



**Consumer  
Focus**  
Campaigning for a fair deal

# Response to the review of barriers to entry, expansion and exit in retail banking

July 2010

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## About Consumer Focus

Consumer Focus is the consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses and public services to put consumers at the heart of what they do.

Consumer Focus gives a strong voice to consumers on the issues that matter to them and works to secure a fair deal on their behalf.

We work with consumers and a range of organisations to tackle the problems customers face and to achieve creative solutions that make a difference to people's lives.

# Introduction

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This call for evidence acknowledges the concentration of the sector around a handful of larger providers and the resulting implications for competition. The universal commercial model has not worked for consumers. It has provided a one size fits all model which does not serve all sectors of the market and their particular needs.

The current crisis has presented us with an opportunity to examine the way services are currently being delivered and promote different models. There is no reason why smaller institutions, who could be more responsive to the needs of the various segments of their market and better able to utilise technology and adapt it to different situations, should not be viable and valuable market players if current barriers are removed.

The review is currently limited to the issue of barriers to entry, expansion and exit. These issues, while significant, are just part of the story. Many of the impediments to competition were identified ten years ago<sup>1</sup> have not gone away, and in fact may be more significant as a result of the recession. Subsequent competition issues such as the Lloyds/HBOS merger need to be reviewed to inform future processes. And the impact of state aid on competition is a problem still waiting for a solution. The broader issues still need to be addressed, such as:

- Encouraging new models (not just new entrants) and consumer oriented innovation, including retail only models, that both provide real choice and safety for consumers
- Promoting a fair and competitive market place, one that ensures that consumers can exert choice to influence the sector
- Guaranteeing the provision of essential services where it is clear that the market will not provide
- Addressing problems of social exclusion by addressing the needs of the vulnerable and disadvantaged
- Supporting a savings culture
- Safeguarding consumer interests in the market
- Reducing risk and securing sustainability of financial services in a broad sense – economically, environmentally and socially
- Ensuring accessible and appropriate redress

It is important to understand how these issues will be addressed and how this review will fit into a wider analysis of competition in the sector. While the review is intended to be short and focused, the consultation period has been extremely short. As a result we have suggested areas where we believe further analysis needs to be done.

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<sup>1</sup> Competition in UK Banking, A Report to the Chancellor of the Exchequer, Don Cruickshank, March 2000

# Regulatory requirements

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## **Question 3: How does the licensing process for deposit taking activities and the capital and liquidity requirements affect the ability of firms to enter into the provision of banking services or expand their provision of banking services?**

New entrants have a significant role in changing business models and delivering value for money. We recommend that the review conducts further research on consumer views about new entrants to better inform the balance of risk assessment and stability versus a more open market place. We suggest consideration of different regulatory approaches for different models and a review of the current requirements to ensure minimum standards are in place for safety and stability while providing better access to new entrants. The EU requirements for Deposit Guarantees, which permits exclusions for certain categories of authorised firms such as Credit Unions, Friendly Societies and independent intermediaries goes some way towards recognising this – as does the regulatory regime for credit unions more generally.

We also recommend that further qualitative work is conducted on the experiences of those dealing with the licensing process, particularly those who have not pursued their applications, to gauge whether the process and broader regulatory requirements are a deterrent.

The current authorisation process for deposit taking activities is complex and lengthy and the requirements designed to avoid risk may also act as a deterrent to new entrants. The capital and liquidity requirements may have created too high a hurdle for genuine new entrants and may in effect mean that start-ups are required to be better capitalised than existing banks. Market evidence, reputational and consumer protection issues are not given the same emphasis they receive in consumer credit licensing. More attention to these areas may deliver a better balance of offerings.

