a substantial drop in the share of commercial loans market taken by challenger banks suggests, those downsides include leaving the "Big Five" banks that already dominate the business banking market in a stronger position than they were before the crisis.

The importance of external finance for SMEs

External finance is an important tool for SMEs. Its significance can be seen in data from the British Business Bank, which shows that in 2019, the majority of SMEs (58%) were using at least one form of external finance. The same research showed the reasons why SMEs want external finance.

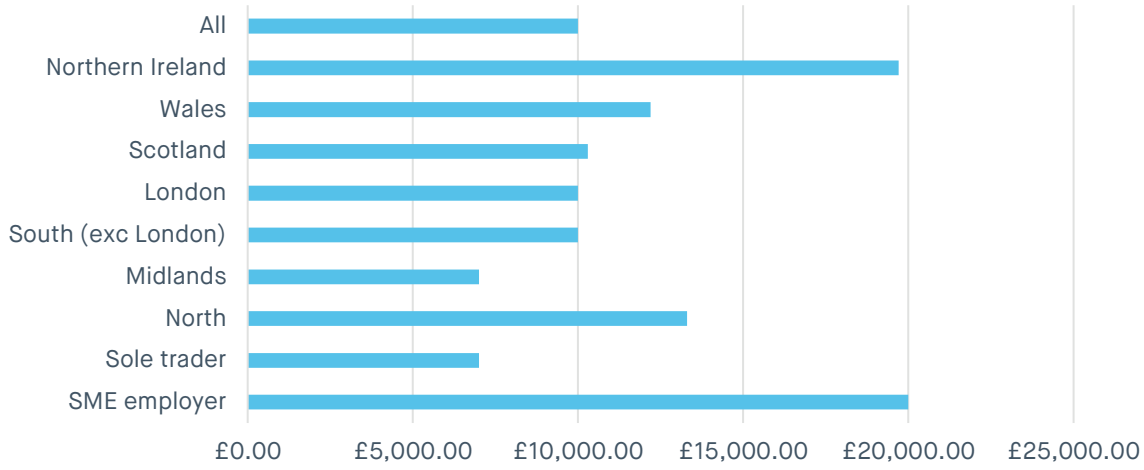
Figure 18: Reasons SMEs sought external finance between 2016 and 2019



Source: British Business Bank (2019), Business Finance Survey: SMEs.

Access to and the use of external finance in general and bank loans in particular varies as a result of factors such as business size, business age and geography. For example, SMEs with employees are more likely to use external finance than sole traders. British Business Bank data show a 20-percentage point difference in use of external financing between the two groups, with 73% of the former using external finance and 53% of the latter. Growth orientation is a variable that also correlates with use of external finance. Those firms that are more growth orientated tend to seek external finance more than those who are not.[71]

Figure 19: Median amounts of external finance sought by SMEs, 2019



Source: British Business Bank (2019), Business Finance Survey: SMEs.

The chart above shows the variation in the median amounts of external finance sought by SMEs between 2016 and 2019, across different parts of the UK. The same survey found that just over eight in ten SMEs obtained the external finance they were after.[72]

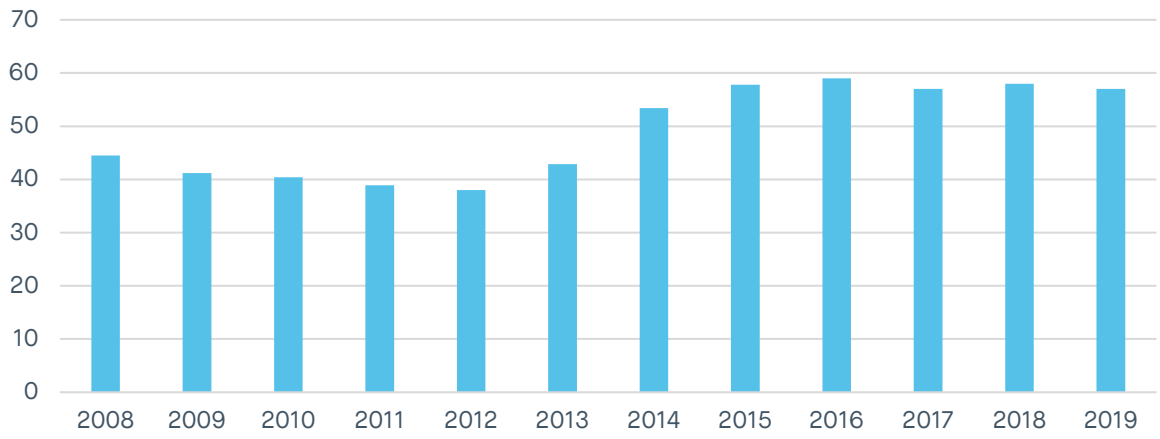
This "success level" was consistent with previous years. British Business Bank data from 2018 and 2017 show a similar proportion of SMEs who sought finance in the preceding three years getting all of what they needed.[73]

However, the picture, once disaggregated is more complex and less positive. UK Finance data illustrate, for example, a divergence in the success level depending on the type of external finance sought. Between 2011 and 2017, typically 82.6% of overdraft applications from smaller businesses were approved by providers.[74] In contrast, over the same period, on average, 69% of SME loan applications to banks were accepted.[75]

Bank loans for SMEs before the COVID crisis

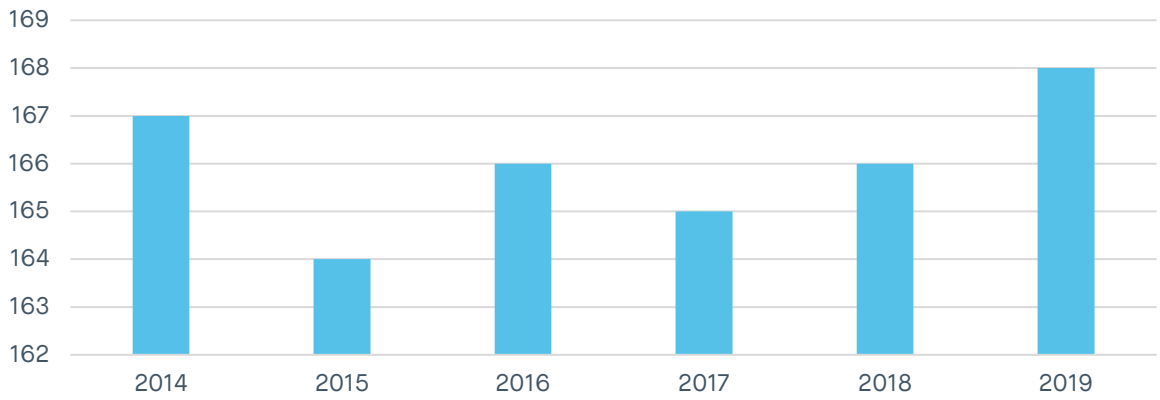
The data presented in the charts below show the trend in new lending since the financial crisis of 2007-08. New lending to SMEs fell year on year, until 2013, when the trend reversed. Between 2014 and 2019, UK banks have been supplying UK SMEs with more than £50 billion of commercial loans a year.

