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# CMA wants banks to follow Über model to improve competition in small business banking market

*Competition & Markets Authority 'Retail banking market investigation' final report – 9 August 2016*

## Article by David Bowden

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# CMA wants banks to follow Über model to improve competition in SME business banking

**The CMA has today published its final report 'Retail banking market investigation'. Most of the initial press focus has been on overdraft pricing on personal current account market. However, despite the report's title, at least a third of the CMA's study and recommendations relate to the market for current accounts offered by banks to their small and medium enterprise ('SME') customers. The CMA makes 7 specific recommendations on the SME market and sets out how these measures can be implemented by way of either a legislative order or binding undertaking. These measures need to be implemented by quarter 1 of 2018.**

*'Retail banking market investigation' final report*
https://assets.publishing.service.gov.uk/media/57a9c52b40f0b608a700000a/retail-banking-investigation-full-final-report.pdf *9 August 2016*
*Competition & Markets Authority*

**What is the background to this investigation?**
The CMA was tasked with investigating both the personal and business current account market. It has taken evidence and considered what changes need to be made to improve competition and to facilitate the entry to challenger banks. The market for business current accounts is dominated by 4 large banks.

**What had happened following previous inquiries and investigations?**
Banking seems to be one of the hardy perennials that forever keep competition regulators busy. The CMA as well as its predecessors such as the OFT and MMC have generated many reports and investigations over the years. In recent times there had been 3 of note:

- Sir Donald Cruickshank's review of retail banking (2000),
- Independent Commission on Banking chaired by Sir John Vickers (2011), and
- Parliamentary Commission on Banking Standards (2013).

Recommendations from these reviews have seen (or will see):

- establishment of the Payment Systems Regulator,
- introduction of a current account switching service, and
- ring-fencing of retail banking businesses from wholesale banking.

**Are there any headline findings from the report?**
In a nutshell that there is poor or ineffective competition in the market for business accounts for SME customers. The pricing is opaque and comparison is difficult. There is little shopping around. The challenger banks have yet to make any headway. There is little innovation. The market is dominated by 4 main banks.

**What remedies does the CMA recommend for the SME current account market?**
It makes the following 7 specific recommendations:

- Competition to develop SME comparison tools,
- Loan rate transparency,
- Loan price and eligibility indicator,
- Standard information requirements for BCA opening ,
- Sharing of SME information,
- 'Soft' searches, and
- Role of professional advisers

**Are there any opportunities for financial technology firms?**
The CMA says that '*Open APIs are central to our package of remedies'*.

In paragraph 157 of the summary of the final report, the CMA has this to say:

> '157. *The pace of technological change in retail banking is speeding up – mobile banking tools have been rapidly adopted, and a growing financial technology ('FinTech') sector is developing and applying new tools.* **Application Programming Interfaces** *("APIs") will allow publicly available data and customers' own data to be shared with trusted third parties, and "open standard" APIs can be particularly powerful (with necessary safeguards for security and privacy) in opening up new customer information and advice services*.'

In relation to the proposed foundation measures, the CMA says this about APIs:

> '167. *APIs are the key to the digital services that are used on computers and smartphones. They enable users to share information, for example on location or preferences. They are the technological*

> *drivers behind digital applications like Facebook, Google Maps and Uber. In banking, APIs can be used to share, in a secure environment, information such as the location of bank branches, prices and terms of banking products. APIs may also be used, with the customer's informed consent, to share securely their transaction history to enable access to tailored current account comparisons and other services*.'

The CMA then goes on with its proposal on APIs:

> '168. *We are requiring the largest retail banks in both GB and NI to develop and adopt an API banking standard so as to share information to a specified timetable and we are requiring it to be an open standard so as to enable it to be widely accessible. This will enable intermediaries to access information about bank services, prices and service quality. Customers who are satisfied about privacy and security safeguards, and are willing to give consent, will be able to share their own transaction data with trusted intermediaries, which can then offer advice tailored to the individual customer. This will make it easier for customers to identify the best products for their needs*.'

**Do the proposed 'foundation measures' affect SME current accounts?**
The CMA recommends 3 foundation measures which are intended to apply to the personal and SME business current account market. These are:

- Open Banking standard by way of an API,
- Service quality information, and
- Customer prompts

As to service quality the CMA says it will require '*banks to display prominently a number of core indicators of service quality. Our preferred measures of quality are based on customer willingness to recommend their bank to friends, family or colleagues. Data will be collected twice a year on a standardised basis, so that customers can easily compare across banks*.'