Where there have been new entrants they have tended to adopt old models given the cost and complexity of creating branch networks from scratch. It is far easier to get authorisation if you buy off the rack rather than tailor to needs, hence the takeover of existing shells or mergers rather than stand alone applications. Assessments favour those who take over existing networks or old systems as being better equipped, eg, Virgin recently bought Church House trust and Walton and Co is negotiating for Hampshire trust. This is in effect stifles innovation and new approaches and creates the further challenge of absorbing and integrating existing branches and updating information technology systems.

While bank launches are uncommon in Britain, they are not unusual in the US where you can purchase off the shelf technology packages that offer all the transactional capability of modern banks at low cost. More flexibility on systems and operational requirements may encourage more start-ups.

**Question 4: To what extent do any other regulations, such as anti-money laundering rules and consumer credit licensing requirements, form significant barriers to entry or expansion? Are there any more subtle sources of regulatory requirements which nonetheless form a significant barrier to entry or expansion?**

**Consumer credit licensing**

The existence of the two processes for credit and deposit taking activities is itself an anomaly and adds further costs in terms of both the application process and the ongoing regulatory burden for many financial institutions wanting to carry on both activities. The consumer credit process is a less complex and time consuming process which appears to be more responsive to market and consumer issues.

The licensing system itself has the potential to better shape the sector in a way that meets the needs of consumers. A review of the licensing system is needed to better align the two distinct processes. It would provide an opportunity to reconsider the objectives of licensing and its potential regulatory tools to drive a fairer market place where there was more choice.

**Money laundering**

The application of money laundering legislation in the UK still seems to be working in a way that creates barriers to those firms offering new models entering the market (particularly e-commerce models) and to provision for some segments of the market. Identification requirements are onerous and may act as barriers to the entry of models such as M-PESA (Kenya) and GCash (Philippines).

Money laundering regulation is also a way of discriminating against sections of the market. Identification still appears to be a key barrier to banking for some from marginalised groups, such as new immigrants, ex-offenders and homeless people without a fixed address and not in receipt of benefits.<sup>2</sup> Consideration should be given as to whether the requirements are setting too high a bar for entry into the market of segments of consumers and potentially new models serving those consumers.

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<sup>2</sup> Consumer Focus, On the margins, Society's most vulnerable people and banking exclusion, June 2010.

# Essential inputs

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## Question 5: Are there any ways in which payment systems operate which you consider restrict entry or expansion in the provision of banking services?

New technology should offer great opportunities for new business models, small operators and more efficient and convenient payments methods. However incumbents are stifling the market and payments regulation needs to do more to lead the future development of payment services. Firms' investment plans for information technology are broadly flat for the next 12 months, while the balance for those planning to spend more on marketing in the coming year has risen to +53 per cent, the highest in 10 years.<sup>3</sup>

There are areas where co-operation is required and is good for the system, in particular in setting standards for payments methods and ensuring security and interoperability of systems and adequate redress when things go wrong. However even where there are controlled payment systems, there is no standardisation (eg the Faster Payments Service, ATMs and accessibility). The reason often cited for lack of innovation in the current concentrated market is the slowness of systems to respond and the difficulties of unifying and upgrading these, particularly post merger and acquisition.

Historically innovations have disproportionately arisen from small companies, however small stakeholders expressed a measure of dissatisfaction with the access and support they received from the Payments Council when proposing innovations.<sup>4</sup> More pro-active work in supporting innovation and enforcing adoption and a more inclusive membership structure to enable entry to payment providers that are not financial institutions is needed to remove barriers to innovation and market entry.

The Cruickshank Review identified profound competition problems and inefficiencies in the market for payment services.<sup>5</sup> Issues such as slow clearing cycles for cheques and automated payments, high charges for cash withdrawals and interchange fees levied by monopoly providers still prevail despite improvements leveraged by the Payments Council

New payment methods, and in particular payment methods that may actually benefit consumers, must be fostered within the system rather than developing outside it. Kenya (M-PESA), the Philippines (GCash), and West Africa (Orange Money and MTN Pay) are utilising mobile phone technology as an alternative to developing bank infrastructure and in a way that is consumer friendly and accessible. Online peer to peer lending platforms such as Zopa and Wokai (in China) are also gaining in popularity. Contactless solutions have gained currency in transport networks but have had little impact on financial services in the UK despite having a major foothold in countries such as Japan. Customer controlled payment systems are offered elsewhere but are not a feature of the UK payments system.