Figure 20: Gross new lending to SMEs, 2008 to 2019, £ billion



Source: UK Finance (2018), SME finance in the UK: past, present and future and British Business Bank (2021). Small Business Finance Markets 2020/21.

Figure 21: Stock of outstanding loan debt, £ billion



Source: British Business Bank (2021). Small Business Finance Markets 2020/21.

The profitability of business loans for larger banks

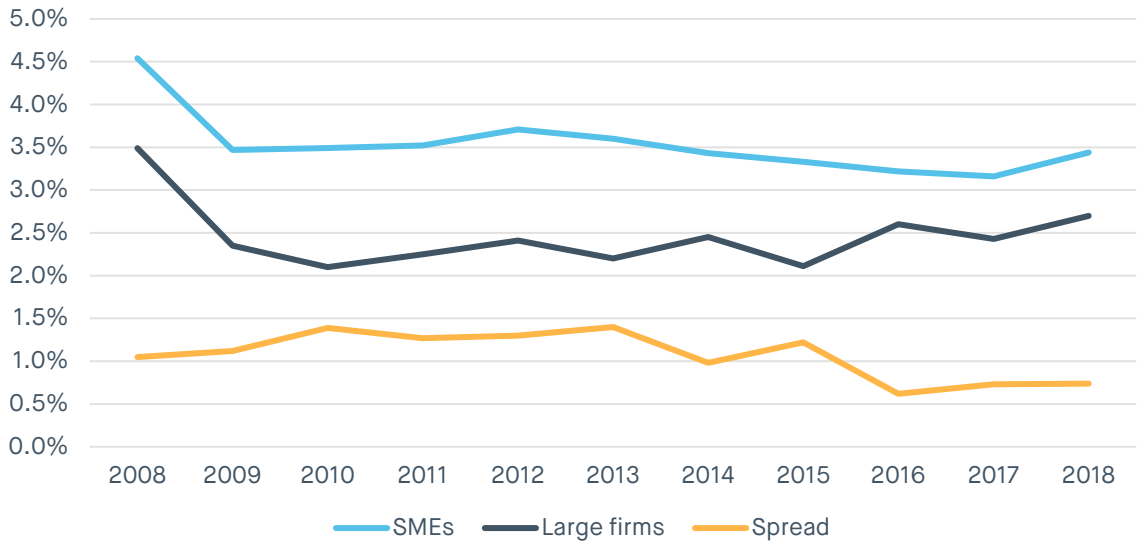
Commercial loans are lucrative business for banks. When the CMA published its market review in 2016, it suggested that banks held about £90 billion of loan balances.[76] It estimated that between 5% and 11% of the loan books of the major banks consisted of loans (secured and unsecured) to businesses.[77] SME lending, the CMA pointed out, generated higher returns than mortgage lending.[78]

The FCA, in an analysis of bank business models, highlighted how the combination of the large market shares of the "Big Five" and the returns (determined by factors such as the size of the margin on the interest rate charged) on the loans helped bigger providers obtain a much higher "all-in yield" on SME lending than that achieved by the smaller (e.g. mid-tier) banks.[79] This relationship has been, similarly, identified in other analyses, which have concluded that: [80]

> *"...business lending is a...significant source of bank profits, its quantitative importance varies dramatically across bank size...The profitability of business lending depends on whether banks are large or small..."*

Competition in the banking sector is linked to the cost and availability of credit. [81] [82] The more competitive the market as a rule, the more credit tends to be available (to those entrepreneurs and firms who need it) and at cheaper prices (i.e. lower interest rates). Therefore, the interest rate spread between that charged on business loans and paid-out on BCA balances, for example, can be expected to be an indicator (one among many) of the vigour of competition in the loans market. OECD data, presented in Figure 22, shows that after a precipitate drop in the average rate of interest charged on a business loan in 2008-09 (when the Bank of England base rate fell to less than 1%) the rate on commercial loans has stayed relatively stable and above 3%. Significantly above the typical 0.07% interest paid out by the larger banks, for example, on BCA balances.

Figure 22: Typical interest rate on a UK SME and large company loan



Source: OECD (2020), Financing SMEs and Entrepreneurs 2020: An OECD Scorecard.

It is too early to tell how the dynamics of the SME loans market will evolve over the coming years, especially after the interventions to reduce the negative impact of COVID end. Nevertheless, if the disruption to the commercial loans market caused by the latter (including the fall-out from the emergency loan guarantees scheme set-up by the Government) leads to a more consolidated commercial loans market, then the increased concentration would be expected to lead to fewer commercial loans being made by banks, less being lent out in total and a wider interest rate spread between that charged on loans and that paid-out on BCA balances.

The "finance gap"

While substantial amounts of finance are being made available to SMEs across much of the country by banks below the headline numbers the picture is more nuanced and less positive for entrepreneurs and SMEs than might, at first, appear to be the case. There are "gaps" in the provision of loans to some categories of SME and to smaller firms in some parts of the country. The "gap" exists despite efforts over many decades to reduce the risks inherent in SME lending,[83] through schemes such as the Enterprise Finance Guarantee, operated by the British Business Bank.[84]

Policymakers and politicians should note that, the existence of a "finance gap" and the consequent constraints placed on those businesses who suffer from the limitations difficulty accessing external finance creates, is likely to have implications for other wider national policy objectives. These include the "levelling-up" of regional economies across the country and increasing the UK's productivity growth. Both of these objectives are closely connected. Achieving them implies an expanded and more dynamic private sector which is more evenly distributed across the country.