It also says that it will require '*banks to collect and publish a wider range of additional quality measures that they will make available, alongside the core indicators, through open APIs to intermediaries which can use them in new kinds of advisory and comparison services*' but that that it will rely on the FCA to deliver this.

As to customer prompts, the CMA says that is proposal is that business customers (as well as personal ones) '*should receive occasional reminders ("*prompts*"), at suitable times, to encourage them to consider their current banking arrangements and shop around for alternative banking services. Some prompts might be triggered by specific events affecting the customer such as the closure of a local branch; others might be periodic, such as a reminder included in an annual statement*.' Again the CMA proposes bouncing this proposal over to the FCA to implement by means of '*randomised controlled trials'*.

**Do any issues arise from these proposed foundation measures?**
The CMA sees the API as critical to delivery of its open banking standard. This raises issues of data security which are different from banks to that operated by Über for its taxi hailing programme on mobile telephones. The CMA seems to gloss over these difficulties but customer confidence in the security of their banking data remains critical. The CMA makes vague noises about a '*blueprint*' but disappointingly provides little further detail.

Whilst for personal current account, lifestyle events such as marriage, divorce, retirement or moving house are obvious trigger events to receive customer prompts, it is more difficult to see what the obvious comparators are for SMEs. The CMA offers these 3 events:

- start-up phase when first opening a business current account,
- the end of the 'free' banking period usually after 12 to 24 months. and
- more established SMEs whose needs for other banking products or lending may increase.

**What does the CMA mean by competition to develop SME comparison tools?**
The CMA notes the problem:

> *'110. it is difficult for SMEs to compare charges across banks. This is because of the complexity of tariff structures, the variability in usage and the lack of publicly available comparable information on the quality of banks' services. The equivalent of Midata in PCAs does not exist for SMEs and there is a lack of effective price comparison tools, making comparison time consuming and difficult'*

The CMA has then has this to say:

> *'206. Although there are several comparison websites currently available on the market..., they each individually offer only a part of the service required to compare SME banking products and providers*

> *effectively. We think that SMEs would be best served by tools that provide a "*one-stop-shop*" that would enable them to quickly and reliably compare banks on price, service quality and lending criteria across the whole range of providers. '*

Surprisingly the CMA wants this to be delivered by the charity Nesta who it wants to offer a 'challenger prize'. Margaret Thatcher famously said that the '*trouble with Socialism is that eventually you run out of other people's money to spend*'. No doubt conscious of this the CMA will not fund this but instead will require '*banks to support and fund the organisation of the prize process and to contribute funding to the prize fund'*.

The CMA is giving Nesta 18 months to deliver this failing which the CMA will implement its remedy which '*will require the creation of an industry funded SME comparison tool*.'

**What will the CMA's loan rate transparency proposal look like?**
The CMA wants to require all lenders offering business loans to SME customers to '*publish standard rates for unsecured loans and overdrafts of up to £25,000 in value and that this information is made available as open data to intermediaries*.'

The CMA does however lay it on thick when it lambasts the banks for their laziness in their treatment of business customers. It says:

> '103. We also assessed the levels of innovation in SME banking. We found that there has been little product innovation and innovation has tended to focus on the digitalisation of banking and reducing customer reliance on branches. These innovations have lagged behind the levels observed for PCAs. For example, some banks do not offer mobile banking to SMEs and/or offer less functionality than they offer to PCA customers'

**What will the CMA's loan price and eligibility indicator look like?**
In addition to loan rate transparency, the CMA wants to require '*the largest SME lenders to offer a tool on their websites so that business customers can get an indicative quote and know, provisionally, whether they would be eligible for the loan or overdraft they seek'*. The CMA castigates bank's loan pricing at present for SMEs as '*opaque*'.

**What standard information is the CMA proposing banks provide when a business current account is opened?**
Again rather disappointingly the CMA ducks this issue and bounces it all back to the banks' trade body to try and fix. For what it's worth the CMA says this:

> '218….We are therefore requiring BCA providers to adopt a core set of standard information and evidence requirements for opening a BCA. We expect this to be achieved through an industry working group co-ordinated by the British Bankers' Association (the BBA) which is currently ongoing. We are recommending that the FCA supports and facilitates the implementation of this remedy through participating in the proposed industry group as an observer.'