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<sup>3</sup> CBI/PwC Financial Services Survey, 28 June 2010.

<sup>4</sup> OFT1071, Review of the operations of the Payments Council, March 2009, 25.

<sup>5</sup> Competition in UK Banking, A Report to the Chancellor of the Exchequer, Don Cruickshank, March 2000

Consumer Focus has called for the introduction of consumer initiated and controlled payment options to provide more efficient processing and better money management for consumers.<sup>6</sup>

Both contactless and prepaid cards are easy to use and accessible. Prepaid cards in particular offer a number of opportunities to financially excluded consumers, particularly those without a bank account or those who are reluctant to use a standard current or basic bank account to its full potential. Being able to transfer a set amount of money onto a prepaid card can potentially help them to manage their budgeting needs while at the same time allowing them to use ATMs, buy goods on-line or over the phone or use the cash-back facility in shops. There are no credit checks and no fees for going overdrawn. However there are a number of consumer protection issues regarding the prepaid card market, primarily concerning 'open-loop' cards and concern about the level of charges that may be applied and there must be regulation to minimise the danger of consumers losing funds stored on prepaid cards due to fraud, physical loss or the insolvency of the card provider.<sup>7</sup>

The Payments Council has been monitoring the market and has agreed to review this again by the end of 2011. Similarly mobile payments are being monitored. It is likely to mean that these methods will develop independently of the introduction of a set of standards or will be left without support in a market that has been slow to adopt them. These systems are likely to offer less costly alternatives for small or new entrants and to attract consumers.

The Faster Payments Service (FPS) is the first new payments service to be introduced in the UK for 20 years, but despite three years of operation it still does not do what it says on the label. It was intended to provide commitments for electronic payments to be made in real time. However, it is not universally available for all electronic payments. Banks determining what type of payments that they will process via FPS, there are limitations as to the amounts transferred and these vary from bank to bank, and some charge considerable premiums to transfer money via FPS. Not all banks are signed up to the process, so a payment can go out fast and then ramble around a receiving bank's system for days. Electronic models such as UKash, Paypal and phone applications are delivering a better service but remain outside the system.

Payment cards were the subject of an EU Competition Commission inquiry which found that highly concentrated markets, particularly for credit card acquiring, may enable incumbent banks to restrict new entry and charge high card fees<sup>8</sup>. Fees are set essentially by the two main providers, Visa and Mastercard. Charges are being levied well in excess of the cost of processing the transactions and contributing to rising prices and restriction on access to these systems.<sup>9</sup> Large financial institutions are in a much better position to negotiate these charges whereas small organisations would not have this leverage. Interchange fees are also an issue for ATM access and may discourage new entrants and provide impediments to current alternative providers such as the Post Office Card Account.

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<sup>6</sup> Consumer Focus, Opportunity Knocks, Providing Alternative Banking Solutions for low income consumers at the Post Office, January 2010.

<sup>7</sup> Consumer Focus response to 'The End of Cheques?' Treasury Committee Inquiry, March 2010.

<sup>8</sup> [http://europa.eu.int/comm/competition/antitrust/others/sector\\_inquiries/financial\\_services/](http://europa.eu.int/comm/competition/antitrust/others/sector_inquiries/financial_services/)

<sup>9</sup> Recent figures from the British Retail Consortium estimate that the average credit card transaction costs retailers 34p, compared with 8.5p for a debit card transaction and 2.1p for cash. This is in addition to the rental of the mobile card terminal, which can be about £500 a year and interchange fees levied by the customer's bank and the retailer's bank.