Evidence for an SME "finance gap" is abundant:

- UK Finance identified comparatively low authorisation rate, by banks, for new loans compared to that for other (more expensive and often more short-term) credit facilities such as overdrafts.
- The British Business Bank, in a 2019 survey found that 9% of UK SMEs had a bank loan,[85] [v] however, around 14% of SMEs had sought a loan from a bank in the three years prior.[86]
- Research undertaken in 2019 for the EU into SME financing also found evidence of a "gap" between the proportion of UK SMEs that apply for loans (15%) and those that obtain them (10%).[87]

A growing body of academic work has similarly identified the presence of a SME "finance gap". It suggests that the problems in accessing loans correlate with a number of business demographic and geographical factors:

- Younger and smaller firms (i.e. those at the smaller end of the SME spectrum and under five years old) struggle to access loan finance more than those at the larger end of the small category, medium-sized businesses and older

[v] Research conducted for the EU in 2019, found that 10% of UK SMEs had relied upon loan finance between April and September 2019. Confirming that the BBB figure of 9% is roughly right. Notably the 10% figure was 5% below the EU 28 average. Source: SAFE. (2020).

enterprises.[88] British Business Bank data confirmed that, in 2019, smaller firms under five years old were much less likely to be able to get any, or all, of the external finance they wanted (73%), compared to older SMEs (84%).[89]

- Enterprises which are more innovative and high growth tend to struggle too. As a report from the London School of Economics noted:[90]

  "Loan rejection rates are generally higher for high-risk and smaller firms and those with shorter banking relationships...The British Business Bank...[found that]...32% of high-growth firms report that obtaining finance is a significant obstacle to their success, compared to only 25% of other firms".

- Younger and more innovative SMEs in peripheral and rural regions are especially poorly served by financing institutions and struggle more than their urban counterparts to access external finance in general[91] and loans in particular. As a result of the difficulties with the latter, such firms often have to turn to more expensive and short-term forms of external finance, such as using credit cards, to meet their needs.[92]

The "finance gap" is composed of more than just those who are rejected for a loan (or, indeed, any kind of external financing) or those who aren't able to obtain all of what they need. It also includes those entrepreneurs and firms that are "discouraged" from applying for finance in general and loans in particular, in the first place. Despite a loan being potentially helpful to their business.[93] This phenomenon is often referred to as the "discouragement".[94]

Estimates of its size vary. Some have suggested that as many as one in ten SMEs are affected by it,[95] others that it impacts around 4% of firms[96] or perhaps less.[97] It is difficult to measure. Nevertheless, there is sufficient evidence to demonstrate that it is a problem for some entrepreneurs and businesses.

Factors behind "discouragement" include:[98]

- Media-shaped perceptions among business owners about banks and the availability of loan financing.
- Previous experiences with banks, including "signals" that some businesses would not be considered suitable for loans.

Analysis suggests that, perhaps between a third and half of those who are "discouraged" would have been able to access the finance they needed had they applied.[99] Indicating that "discouragement" is leaving some businesses needlessly under-capitalised. As with loan rejections, "discouragement" is a phenomenon that demonstrates notable regional differences.[100] Research by the Enterprise Research Centre found the highest rates of "discouragement" were in London, followed by Northern Ireland, Scotland and the North West of England.[101]

Further, "discouragement" tends to be found, more commonly, among those SMEs that are more growth-oriented SMEs. This suggests that borrower "discouragement" may ultimately play a role in limiting business growth and, in-turn, the prosperity of the areas where those businesses facing such constraints operate from.

The connection between difficulty accessing finance (whether as a result of application rejection by providers, partial offers meeting some of a business's needs or "discouragement"), demographic factors (business size and age), business characteristics (e.g. growth orientation, innovativeness, etc) and geography should concern policymakers pursuing a "levelling-up" agenda and aiming to boost UK productivity. The kinds of businesses that are central to both agendas are the firms that are, it seems, most likely to face obstacles in obtaining finance. Not only do those businesses suffer the consequences of that but the local and regional economies in which those businesses operate do too.

There are good reasons for policymakers to consider that concentration in the business banking market contributes to the finance "gap" described above. There is an established relationship between the levels of concentration in the banking sector and financing constraints.[102] The more concentrated the market is for finance, the more limited credit availability tends to be.[103] [104] As a result, the comparatively high concentration in the business banking market could be holding back the "levelling-up" and productivity growth agendas.

In the context of the emerging evidence of the impact of the government's COVID interventions on the commercial loans market in particular, the problems caused by concentration could grow in the next few years. Unless a more competitive business banking market could be encouraged. More rivalry, under normal conditions, would be expected to incentivise banks to try and expand the market by reaching out and meeting the needs of many of those firms who are currently under-served because they are riskier (but viable) or have not engaged with commercial loans at all in the past, but could benefit from doing so.

Relationship banking

One factor, often linked to the SME "financing gap", is the closure of bank branches, the centralisation of banking operations and the contention that these trends have led to the loosening of the relationship between entrepreneurs and smaller firms on the one hand and their banks on the other.[105]

Estimates suggest that the number of bank and building society branches in the UK halved between 1986 and 2014.[106] ONS data shows that since then the number of branches have fallen further to just over 10,000 in 2019.[107] Bank branches alone reduced by 25% between 2012 and 2019.[108]

The closure of branches has been driven by:

- The advance of communications technology. The branch has become one among a number of avenues for accessing banking services. Indeed, some smaller businesses welcome this, with a large minority (26%) of SMEs happy to move all their banking to a digital format.[109]
- The fallout of the 2007-08 financial crash. In response to the financial mistakes made by banks and financial "hit", there was retrenchment through a revision of the operating model of many banks to one based upon more centralised and standardised decision-making. This has been particularly noticeable in relation to the provision of finance to businesses in general and loans specifically.[110] [111]

- A management focus on efficiencies. Branches are expensive and an area where significant short-term cost savings can be found.