**What changes were made to data sharing by the SBEEA 2015?**
For more details on the impact of the Small Business, Enterprise and Employment Act 2015 ('SBEEA') please see my earlier piece for LexisPSL® called '*A big future for small and medium-sized businesses*'. The link is here:www.ewriter.eu/articles/SMEFinance.pdf

In section 4 of SBEEA 2015 HM Treasury is given the power to get major banks to provide the credit data of their SME customers to smaller funders. CRAs will share the credit data. The banks **must** seek permission from their business customers before sharing this information. Details of this are in the Small and Medium Sized Business (Finance Platforms) Regulations 2015 ('FPR').

The aim of this proposal is to ensure that smaller funders, who are not currently part of credit data arrangements, can access the information. The hope is that this will increase lending to SMEs. The aim is also to improve competition in the market for business current accounts. The explanatory notes that accompanied the FPR proceeded on the basis that established banks hold data on current accounts of their SME customer, yet this data was retained by lenders and not shared with CRAs in the same way that data on personal current accounts, credit cards or loans is presently shared.

**What sort of SME information is the CMA proposing be shared?**
This is yet another missed opportunity by the CMA. It also appears not to have scrutinized either the scope or operation of the SBEEA. Again for what it's worth here is what the CMA says on this:

> *'217. We considered whether further action is needed to require banks to pass to CRAs further information on SMEs such as transaction data. Regulations under the SBEE Act came into force in June 2016, requiring providers to share SME data, through CRAs, with alternative providers. In addition, our foundation measure to adopt an open API standard will enable SMEs to share their transaction information with intermediaries. Given this, we did not see a need for a further intervention in this area.'*

**What are 'soft' searches and what role does the CMA think they can play?**
The CMA says that it will recommend to HM Treasury that it works with the credit reference agencies ('CRAs') on this. The CMA wants '*SME lenders to implement a mechanism for "soft" searching, so that SMEs are confident that they can shop around for credit and obtain indicative price quotes without adversely affecting their credit rating*.' The CRAs have done work on soft searches for personal customers.

At the moment business customers shopping around for credit, will have a footprint on the credit file that they have applied for credit. If there are a number of these footprints, that will tend to indicate to lenders that these applicants are credit hungry and it may mean that SME customers who take the prudent course in shopping around find that it backfires on them and they end up being declined for credit instead.

**What role does the CMA want professional advisers to play?**
It would do violence to the word 'proposal' to describe what CMA wants to achieve here. The best that can be said is that the CMA has some vague aspiration which it expresses as:

> *'219…..Professional advisers, particularly accountants, have an important role in helping SMEs make good business decisions, including decisions about their choice of provider. We are therefore recommending that BEIS works with the BBB and professional associations to explore ways in which their members can channel advice on choice of banks and sources of finance to SMEs.'*

Whether this leads to anything remains to be seen. It is breath-taking that the banks are seeking to blame small business' accountants for the lack of competition in the SME banking market.

**In terms of market share which banks are dominant in the SME market?**
The CMA summarises its findings on this at paragraph 95 of its 'Summary of final report'. It says that in Great Britain that the 4 largest providers of SME business accounts are Royal Bank of Scotland, Lloyds Banking Group, Barclays and HSBC. Within Great Britain, the CMA finds that these 4 banks had an 83% market share in 2015 which had declined by only 1% since 2012.

In Northern Ireland, the CMA says that the 4 largest providers are Royal Bank of Scotland, Danske (trading as 'Northern Bank'), Bank of Ireland and Allied Irish Bank. Within Northern Ireland, the CMA finds that these 4 banks had an 86% market share in 2015 which had declined by 2% since 2012.

**Have the 'challenger' banks made any inroads into the SME market?**
The answer to this appears to be 'no' or 'not yet'. The CMA sees the following as challengers in relation to SME banking:

- **Aldermore** entered in 2009 providing SME lending,
- **Metro** entered in March 2010 and offers SME banking including BCAs,
- **Santander** entered the SME banking markets [after its acquisitions of Abbey National plc (2004), Bradford & Bingley Building Society (2008) & Alliance & Leicester (2009)],
- **Handelsbanken** has significantly extended its UK operations almost doubling its branch network between 2011 and 2015.

The CMA also notes that a number of new challenger banks have recently been authorised by the FCA and it is too early to tell what impact this will make. These new entrants are:

- **Atom Bank** (authorised in June 2015, digital PCA and SME),
- **Starling Bank** (digital PCA),
- **CivilisedBank** (SME), and
- **OakNorth** (authorised in March 2015 SME banking but not BCAs).