<http://www.brc.org.uk/details04.asp?id=1755>

# Barriers to scale

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## Question 10: How significant are the issues associated with building up and expanding a customer base to achieve a viable scale in personal banking?

There is no reason why small, more sustainable models, should not exist alongside the big banks if the market was functioning competitively and they may even have advantages over the bigger institutions.

The Executive Director of Financial Stability at the Bank of England comments that: 'Economies of scale appear to operate among banks with assets less, perhaps much less, than \$100 billion. But above that threshold there is evidence, if anything, of diseconomies of scale. Of the bank mergers and acquisitions which have taken place recently the majority have resulted in the merged firm under-performing the market in the subsequent period.'<sup>10</sup>

In fact, a study by Berger and Mester found economies of scale in banking are exhausted at relatively modest of assets, perhaps between \$5-10 billion.<sup>11</sup>

The Federal Deposit Insurance Corporation in the US suggests that 'increases in bank competition lead to increases in the importance of small firms across all size categories. That is, the size distribution shifts toward small establishments as the industry becomes more competitive. The results are consistent with the notion that market power in banking creates a barrier to entry and this has a knock on effect on the creation and expansion of relatively small firms.'<sup>12</sup>

The size and consolidation of the major players deters competitors and has required the State to bail out the banks because they have become 'too big to fail'. But apart from the underlying significance to the economy that has resulted in state intervention, size and consolidation leads to greater risk exposure in other ways. A recent study of the European banking sector shows that concentration in the commercial banking sector increases the probability of financial distress.<sup>13</sup>

The size of the main financial institutions has meant they are slow to change and this becomes an impediment to efficiency and innovation. 'Systems issues' are often used as an excuse as to why consumer benefits cannot be delivered and necessitates long lead times to the introduction of new regulation. Infrastructure has become either too cumbersome or too complicated (related to the complexity of products on offer and the maintenance of combined banking models).

The gobbling up of smaller players through mergers and acquisition has only led to further impediments as systems are run in parallel and there is a lack of co-ordination and communication between systems operated by the one licence holder. Smaller firms with new technology have a great advantage in this area in terms of a greater responsiveness and capacity to innovate.

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<sup>10</sup> Andrew Haldane, The \$100 billion question, Speech give to the Institute of Regulation and Risk, Hong Kong, 30 March 2010.

<sup>11</sup> Berger, A N and Mester L J (1997) Inside the Black Box, What Explains Differences in the Efficiencies of Financial Institutions, Journal of Banking and Finance, w21(7), 895-947

<sup>12</sup> <http://www.fdic.gov/bank/analytical/banking/2006jan/article2/index.html>

<sup>13</sup> Cipollini and Fiordelisi, "The Impact of Bank Concentration"  
<https://www.cefin.unimore.it/it/Paper/Cipollini%20Fiordelisi.pdf>

### **Question 11: To what extent are issues of customer inertia in personal banking aggravated or alleviated by the range of products offered by either the entrants or incumbents?**

High Street retailers traditionally build reputation through value for money, competitive pricing and a relationship with their customers. They know their markets, conduct research on what consumers want and tailor their products accordingly.

The financial service sector has been different. Most financial products, by their nature, may not be conducive to shopping around as they are purchased infrequently and their impact is often long term. The complexity and sheer volume of offerings, charging structures, and the difficulty in comparing products create further impediments to demand-side drivers.

Customers are being provided with products that benefit those in the industry. The Retail Distribution Review's recommendations to better regulate so-called 'independent' financial advisors and to clarify where incentives and commissions are driving sales will help change the emphasis to what benefits the customer. But this alone will not be enough to instigate a culture of customer orientation or provision of products that are fit for purpose.

