Financial Conduct Authority

Competition Report

2013-16

Contents

Chairman's foreword and Chief Executive Officer's introduction	3
Chapter 1 – Overview	4
Chapter 2 – Activities under concurrent competition powers	10
Chapter 3 – Retail banking	12
Chapter 4 – Retail lending	19
Chapter 5 - General insurance and protection	25
Chapter 6 – Pensions and retirement income	29
Chapter 7 - Retail investments	34
Chapter 8 - Investment management	37
Chapter 9 – Wholesale financial markets	41
Closing remarks	45
Abbreviations used in the Report	46

Chairman's foreword

How well competition works has a profound effect on the financial services and products we use every day. At its best, it delivers lower prices, the quality of service consumers want, better value for money and new and innovative products that help us all.

For the last three years we have had an objective and duty to promote effective competition. In 2015 we were given concurrent responsibility with the Competition and Markets Authority to enforce competition law.

Our competition mandate is almost unique worldwide, and has contributed to our forward-looking and world-leading approach to regulation, as reflected in our drive to support innovation.

Last year, as part of HM Treasury's 2015 Productivity Statement, we were tasked with producing a standalone annual competition report to show how well we are delivering against our competition objective. This report is published alongside the FCA's annual report, which covers all three of our interlinked objectives.

I hope it demonstrates both the breadth of our activities and the real difference they make to ensure competition benefits UK consumers, financial services and our wider economy.

John Griffith-Jones
Chairman

Chief Executive Officer's introduction

The FCA was given its competition objective when we were created in 2013. This report summarises the work we have undertaken to deliver against that objective. In just three years, we have used a range of competition tools and interventions, from investigating markets, making policy and rules that improve competition to supporting innovation. Our aim is to use the full suite of tools available to us, including formal enforcement investigations, to help deliver a better deal for consumers.

It should also be clear from this report just how deeply our competition objective is now embedded across the organisation. Whilst our Competition Division leads on many aspects of improving competition, every part of the FCA makes a significant contribution and it is a key consideration in our day to day decision making.

This report aims to provide new insight into the importance of competitive markets, which serve the interests of consumers and firms. Our intention is this translates into improved industry commitment to put consumers where they belong – firmly at the centre of firms' business models.

Tracey McDermott
Acting Chief Executive Officer

1 Overview

Key points

The Financial Conduct Authority (FCA) was created in 2013. We were given a competition mandate and then additional competition law powers two years later.

This first competition report summarises our activities to promote competition in financial services from 1 April 2013, when the FCA was created, to 31 March 2016, and provides insight into competition in selected markets across the sectors that we regulate. Future reports will focus on the activities undertaken solely in that respective reporting period.

We continue to carry out market studies, and are in the process of implementing a range of remedies to make competition work better for consumers in the markets we have studied.

We are also embedding competition thinking across the wider policy, supervisory and enforcement work that we do. Our wider competition activities include setting up the Innovation Hub and establishing, with the Prudential Regulatory Authority (PRA), the New Bank Start-up Unit (NBSU), both of which are intended to improve competition in order to generate better outcomes for consumers.

Introduction

As part of HM Treasury's 2015 Productivity Statement *(Fixing the foundations: creating a more prosperous nation)*, the UK Government asked both the PRA and the FCA to publish Annual Competition Reports to explain how we are delivering against our respective competition objectives and set out clearly the steps we are taking to drive more competition and innovation.[1]

We have a strategic objective to ensure that the financial markets we regulate work well and three operational objectives, to:

- secure an appropriate degree of protection for consumers
- protect and enhance the integrity of the UK financial system, and
- promote effective competition in the interests of consumers

We also have a duty to promote effective competition when addressing our consumer protection and market integrity objectives.

We have published this report alongside our 2015/16 Annual Report.[2] This report summarises our work to deliver against our competition objective for each sector that we regulate, including specific steps to promote innovation. It also provides a high-level account of competition in selected aspects of the sectors. The PRA has published a separate Annual Competition Report relating to its own competition objective and activities.[3] As this is our first Competition Report it covers relevant competition activity over a three year period from 1 April 2013 to 31 March 2016.[4] Future reports will focus on the activities undertaken in that respective annual reporting year.

Our competition mandate and powers

Our competition mandate (the competition objective and duty), was introduced as part of the reform of financial regulation following the crisis of 2008.

The Financial Services and Markets Act 2000 (FSMA) sets out our mandate to promote competition.

1. HM Treasury, 'Fixing the foundations: Creating a more prosperous nation', July 2015 paragraph 12.12. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/443898/Productivity_Plan_web.pdf
2. See www.the-fca.org.uk
3. http://www.bankofengland.co.uk/publications/Documents/annualreport/2016/compreport.pdf
4. Where significant work has been undertaken between 31st March 2016 and the date of publication this has been referenced however this will be covered in detail in a subsequent report.

Since April 2015, we have also had powers to enforce against breaches of competition law under the Competition Act 1998 (CA98) and conduct market studies under the Enterprise Act 2002 (EA02),[5] concurrently with the Competition and Markets Authority (CMA), the UK's primary competition authority.

What do we mean by 'competition'?

Competition in the commercial world means firms striving to win customers, with innovative firms bringing ideas to market, successful firms thriving, and unsuccessful ones making an exit.

When markets are competitive, consumers will be offered variety and choice, with firms striving to win custom on the basis of service, quality, price and innovation.

In such circumstances, consumers can feel confident in exercising choice and competition is strengthened.

Competition is not an alternative to regulation. Proportionate regulation is a pre-requisite for competition in financial services to thrive. Consumers need to know they can trust the firms they buy from and that they are appropriately protected when something goes wrong.