Analysis has identified a clear connection between the centralisation of commercial decision-making having a negative impact on access to credit of smaller businesses.[112] [113] and between bank branch numbers and access to credit for smaller firms.[114] There is also some evidence that indicates that there are positive effects from relationship banking through branches) on the availability of finance for SMEs[115]

Typically, lending to SMEs (within a given postcode area) grows - from quarter to quarter – by more than 2%.[116] After a branch closure in a postcode, average quarter-on-quarter growth of lending was estimated to drop to under 1%.[117] In addition, in places where the latest branch closure is the last branch, the impact is estimated to be greater still. In such areas, quarter-on-quarter lending growth becomes negative, resulting in £1.5 million less in lending, per postcode per year.[118]

The issue of bank branch closures has been most acute in the more peripheral areas. Leading one analysis to suggest that:[119]

> *"...the huge decrease in bank branches may have exacerbated credit constraints for SMEs in more remote UK regions...".*

The positive benefits for SMEs of the kind described above, and their connection to the existence of a branch network (and the subsequent closer relationship that many businesses have with their bank) is reflected in opinion surveys and qualitative research with SMEs, which shows branches are popular, not least because of their role in facilitating relationship-based banking. Evidence from YouGov, for example, found high levels of support for branches, with 68% of SMEs considering a bank branch "important", and 66% saying branches are a "necessity for discussing issues face-to-face".[120] Business groups, such as the Federation of Small Businesses have, as a result of research with their membership, also made similar observations about the importance of bank branches.[121] The benefits and subsequent popularity of the branch network among the SME community was noted by the CMA in its most recent market review.[122] It found that the branch was seen by SMEs as important for the maintenance of a more relationship-based approach to banking.

It is unsurprising therefore, that access to a branch network influences the decisions of many business owners, about who to select as their primary or only BCA provider, alongside factors such as existing relationships.[123] Further, a significant minority of SMEs (31%), want a "closer relationship" than they currently have, with their banks. [124] A branch network is likely to play a central role in meeting that demand – where banks provide such enhanced services. Certainly, services for SMEs, such as business finance advice (which banks are well positioned to provide) can play an important role in helping smaller firms obtain the most appropriate external finance and accrue the benefits that come from it.[125] [126]

Given the kinds of damage that closing branches can cause and the gains that can accumulate from a close and on-going relationship between a business and their bank, it is reasonable to suggest that closing the "finance gap" is likely to be easier where branches and relationship-based banking continues to have a central role in the

delivery of business banking. No doubt alongside technological innovations, which increase efficiencies and flexibility. Certainly, for policymakers looking to "level-up" the regions and nations of the UK and boost nationwide aggregate productivity growth, the largely negative impact of the loss of branches and the fraying of relationship-based banking on access to finance by entrepreneurs and SMEs, must be cause for concern.

SME vulnerability and trust

Just like individual consumers, SMEs are often substantially less informed, financially sophisticated and powerful than the banks they deal with. Indeed, the analogy between small firms and consumers has been explored in considerable detail by academic and competition expert Amelia Fletcher, in work commissioned by the Federation of Small Businesses.[127] High profile examples of misconduct by banks, towards SMEs[128] [129] are, in part, consequences of some of the failures in the banking market described in this report:

- Between 40 and 60,000 smaller businesses were inappropriately sold swaps and embedded swaps by high street banks.[130] [131] In an investigation, the Financial Services Authority (pre-cursor to the FCA) found that 90% of the products were mis-sold,[132] leading in some cases to insolvency.[133]
- A second scandal was RBS's treatment of distressed SMEs by its Global Restructuring Group (GRG).[134] The FCA commissioned independent report into GRG's behaviour towards many of the small firms that it engaged with. It found that "*...there had been widespread inappropriate treatment of SME customers by RBS*".[135]

Subsequent to the misconduct problems associated with swaps and embedded swaps, the public and political concern surrounding RBS's business restructuring services, pressure from a Treasury Select Committee inquiry[136] and the report of the Parliamentary Commission on Banking Standards[137] the authorities took steps to improve the protections available to smaller businesses. For example, the scope of the Financial Ombudsman Service (FOS) has been widened to cover more SMEs, so they have available to them a more realistic route for obtaining redress.[138] Further, it should be acknowledged that the FCA provides SMEs with other protections.[139] However, it remains the case that much of business banking is comparatively unregulated and what protections that are in place, are not systematic and based on a clear and coherent analysis of the vulnerabilities of SME users of financial services products.

SME customers, therefore, neither have the protection of a highly competitive market to ensure their banking needs are best served or the protection of regulation to minimise the detriment they suffer as a result of the challenges they face in engaging with financial services, (such as banking) due to the asymmetries of sophistication, information and power that exist in the SME – bank relationship. Therefore, it seems inevitable that the malfunctioning business banking market will see ongoing financial detriment suffered by SMEs and more of the misconduct scandals that have made the headlines in recent years.

CHAPTER FOUR – POLICY RECOMMENDATIONS

The UK competition framework

Competition is often the Cinderella issue in economic policy. It is technical, difficult to improve, and it can take a long time for its positive effects to be noticed, if indeed they are noticed at all, because they can be highly diffuse. However, if the UK wants to drive up its productivity and maximise consumer welfare, it is vitally important. The regulatory framework has gone through a number of significant changes since the 1970s. Most recently there have been a number of structural changes, including the abolition of the Office for Fair Trading (OFT) and the Competition Commission, the establishment of the CMA and the realignment of the responsibilities between the former on the one hand and Trading Standards on the other.

Making competition a political priority

The fundamental deficiency in the UK's competition framework is political. Competition is not given the priority that it requires, given its centrality to so many other policy objectives across government. Therefore, a specific Ministerial portfolio needs to be created that focuses solely upon competition and consumers. This Minister would straddle the Treasury, BEIS and the Cabinet Office and have the authority of the Prime Minister to ensure all departments are taking note of competition issues in their work that might impact on markets and interrogate all departments about how their regulatory efforts impact consumers and most importantly the dynamism of markets.

All new regulatory proposals with implications for competition in markets would need to get "sign-off" from this Minister. Further, every proposal produced by a department or regulator with potential consequences for competition should be required to show how it might be expected to impact competition and consumers as part of the Regulatory Impact Assessment (RIA) that accompanies it.

Utilising largely un-used provisions in the Small Business, Enterprise and Employment Act 2015 for new regulations to be "tested" for their impact on competition, perhaps bolstered by new legislation, the new Minister would be able to require the CMA to evaluate proposals put before them for their likely impact on competition. This would be a process that closely mirrors the RIA process and runs in parallel to it. Ultimately, evaluations by the CMA, about the likely impact on competition of a particular proposed measure would be presented to a committee co-chaired by the Better Regulation Minister and the Competition and Consumer Minister.