The FSA's Treating Customers Fairly programme is aimed at ensuring that products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted, promoted and sold accordingly. Consumers should be provided with products that perform as firms have led them to expect, and associated services are of an acceptable standard. However, there has to date been little testing of whether products are fit for purpose or appropriate and little done to actively regulate products for user safety. The FSA has indicated that they are prepared to take a more pro-active approach in this area<sup>14</sup> and the formation of the Consumer Protection and Markets Agency provides a significant opportunity to establish the regulatory background against which competition thrives.

There is a lack of appropriate products for different segments of the market. Low income consumers are not considered profitable and the structure and pricing of banking products can act to exclude vulnerable people with a covert and insensitive approach to penalty charging undermining hard-won financial stability and giving little scope for choice or switching.

Basic bank accounts (BBAs) are important as a potential entry level product and for those on low incomes. Their appeal might be more universal, and less stigmatised, if some of the shortcomings were addressed. These include practised and perceptual barriers to opening accounts, the gap between essential account features and the functionality some BBAs offer (or don't offer) and the perceived and actual risks associated with operating such an account.<sup>15</sup> Greater responsiveness of financial products to consumer needs, combined with fair charging models, will help combat disadvantage experienced by those on the margins.<sup>16</sup>

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<sup>14</sup> Hector Sants, UK Financial Regulation: After the Crisis, Speech of 12 March 2010.

<sup>15</sup> Consumer Focus, Opportunity Knocks, Providing Alternative Banking Solutions for low income consumers at the Post Office, January 2010.

<sup>16</sup> Consumer Focus, "On the margins, Society's most vulnerable people and banking exclusion", March 2010

Our research has also shown a demand for functional products that eradicate risk, that gives people control and that they can trust. Adapting the POCA account and increasing the products, accessibility and functionality of a Post Office Bank would be a welcome and well supported option in the light of the failings of the current market.<sup>17</sup>

### **Question 12: Are there ways of overcoming customer inertia which may lower the barriers to entry and expansion these represent?**

There are a number of significant obstacles to customer's exercising their market power, including low switching rates and fears of switching, charging and incentives, the availability of appropriate products, the baseline provision of essential services and the lack of different models.

The consumer currently has limited choice in financial services and has intrinsically been reluctant to exercise that choice because of a loyalty to institutions once considered stable and providing an essential (not an optional or desirable) service and to a certain degree the perception that they are all the same. Our recent research has shown that switching among consumers of financial services remains consistently low as compared to switching utilities such as energy. Switching rates for current accounts in the UK has lagged at around 7 per cent for the last 10 years, whereas utilities such as energy and phones show switching rates well in excess of this, starting at 26 per cent. Those who are not interested in switching believe that there is little value to be gained because there is little difference in what is on offer. For those that are interested in switching, many are put off by the costs and risks involved, such as the potential for errors in transferring Direct Debits and the detrimental impact on their credit rating. We recommend the following to improve the switching process:

- Disincentives applied to financial institutions for errors and delays
- Improved use of technology in switching processes
- Consumer control of payments, giving certainty that transfers have occurred.
- Pre-notification of all fees and charges and consistency of representation
- Investigate portable account numbers
- Review use of time with same bank as a relevant factor in credit recording
- Introduce stronger consumer protections, including measures to end unfair bank and financial charges.<sup>18</sup>

### **Charging and reward models**

Greater transparency and comparability would assist consumers in actively exercising choices. The growth of comparison web sites, accompanied by underlying regulation, in utilities and insurance, have greatly improved switching rates in those areas. However, in the financial services arena, under the prevailing model of so called free banking, charges are hidden and punitive and so present barriers to comparison. A consumer will not make decisions and cannot make comparisons on the basis that they are likely to encounter financial difficulties. Penalty charging is not a fair business model and is difficult for a consumer to predict or manage.

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<sup>17</sup> Consumer Focus, Opportunity Knocks, Providing Alternative Banking Solutions for low income consumers at the Post Office, January 2010.