The CMA also notes that 'alternative finance currently accounts for a small share of SME lending (less than 2%)' and within this are the new finance provides contemplated by SBEEA. The lack of progress of the challengers is of real concern to the CMA. In its final report summary it says this:

> '102. *We observed that some banks which appear to offer above-average pricing and below-average quality are gaining market share and conversely that banks appearing to offer below-average prices and above-average quality are either losing market share or are gaining market share at a slow pace*.'

**How has the CMA broken up the market geographically?**
Although the CMA notes some differences in Scotland in terms of market penetration, it has decided to treat Great Britain as one market. However, the CMA is treating Northern Ireland as a separate market because of the dominance of a different set of banks there.

**Does the CMA consider the impact of Brexit?**
No. There is no mention of Brexit in the CMA's report. Cleary this will be more of an issue in relation to both the personal and current account markets in Northern Ireland.

**How does the CMA propose that its remedies be implemented?**
The CMA proposes its remedies be implemented in 3 ways:

- Voluntary industry cooperation by the banks' trade body with other government bodies,
- Undertakings, and
- Legislative order.

**What timetable does the CMA propose for its proposed changes?**
The CMA wants the following to happen by the end of quarter 1 of 2017:

- Co-operation with the FCA in its research and trials of prompts, and
- Development of a comparison service for SMEs.

By the end of quarter 3 of 2017 the CMA wants its proposal on publication of SME lending product pricing published. By the end of quarter 1 of 2018 the CMA wants these measures implemented:

- Transaction history for customers,
- Development of SME loan price & eligibility tool, and
- Business current account opening procedures.

The CMA is allowing banks until Q1 of 2018 to develop and adopt an open API standard. Finally the CMA is giving banks until Q3 of 2018 to implement service quality metrics.

**Will the banking industry accept these changes or will we see a legal challenge?**
There is some tension displayed in the way the banks have engaged with the CMA throughout the consultation process which led to the final report. For example Lloyds Banking Group put in a submission (a non confidential version of which the CMA has published) which then generated a response from Nationwide Building Society that:

> '*LBG argues that flaws in the CMA's methodology have made the results from the analysis unreliable, and the CMA should therefore not present them or draw conclusions from them in its Final Report. Nationwide does not consider LBG's conclusions to be valid.'*

It is also quite telling in the report that the CMA was frustrated when it was told that the larger banks did not hold the data sets in sought or had not analysed data in relation to personal or business banking separately. It is not clear if this is entirely correct or whether that data is indeed held or analysed in that way but will only be produced if there is a challenge against the CMA's findings to the Competition Appeal Tribunal.

**What will banks need to do to prepare for these changes?**
They will have their work cut out. They will need to cooperate with the FCA in trials for the API and the development of the price comparison tool. They will need to do the systems work so that loan rates have transparent pricing. They will need to work with the CRAs to develop 'soft' searches and do the development work so that they are in a position to share SME data with CRAs. As the business current account market is static, banks as CRA subscribers will also need to ensure the data they hold on their business customers is of the requisite quality. Finally banks will need to give their business customers the prescribed information on account opening. The long stop date for implementation of all these changes is Q3 of 2018.

**What will credit reference agencies need to do to prepare for these changes?**
In addition to the 'soft' searches, the CML notes that the account opening process for business account '*can be lengthy and onerous, particularly because of banks' informational requirements for*

*undertaking AML compliance'*. There is work to be done to see what scope there is for streamlining here.

**Is there anything else worth noting from the report?**
In relation to SMEs, the CMA says that in 2014:

- 48% had credit cards,
- 43% had overdraft facilities,
- 18% had held a loan, but that
- Very few with a turnover below £2 million had taken out:
  - commercial mortgages,
  - invoice finance, or
  - asset finance.

The CMA reports that in 2014 the average net revenue including the value of funds per active business current account was £736 and that '*nearly a half of net revenue is from the value of funds deposited and just over a third from overdraft charges'*.

**What is likely to be the impact for SMEs?**
Whilst the CMA's proposals look like helpful first steps to improving pricing transparency and innovation for business current accounts, time will tell whether any of the CMA's proposals will make any difference or whether they will ingrain any change in a banker's mindset to the arrogant way they treat their business customers. The CMA has already noted that:

> '*An overall consequence of this is that larger longer-established banks are able to maintain high and stable market shares'*.

**9th August 2016**