If the competition consequences of a proposed measure were judged to be negative, the committee would have the power to "flag" measures that would be detrimental to competition and thus have them "returned" to the relevant department for revisions to improve their design to lessen their impact on regulation. The reasons for the "flagging" would be fully explained in an accompanying public statement. Further, departmental adherence to these internal Whitehall "competition" requirements would be measured and reported-on annually, to Parliament, by the Minister.

Two recent interventions about the future of the UK's competition framework have identified several ways that the Government might consider strengthening the current competition and consumer framework. One from former Chairman of the CMA Lord Andrew Tyrie.[140] The second by John Penrose MP, who, at the request of the Government, recently produced a report about the future of the competition policy landscape in the UK.[141]

The report by John Penrose identified the need for more regular analysis by the CMA of the state of competition across the UK economy.[142] This is similar to an idea proposed by the SMF in its *Competition, Not Concentration* report.

It is vital that the CMA's analysis on the state of competition in the UK[143], published last November, is updated regularly and even expanded in some areas. For example, snapshots are helpful but data capturing trends over time is more valuable for policymakers. An annual "state of competition" report should be a more explicitly collaborative effort (albeit led by the CMA) between Trading Standards, Citizens Advice and the economic regulators, to ensure it is able to build a more detailed picture of consumer detriment across the economy.

Recommendation one

Establish the position of Minister for Competition and Consumers, to ensure competition and consumers are prioritised across government and considered by policymakers in all relevant departments and agencies.

Building on the CMA's recent report on the "state of competition", a key duty of the new Minister should be to present to Parliament a regular "state of competition" in the UK report, ahead of an annual debate on the findings.

Takeover and mergers policy

When considering the implications of mergers and acquisitions in markets, regulators undertake detailed assessments and consultations to establish the potential implications for customer outcomes and market competitiveness. This analysis is thorough, rigorous and provides a valuable safety net to prevent mergers and acquisitions which undermine competition, and which potentially lead to higher prices and reduced levels of product innovation.

At present, when considering whether to permit a merger, the Competition and Markets Authority identifies possible "theories of harm" – ways in which the merger might lead to worse outcomes in a market[144] – such as a substantial loss of competition and higher prices. If these theories of harm are considered likely to occur, and no credible remedies to these harms can be implemented, then the CMA can prevent a merger going ahead.

While the "theories of harm" approach to assessing mergers has helped prevent detrimental mergers going ahead, we note some of the inherent challenges and judgment calls involved in the process. Assigning probabilities to theories of harm is

often a subjective process with significant uncertainties – meaning that mergers may be permitted when the *actual* probabilities of harm to customers are inherently greater. This is not a criticism of the CMA's processes, but an inherent challenge with assigning probabilities to economic events.

As well as difficulties associated with assigning probabilities to harms, there are challenges associated with measuring the *scale* of harms, particularly when harms may take several years to materialise. One type of harm that is difficult to measure, for example, is what economists call "X inefficiencies" – inefficiencies that arise when firms behave in a sub-optimal manner due to a lack of competitive pressure. Similarly, the net impacts of product bundling in markets such as banking and telecoms are often difficult to establish. While bundling following a merger may enable efficiency savings and lower costs for customers, it can also act as a barrier to switching and make it harder for new entrants to compete in a market.

Given the inherent uncertainties associated with establishing the likelihood and scale of harms to customers following mergers and acquisitions, our preference is for the "theories of harm" framework to be replaced with a new "presumption in favour of competition" – under which the CMA would be expected to prevent mergers in the most concentrated markets unless it could be demonstrated that there was a strong chance of the merger leading to improved outcomes for customers (for example, lower prices, better service quality and higher levels of product innovation) while not undermining competition.

Recommendation two

Introduce a presumption in favour of competition into Takeover and Mergers policy.

Enhancing competition in the banking sector

There is an inevitable trade-off between competition in the banking sector and the need for stability, as a result of the special functions that banks play such as their "*...intermediary services between lenders and borrowers by gathering deposits, providing loans, transaction and payment services and financing entrepreneurial projects*".[145] As well as their vulnerability to instability as a result of the "*...unique maturity transformation they undertake in their balance sheets...*".[146] In addition, in the UK there is a history of misconduct by some providers, which has required regulatory action to ensure that users are protected and detrimental practices are eliminated. A degree of regulation is inevitable, even though it may strengthen incumbents. However, there are steps that could – and should – be taken to enhance competition in the banking sector.

Reducing barriers to entry and growth

A key factor driving competition in all markets is the entry and growth of challengers to the incumbents that threatens the latter's market shares. New entrants into the retail banking market have historically been relatively rare. Many of those that have

entered the personal and business banking markets in the last decade or so have done so despite the barriers to entry, and now they face further obstacles to growth.

To reduce barriers to entry and scale, regulatory requirements should not be unnecessarily high and should be as "smart" as possible. As the Independent Commission on Banking (the "Vickers Commission")[147] recognised, standardised risk weightings are likely to be:[148]

> *"...burdensome for certain (relatively less risky) business models...The result may be that small banks are less systemic and easier to resolve than large banks, and yet are required to hold proportionally more capital".*

As UK Finance have noted, the Bank of England has recognised that:[149]

> *"...the current risk weight differentials between the Standardised and the IRB Approach firms are large, create an uneven playing field between different sized banks".*

Currently, the Internal Ratings Based (IRB) approach to risk weighting ends up providing an advantage to larger banks, while the Standardised Approach, which predominates among mid-tier providers for example, bears more heavily on banks which are not as systematically important for stability and are trying to compete with the larger incumbents. With regulatory approval, mid-tier providers are looking to move to take-up the IRB approach.[150]

The recent rationalisations of the regulatory process for starting-up a new bank and the alteration to capital adequacy requirements for new banks introduced in 2013, were welcome steps[151] and have, according to the CMA,[152] made some difference - with, for example, 53 new banks being given authorisation since that time.[153]

Further steps were taken in 2017, with a looser approach to Pillar 2A capital rules by the Prudential Regulation Authority (PRA) in the form of a more individuated method of judging adequacy, especially towards mortgage risks.[154] This has helped level the playing field, somewhat, between larger and smaller banks (such as the mid-tier institutions).

However, where policymakers and regulators can go further for new entrant and challenger banks under the international (Basel III) rules, they should look to do so. The current capital requirements obligations are more burdensome for new entrant and challenger institutions (i.e. those that are not "systematically important financial institutions" for the purpose of the Basel III rules).[155] The PRA should give further consideration as to how the barriers to entry and growth associated with these rules can be lessened, where such changes are unlikely to cause undue risk to the overall stability of the banking system.