<sup>18</sup> Consumer Focus, Upcoming research report

Penalty charging is also a barrier to consumers entering the market. One of the concerns among low income consumers is that the cost of having a bank account can lead to greater financial insecurity due to revolving credit and penalty charges. Respondents to our research on consumers without accounts cited lack of transparency in account based transactions as undermining budgetary control and planning.<sup>19</sup> The choice people make in these circumstances may not be the best one. Our recent research into pay day lending has indicated that many consumers chose pay day lending because they found the fee structure easier to understand, even though rates are very high and it may cost them more.<sup>20</sup>

There needs to be a limit on the number of fees and charges and objective methods introduced in determining pricing. What you see should be what you get. Headline rates and APRs need to roll up all the fees and charges and provide a basis for predicting charges through the whole life of the product. All financial products should be capable of comparison and so the number of variables has to be consistent and necessarily limited. In addition, giving consumers more control over payments going in and out, particularly in relation to direct debits, will reduce uncertainty and assist people in better managing their money so they are less likely to be subject to penalty charges.

The current charging model also has an impact on competition. The cross-subsidy model supports existing institutions and combined models, as they have the established business from which to divert resources and a wide model which allows for this to happen. The products and services offered, and the terms on which they are offered, may not necessarily reflect cost (at least in the short term) or be a product of competitive measures. Existing players use introductory offers to lure in customers with the confidence that profits can be made through changes to these offers because it is unlikely a customer will switch, or because of the difficulty of switching itself<sup>21</sup>.

New entrants are more likely to want to start on a covering costs basis and so pricing will be related to cost. They may not be able to compete with the introductory offers on price and the 'free' models, even if they adopt more transparent models of up front charging.

### Safe and simple

Consumers would welcome a set of basic and safe products that met their needs and these should be readily available, not collecting dust on a back shelf, and should not be treated as second class products.<sup>22</sup> Financial institutions should continue to address the supply-side issues that restrict the take-up and appeal of their products, for example standardisation initiatives to ensure that consumers are able to open a BBA without obstacle and with a positive in-branch experience, whenever they are eligible to do so.

In the area of product regulation, the Mortgage Market Review Discussion Paper proposals<sup>23</sup> and the policy paper on Distribution of Retail investments<sup>24</sup> go some way towards the regulation needed to assure consumers that products and services are safe and fit for purpose in terms of affordability and risk. Regulatory intervention of this nature is needed at least in the short term to restore balance to markets.

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<sup>19</sup> Consumer Focus, *On the margins*, Society's most vulnerable people and banking exclusion, March 2010, 3.

<sup>20</sup> Consumer Focus, Upcoming report on Payday lending.

<sup>21</sup> ISA Super complaint, <http://www.consumerfocus.org.uk/campaigns/super-complaint-cash-isas>

<sup>22</sup> Consumer Focus, *Opportunity Knocks*, Providing alternative banking solutions for low-income consumers at the Post Office, January 2010

<sup>23</sup> FSA, DP09/3, Mortgage Market Review, October 2009

<sup>24</sup> FSA, PS 10/6, Distribution of retail investments: Delivering the RDR – feedback to CP09/18 and final rules, March 2010

Consumers don't need a plethora of extra choice but where there are choices they should be clear, transparent *and* safe.

### Essential services

There is a need for incentives for different models that will cater to different sections of the market. Community based solutions will be better able to respond to some of these needs but a true safety net is unlikely to be provided by the market alone.

Our research among low income consumers has shown that they want a custom account that is simple, convenient and offers control over their money, an account that is offered by a trusted provider. There was strong support for the Post Office Bank delivering this service, being seen as a community based and trusted institution.<sup>25</sup> If the market is not serving a sector some of the barriers to extending public policy initiatives, such as access to payments systems and ATMs, need to be removed.

### Real choice and new models

There is a distinct lack of bank diversity in the UK as opposed to other EU Countries that are characterised by a mixed market of commercial and non-commercial players. Co-operative banking is prevalent in all other major EU countries and similarly in other countries such as USA, Canada and Australia.

A recent survey showed that a significant proportion of consumers were interested in the ethical credentials of their financial products and services.<sup>26</sup> This coupled with the increased popularity of the co-op bank and building societies during the financial crisis<sup>27</sup> support the adoption of sustainability in a broad sense; social, environmental and economic; as criteria to assess and prefer a financial institution. Appropriate encouragement of alternative sustainable models should be prioritised and consideration needs to be given to taxes or tax incentives such as the Netherlands Green Funds Scheme in addition to commitments to the Big Society Bank, the Green Investment Bank and improving functionality of the Post Office Bank, to kick start a diverse and sustainable market.

### Information and education

There has been a renewed interest in financial education and capability. Our concern is that the easy solution is to provide more information or to 'educate' the consumer and let the consumer take responsibility. But being a consumer should not be a full time job and provision of more information will not necessarily help to clarify choices. Our previous research has shown that many pieces of information were simply not having the impact on consumer behaviour that they set out to achieve. Consumers rejected much of the information because it was not helpful or was presented in a complex or unappealing format. Information requirements were also an irritant for business, due in large part to the complex systems companies have to put in place to ensure compliance.<sup>28</sup>

However the reality is that even if given information, education and choice consumers don't always pick the best option, either because they lack the skills, the choices are complex or technical, or because they have better things to do with their lives.

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<sup>25</sup> Consumer Focus, Opportunity Knocks, Providing Alternative Banking Solutions for low income consumers at the Post Office, January 2010.

<sup>26</sup> EIRIS, What's needed to mainstream green and ethical finance?, November 2009

<sup>27</sup> Neville Richardson, How can the consumer gain a voice in reform of financial services? in 'Rethinking Financial Services', Consumer Focus, June 2010, 45.

<sup>28</sup> National Consumer Council and the Better Regulation Executive, Warning Too Much Information Can Harm, November 2007

**Question 15: Has the financial crisis led to reduced confidence in the viability of smaller institutions such that potential entrants into SME banking will find it more difficult to enter and small banks to expand?**

**And Question 18: How has the financial crisis affected trust in banks in general and incumbent banks in particular? How does this affect the ability of new entrants to join the market or smaller providers to expand in retail banking?**

There is great level of resentment at the banks, founded on a history of concern about poor service and mis-selling, and intensified by the perception that they have caused the recession and grown rich at our expense. Few people now trust the banks to do what is right.<sup>29</sup> Trust and confidence in the sector fell by 11 per cent between 2008 and 2009. For those big brands directly associated with the crisis the fall was much larger.<sup>30</sup> Research by CII shows one in five UK consumers believe that they will never trust financial services again.<sup>31</sup> Addressing people's low expectation of the sector is crucial<sup>32</sup>, particularly if we are going to promote the savings and banked environment necessary to replenish capital stocks.

For low income consumers a lack of trust is the primary impediment to being banked. The majority of customers without a bank account are in this position because they've had bank accounts previously and had a bad experience; or they simply don't trust the banks with their money.<sup>33</sup>

It is clear that some providers have benefited from consumers' lack of trust and more risk-averse attitude with increased popularity of co-operative models and the increasing success of peer to peer platforms such as Zopa. It should be noted however that the research also shows that customers have high satisfaction levels and higher levels of trust in their *own* bank<sup>34</sup> than in the wider system. Loyalty factors and fear of switching<sup>35</sup> may still act as impediments to customers conditioning the market through switching. The failure of companies like Icesave will add to the concerns about whether a new start up can be trusted, particularly in times of crisis. There may also be a reluctance to move to new or small providers because consumers know the Government will bail out the big banks. More research needs to be conducted to determine how this may impact customer choices and what assurances need to be provided in relation to new entrants.