The Bank of England's review of MREL regulations is also a welcome opportunity to level the playing field between large and mid-tier banks. A more transparent and predictable system, that minimises 'cliff-edges' and supports smaller banks to grow rather than exacerbating their disadvantages could play an important role in stimulating a more competitive and less concentrated banking market. While protecting the stability of the system and minimising costs to depositors and taxpayers

are correctly the Bank of England's primary priorities, it should also consider the competition effects of its regulations as part of the MREL and other review processes.

Recommendation three

The Bank of England's PRA should expedite the introduction of the so-called Basel IV rules to put a "floor" under the capital reserves of the banks that utilise the IRB models for risk modelling and identifying their reserve requirements and reduce the advantage that the IRB approach gives to bigger banks.

The Bank should also take the opportunity offered by its ongoing review of MREL to ensure regulations do not excessively disadvantage mid-tier banks, by making them more transparent and predictable and minimising 'cliff-edges'.

Further ahead, the PRA should examine the extent to which barriers to entry and growth could be reduced further – for example through reductions to capital requirements – while at the same time maintaining stability of the banking system.

Market stimulation through government procurement

A key lesson from the economic success of many of the East Asian Developmental States such as South Korea and Singapore is that direct government procurement, in a range of areas, can help catalyse private industry and ultimately achieve a desired policy goal.

The Government, local authorities and relevant agencies (such as regulators) should ensure that their own bank accounts are actively managed, and that the best banking deals are sought out, not only for taxpayer value for money reasons but as a tool of public policy to encourage a more competitive banking sector.

A duty, mandating such "active management" should be placed on the "Government Banking" service and all parts of the public sector which have authority over a bank account in which public money sits and is transferred into and out of. Public authorities should be using their "consumer" power to help ensure the banking market is competitive by encouraging new entrants and challengers wherever prudent and practical to do so. It is shame that the recent Green Paper on public procurement failed to consider these issues[156] and lacked ambition in how the state can play a direct role in shaping policy outcomes through its own purchasing activities.

Further, going forward government should explore how future policies aimed at bolstering lending, such as the CBILS and BBLS schemes during the COVID-19 crisis, could enhance competition in the banking market – or at least are not detrimental to competition. As noted in the previous chapter, the market share of the largest banks, with respect to business lending, has increased as a result of CBILS and BBLS. With future schemes, more consideration should be given to the role that smaller lenders could play in supporting access to finance across the economy. This includes ensuring

that challenger banks are involved in governmental and Bank of England discussions, at an early stage, with respect to such policies.

Recommendation four

The Government should place a requirement on "Government Banking" and all departments and state agencies to actively manage the bank accounts they have under their authority to ensure both value for money and support government competition objectives for the sector, where prudent to do so.

Further, the Government should ensure that future lending support schemes, such as CBILS and BBLS during the COVID-19 crisis, can support competition in banking. This includes ensuring that challenger banks are involved in governmental and Bank of England discussions, at an early stage, with respect to such policies.

Encouraging switching

Low switching rates are both a symptom and a cause of an uncompetitive market. As this report has highlighted, PCA and BCA switching rates among retail bank customers are low and evidence of the lack of competition in the sector. Much has been said by the CMA and others about why switching levels remain subdued in banking. As highlighted above, the reasons are multiple and mutually reinforcing. Low levels of customer engagement, opacity due to product complexity and considerable investment needed to search out and identify alternatives, along with significant risk if a switch goes wrong all for what are often meagre gains, have all played their role.

Given the limited success of previous reforms it is time to go further by utilising consumer "prompts" as another mechanism to encourage more consumer engagement and switching. Basing their design on the findings of the FCA commissioned research into this issue,[157] the regulator should require banks to prompt customers every two years about their PCA or BCA that they have with their bank (or banks) in order to have current customers either re-affirm consent (either actively or passively through a roll-over mechanism) for the continuation of their current PCA or BCA arrangements, or to alert the customer to the opportunity to re-evaluate what they have currently and whether there might be gains from switching.

In addition to creating opportunities for more switching through building consumer "prompts" into the banking market, the switching process itself needs further improvement. Too many people still see it as too much of a risk. This is especially true of business banking customers where a problem with switching their BCA could be catastrophic for their business. This lack of confidence could be ameliorated somewhat by greater transparency about the switching process and confidence that all parties are operating best practice standards. Therefore, the regulator should take steps to increase the transparency of the switching process. This should include agreement by the regulator on what constitutes best practice standards in this domain (especially around communication with customers about the process) and publicly ranking the performance of the banks and identifying adherence to, and failure to adhere to, those best practice standards.

Another incremental improvement that could be particularly helpful to the most disengaged consumers is the creation of a database of disengaged customers, similar to the one that Ofgem recently trialled for the energy sector.[158] The database could include those that have not switched current account in more than three years, and additional measures could be taken to encourage such individuals to engage with the market – for example, they could receive product information from alternative banks, as well as more guidance and assurance on the switching process.

Recommendation five

The Treasury and FCA should take steps to improve the "switching environment" for consumers and SMEs, with a package of measures aimed at reducing some of the most significant remaining barriers to switching. Measures should include:

- Requiring banks to "prompt" their PCA and BCA customers to renew their consent for continuing to bank with their current bank (or banks) by creating an artificial "prompt point" to stimulate switching, or at least the consideration of switching among consumers and businesses.
- Building more transparency into the switching process, through a code of best "switching" practice, with adherence monitored by the FCA and bolstered by a public reporting system ranking performance against it.
- Trialling a Disengaged Customer database and explore how best to utilise it to reduce detriment to the most disengaged customers.

The CMA has previously identified Anti-money Laundering (AML) laws as a source of friction to switching in the BCA market in particular. Given the general lack of effectiveness in AML rules in substantially reducing money laundering[159], continuing with them when they create such significant negative spill overs for key elements of the economy such as competition in the banking sector, seems counterproductive. Therefore, the Government should look to make the rules more risk-based and proportionate and banks should be encouraged by the regulator to utilise the best available technology to reduce the "frictions" for customers who want to open a new bank account or switch their existing account(s), as a prelude to a more thorough review of the rules.

Recommendation six

Trim back some of the unnecessary regulatory barriers that make switching more onerous for SME customers, in particular. This means making the current Anti-money Laundering rules more risk-based and proportionate, while the regulator should encourage banks to utilise the latest technology to reduce the bureaucracy associated with AML compliance further.

We believe that Open Banking has potential to enhance customer switching rates, through a number of channels. Firstly, it should pave the way for more sophisticated price comparison services for current accounts, savings and other financial services. Secondly, by enabling the sharing of financial transaction data, it should make it easier for banks to gauge lending risk and offer appropriate rates of interest.

As discussed in the previous chapter, incumbent banks often have an informational advantage which makes it easier for them to offer lower interest loans than challenger brands. Open Banking could help level this playing field. Experian has recently launched the UK's first service to give consumers the ability to instantly improve their credit score, using information such as regular video and music streaming payments and council tax payments. The company says early analysis suggests over half of people (51%) using the new service will receive an instant increase to their Experian Credit Score.[160] Separately, Credit Passport uses Open Banking data to provide more accurate credit scores for SMEs.[161]

However, while Open Banking usage is increasing, it remains limited and there are questions over the extent to which less engaged customers will utilise it. While we believe developments in this space have potential, there is a need for policymakers to go further to encourage switching and customer engagement – hence the range of other measures cited above.

Providing greater assurance in switching to a challenger brand

We noted in the previous chapter that consumers are less likely to use a challenger bank than a challenger energy or telecoms company – probably due to the perceived financial risks associated with "something going wrong" at a challenger bank. For example, some may be concerned about a bank failing, resulting in loss of savings.

Such concerns persist despite the existence of the Financial Services Compensation Scheme (FSCS), which provides up to £85,000 of deposit protection per person, per bank, building society or credit union (and up to £170,000 for joint accounts). Business current accounts are also covered by the FSCS.

The SMF has previously argued that, while the FSCS provides customer protection, it may undermine competition; customers become less likely to switch or conduct regular "due diligence" reviews of their bank, due to the existence of relatively generous deposit protection.[ii] Indeed, the £85,000 threshold sits above typical levels of household wealth held in bank accounts; the median amount held in current accounts was £1,700 according to the 2016-18 Wealth and Assets Survey. Even at the 75th percentile this stood at just £5,700.

Reform of the FSCS could enhance competition in the market. In particular, we think there may be a case for setting a lower deposit protection threshold for large incumbent banks, than for newer, challenger brands. Given that the amount of deposit protection is so generous at the moment, it would be possible to do this while still providing 100% financial protection for the overwhelming majority of households.

Such a move is unlikely to fundamentally reshape the market, but at the margin, this should encourage more higher wealth customers to "shop around", either switching bank or muli-banking (holding deposits across multiple banks). A greater level of

deposit protection with challenger banks, or lower level of protection with large incumbents, could – combined with an effective communications strategy – provide more individuals with assurance that they can safely bank with a relatively new brand. Indeed, it could offer challengers with a small source of competitive advantage to counterbalance the various disadvantages we have already outlined.

We would expect any differential in deposit protection to be temporary, as part of a broader range of measures aimed at encouraging customer confidence in switching bank and engaging more with the market. It is crucial that changes to the deposit scheme are communicated clearly, with households affected by the decline in protection threshold given notice of the changes – and prompts to take action.

Further ahead, a complete reform of deposit insurance in the UK should be explored, with the aim of providing much greater assurance to banking customers. In particular, we believe there is a case for replacing the FSCS with something akin to the United States' Federal Deposit Insurance Corporation (FDIC).

The FSCS is a "pay as you go" approach to deposit insurance. The scheme is funded through annual levies on regulated firms, with the amount levied based on estimated claims over the course of a year. It has been argued that there are two problems with this approach. Firstly, a pay as you go scheme is unlikely to hold sufficient funds to cope with a large bank failure, meaning customers may be unable to recover deposits immediately and additional government intervention may be required. Secondly, the funding model could undermine lending to businesses and households during an economic downturn, if the levy rises in anticipation of increased claims.[162]

In contrast, the FDIC is an insurance-based system covering deposits of up to $250,000 per depositor, per insured bank, for each account ownership category.[163] Under the FDIC regime, substantial reserves are held which stand ready to reimburse depositors almost immediately if a bank were to fail – it is an "ex-ante" or "pre-funded" approach to deposit insurance.

Recommendation seven

Adopting a pre-funded deposit protection scheme in the UK could support greater rates of customer switching through additional assurance that deposits could be recovered quickly in the event of bank failure. It could also help support business and household lending during future financial crises, compared with the pay as you go FSCS which sees levies increase in such circumstances.

The FSCS should provide enhanced rates of deposit protection for challenger banks, to encourage greater levels of account switching, and reduce the perceived risk of using a challenger bank.

We would expect any differential in deposit protection to be temporary, as part of a broader range of measures aimed at encouraging customer confidence in switching bank and engaging more with the market. Further ahead, policymakers should explore more substantial reforms to deposit protection in the UK, replacing the "pay as you go" Financial Services Compensation Scheme with something akin to the "pre-funded" Federal Deposit Insurance Corporation in the US. A pre-funded deposit protection scheme would provide greater reassurance that depositor funds could be recovered rapidly in the event of bank failure.

Better access to redress

Through the many years of work that the CMA has carried out into competition in retail banking (and its predecessor the Office of Fair Trading) and the CMA's similar work on the energy sector[164], the detriment suffered by smaller businesses has been a prominent concern. However, the inclusion of smaller businesses in the CMA's (and previously the OFT's) work into competition in the banking sector has been unusual. What these instances have shown is that, while smaller firms (and micro-businesses in particular) can suffer from similar problems to consumers, especially when engaging with utilities, there is no systematic championing of them in the competition framework. Nor, as the mis-selling scandals for example show, is there coherent and consistent recognition of the vulnerability of smaller businesses in the financial services sector. This has been a problem recognised by small business groups for a long time.[165] [166] [167] To some extent, the regulators themselves have acknowledged there are issues. That is why in some areas, micro-businesses (and occasionally smaller businesses) find themselves falling within the auspices of one particular aspect of regulatory activity or another, from time-to-time. Nevertheless, the approach has been ad hoc.[168]

The FCA has made some positive steps in this direction, for example by extending coverage of the Financial Ombudsman Service (FOS) to cover more businesses.[169]

However, policymakers should go further and bring more coherence to the situation. This will require the Government to make suitable amendments to financial services legislation to ensure that micro-firms especially, but all smaller firms ideally, are treated in a consistent and comprehensive way by the FCA.