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<sup>29</sup> The Edelman Trust Barometer shows that since 2007 this has plummeted 20 points from 41 per cent to 21 per cent in the UK, <http://www.edelman.co.uk/trustbarometer>

<sup>30</sup> Milward Brown OptimorBrandz, Top 100 most valuable brands 2009

<sup>31</sup> CII/YouGov 2009

<sup>32</sup> Antony Elliot, Financial Services for All, in "Rethinking Financial Services' Consumer Focus, June 2010, 38.

<sup>33</sup> HM Treasury, Financial Inclusion Taskforce, Policis, "Realising Banking Inclusion: the achievements and challenges" May 2010

<sup>34</sup> Chartered Insurance Institute, "What we talk about when we talk about trust", February 2010, 11.

<sup>35</sup> Consumer Focus, Upcoming Research report

### **Question 21: Has the need for a physical high-street presence in order to enter the retail banking market reduced and, if so, why?**

Our research has indicated otherwise. Low income consumers are seen as strongly preferring face to face contact and relationships with providers. Face to face relationships are seen as creating more trust and a greater connection.<sup>36</sup> It is precisely the reach of its network and the fact that it is a trusted brand that gives the Post Office an advantage with many consumers.

A commitment to local bank branches still seems to carry commercial weight. The recently released RBS customer charter includes a pledge to stay open for business if they are the last bank in town and will consider a range of options to ensure a local banking service is available.

The poor record of complaint handling among banks may be another reason why local branches are highly valued. The less costly alternative of self-service interfaces has been widely criticised.<sup>37</sup>

However the preference for a high street presence is in the absence of good alternatives. Consumer trust in online models is not high and there are concerns about their security that need to be better addressed. The failure to guarantee real time transactions for online banking means, unlike in other countries, they do not have any significant advantages over going into a bank.

While new entrants such as Metro bank and Tesco are promoting community presence and better customer access, there is also a real opportunity for new entrants to distinguish themselves in providing better and more responsive online and alternative services.

### **Question 22: Does the prospective divestment of branch networks by RBS and Lloyds significantly change the barriers to entry or expansion?**

Divestment should be used to promote sustainability, competition and a fairer, better functioning market place. There is a significant opportunity to reform current retail banking models through both conditions and divestment criteria associated with state aid supplied to banks. The current conditions providing for maintenance of lending should be supplemented to include provisions on unfair charging and availability of simple and transparent products.

While restructuring for both RBS and Lloyds/HBOS require the divestment of a proportion of their retail and corporate banking assets to be sold to small or new players, a preference for consumer-oriented or consumer controlled, long term, sustainable business models should form part of the assessment. The initial competition for parts of RBS and Northern Rock included well established brands such as Virgin, Tesco and existing financial institutions such as the National Australia Bank. While we may see a difference in philosophy, with more of a customer orientation, these players are neither small players nor new entrants to the retail market.

The profit on our investment is not just about selling at the best price but should also be determined on the basis of delivering a safer and better service to consumers and to the economy. The public interest is a vital factor in the consideration of divestment. A public interest test is a feature of the Canadian regime and the Canadian financial system is notably risk averse. Public interest is at the heart of community banking models such as the German Sparkassen and has provided a check on risky investment activity. The

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<sup>36</sup> Consumer Focus, Low Income Consumers and the Financial Services Sector, Deliberative research. March 2010

<sup>37</sup> Citizen's Advice, "Hanging on the telephone", 2004

German government has been able to agree more stringent conditions for state aid with their Landsbanken.

Running through all of the Landsbanken restructuring plans is the need to reduce their capital market activities and proprietary trading, while returning to their local roots and core banking business. The current public interest in propping up the banks needs to be replaced with the future public interest in a sustainable and responsive industry. Public monitoring, audit and review of the divestment process to ensure conditions are being met needs to be ensured.

## Response to the review of barriers to entry, expansion and exit in retail banking

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