The resulting improvement in the position of smaller firms, should reduce the likelihood of the kinds of misconduct scandals referenced in this report reoccurring by ensuring that, for example, the most vulnerable businesses, when acting as end-users of financial products, can expect to be protected in a similar way to consumers.

Recommendation eight

The Treasury and the FCA should work together to bring coherence to the latter's regulatory treatment of smaller businesses by recognising that, in many ways, they are akin to consumers when engaging with financial products. The newly aligned approach should reflect the position that, in many ways, the smallest businesses should (subject to any exceptions, which must be based upon a strong rationale) be protected in ways similar to individual consumers.

The mortgage market

The mortgage market has gone through a number of significant changes in the last two decades, not least as a result of the financial crash, including changes in regulation and a trend towards 5-year-fixed rate mortgages compared to the 2-year-fixed rate mortgages that were previously popular.

We have identified three issues with the mortgage market as it currently stands, which prevent consumers receiving the full benefits of competition. First, the apparent failure of many intermediaries to secure the best value deal for the clients, with almost a third of consumers missing out on cheaper mortgages. Second, the continued existence of 'mortgage prisoners', stuck on legacy mortgages that they are unable to switch away from. Third, the substantial costs to a significant minority of consumers that are rolled over onto standard rate mortgages when their fixed rate expires.

Encouragingly, measures are being taken to address the first two of these issues. In January 2020, the FCA changed its guidance on mortgage advice to require intermediaries to explain why they have not recommended a cheaper mortgage if a cheaper product exists that meets the customer's needs and circumstances.[170] This is a positive first step, but the FCA should continue to investigate the market to understand the obstacles to customers getting the best price deals, and monitoring the effects of this intervention. As mentioned above, the FCA estimates that 170,000 borrowers on closed or unregulated mortgage books are now eligible to switch, though there is work to be done in particular to support the 14,000 borrowers that it estimates could make substantial savings from changing lender to switch.[171] The FCA should also continue to explore ways to help the remaining 80,000 or so mortgage prisoners that still cannot switch.

More action is needed to address the huge loyalty penalty faced by consumers rolled onto variable rate mortgages. In the first instance, this is likely to involve regulatory protections, not just efforts to increase consumer engagement. The regulator should introduce a transition period requirement for all customers whose mortgage policy expires before they move onto the full SVR. This transition period should be time

limited and involve a cap on the number of basis-points that an interest rate paid by the customer can increase for that period. This would have two positive effects:

- It would give the inert customer more time to engage with their mortgage situation and find a new mortgage deal.
- It would ease the financial "shock" for some people, when a consumer shifts from one deal to the SVR.

Recommendation nine

The FCA should expedite current efforts to identify and address issues that harm consumer welfare in the mortgage market. It should continue its monitoring and investigation of the role and effectiveness of intermediaries, it should seek further ways to support 'mortgage prisoners' and it should offer greater protections for consumers rolled onto standard variable mortgages. the remaining challenges in the mortgage intermediary sector, to ensure that mortgage brokers are delivering value for money for all consumers One of those "additional protections" should include the introduction of a "transition period" requirement for all customers whose mortgage policy expires before they move onto the full SVR. This transition period should be time limited and involve a cap on the number of basis-points that an interest rate paid by the customer can increase for that period.

APPENDIX – DATA SOURCES

To calculate the concentration and competitiveness measures, we have drawn on a number of data sources, documented in the table below:

Table 2: Market share data sources

Consumer market	Market share data sources used in analysis
Automotives	Department for Transport data on new car registrations
Groceries	Market share data collated by fooddeserts.org, owned and hosted by Dr Hillary J Shaw (London School of Commerce) and Dr Julia J A Shaw (De Montfort University) Kantar Worldpanel grocery market share data
Broadband	Ofcom Communication Market Reports Statistica data on broadband market share
Mobile telephony	Ofcom Communication Market Reports Ofcom "award of the 2.3 and 3.4 GHz spectrum bands", 2017 Statistica data on mobile market share
Electricity	Ofgem electricity supply market shares by company
Gas	Ofgem gas supply market shares by company
Personal current accounts	Office of Fair Trading (OFT), "review of the personal current account market", 2013 British Bankers Association, "promoting competition in the UK banking industry", 2014 Competition & Markets Authority (CMA), "personal current accounts: market study update", 2014 Competition & Markets Authority (CMA), "retail banking market investigation: final report", 2016 Financial Conduct Authority, "Strategic Review of Retail Banking Business Models: Progress Report", June 2018 Statistica data on personal current account market share https://www.choose.co.uk/guide/current-account-switching-service.html
Mortgages	Council of Mortgage Lenders/UK Finance market share data for new lending

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[2] Citizens Advice (2020), The loyalty penalty in consumer markets, two years since the super-complaint

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[11] Ofgem (2019), State of the energy market

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[16] SMF (2018), SMF Market Competition Bulletin

[17] Díez et al (2018), Global Market Power and its Macroeconomic Implications

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[21] https://www.thisismoney.co.uk/money/markets/article-9383923/Small-banks-urge-Bank-boss-help-inject-28bn.html

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[24] https://www.thisismoney.co.uk/money/markets/article-9383923/Small-banks-urge-Bank-boss-help-inject-28bn.html

[25] https://www.retailbankerinternational.com/news/current-account-switching-uk/

[26] Pay.UK (2020), *Current Account Switch Service Dashboard Issue 25: Covering the period 1 October 2019 to 31 December 2019*; Pay.UK (2021), *Current Account Switch Service Dashboard Issue 29: Covering the period 1 October 2020 to 31 December 2020*.

[27] https://www.ft.com/content/d8e8e0a8-4e57-11ea-95a0-43d18ec715f5

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[32] Financial Conduct Authority (2018). Strategic Review of Retail Banking Business Models: Final Report.

[33] Ibid.

[34] https://www.uswitch.com/media-centre/2016/07/fear-of-overdraft-rejection-prevents-two-thirds-of-consumers-from-switching-their-current-account/

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[36] Pay.UK, *Current Account Switch Service Dashboard Issue 29: Covering the period 1 October 2020 to 31 December 2020*

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