We want to ensure remedies will be effective in addressing any competition concerns we identify. We will do this by carrying out appropriate analysis of whether this will be the case. For example, our evidence on the impact of annual summaries, text alerts and mobile apps on consumer banking behaviour (see box below).

However, it is important that our rules and activities are proportionate and not an unnecessary barrier to competition.

We will undertake a review of the effectiveness of the NBSU after three years to ensure it is working in the best interests of competition in the sector.

Message received?
The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour[6]

Along with the Office of Fair Trading (OFT), we wanted to understand the impact of annual summaries, text alerts and mobile banking apps on consumers.

We carried out research, based on over 300 million data observations, that showed that annual summaries have no effect on consumer behaviour in terms of the level of unarranged overdraft charges they incur.

However, signing up to text alerts or mobile banking apps reduces the charges incurred by 5% to 8%. Signing up to both services has an additional effect, reducing charges by 24%.

We summarise in Figure 1 overleaf how we identify concerns and address issues which could inhibit a 'virtuous circle of effective competition' with some examples.

Market studies are the most visible aspect of the work we carry out to promote competition. They are holistic, evidence-based studies of how markets work, and whether they could work better. They enable us to look at a particular market in some depth, to understand stakeholder concerns, gather evidence on market dynamics, and propose remedies to improve the way in which competition works in consumers' interests. We feature the key findings from our market studies in later chapters of this report.

5. Please see Chapter 2.
6. FCA Occasional Paper No. 10 March 2015; p. 3, paragraph 4 https://www.fca.org.uk/news/occasional-paper-no-10

Figure 1:
‘Virtuous circle of effective competition’

We help **consumers assess the best choices** for them

We are working with firms to improve how they communicate with consumers. This focuses on how information is presented to consumers, which could empower people to make effective decisions about the products or services they hold or are looking to buy.

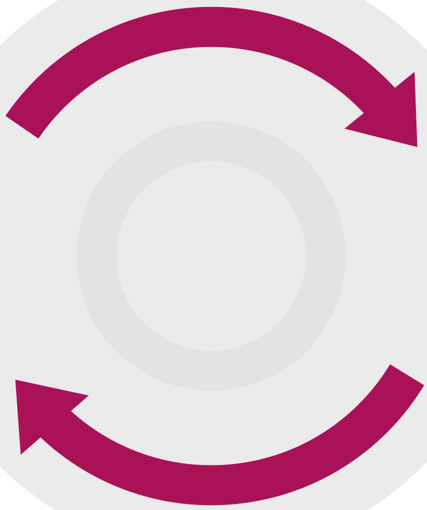
We help **consumers get the information they need**

In our Retirement Income market study we found that a substantial proportion of consumers found the information they receive from providers as generally difficult to navigate. We are seeking to address this through better information in wakeup packs.

We help **consumers to act on their decisions**

We found that disclosing the previous year’s premium was the most effective way to prompt consumers to shop around, cancel or negotiate their insurance policy. Doing so caused the equivalent of 11-18% more consumers to switch or negotiate their home insurance policy.

Effective competition provides firms with incentives to deliver what consumers want and to provide value for money as efficiently and innovatively as possible



Well informed and engaged consumers can play a key role in driving effective competition between firms

We have powers to ensure **firms compete fairly**

We have taken active steps to use our competition powers to address potential breaches of law

We have **encouraged innovation** in financial services

We launched the Innovation Hub. Through the Hub we support firms that are innovating in consumers interests to navigate their journey to becoming authorised. We have helped over 200 innovative firrms, with 20 of those now authorised.

We have **made it easier for new banks to launch**, by improving our authorisations processes

This includes the launch of the New Bank Start-up Unit launched jointly with the PRA to stimulate competition by helping new, prospective banks to enter the market.

Our long-term goal is to help solve the long-standing problems of competition and consumer choice in financial services. We have focused our work on what we considered to be some of the most pressing issues in our first three years.

We also take account of competition across our policy, supervisory, authorisation and enforcement work. This is to ensure that we both recognise competition concerns when they arise, and work to find pro-competitive solutions to other concerns wherever possible, such as in our Smarter Consumer Communications work.

On a day-to-day basis, all decisions our Executive Committee takes are informed by an assessment of the competition implications.

There are also two important ways in which the FCA takes a different approach to its predecessor in how it regulates markets. Firstly, we integrate behavioural economics and data science into our work (see box below). This approach underpins much of our work on remedies and other interventions.

Second, we recognise that it is critical to promote competition to help ensure that markets stay open to new entry and innovation.

Innovation and Project Innovate

Innovation is a crucial aspect of competition as it can be one of the main drivers of consumer benefits and economic growth. We have undertaken significant work to ensure our regulation does not unduly impede entry and innovation:

- we established a dedicated unit to assist innovative businesses – the Innovation Hub. Through the Hub we support firms that are innovating in consumers' interests to navigate their journey to becoming authorised

- we are making it easier for firms to trial innovative ideas through our Regulatory Sandbox, which opened for applications in May 2016[7]

- in March 2016 we signed agreements with the Australian regulator to ensure innovative fintech companies in Australia and the UK have support from financial regulators when entering each other's market.[8] A further such agreement was signed with the Monetary Authority of Singapore in May 2016[9]

Please see our 2015/16 Annual Report[10] for further information on our innovation work.

7. https://www.the-fca.org.uk/firms/fintech-and-innovative-businesses
8. https://www.fca.org.uk/news/regulators-sign-innovative-business-agreement
9. https://www.fca.org.uk/static/documents/mou/fca-monetary-authority-of-singapore-co-operation-agreement.pdf
10. www.fca.org.uk/annual-report-2015-16

Behavioural Economics and Data Science

In April 2015 we created a new team to look at how we can use behavioural economics as part of a broader framework to analyse how financial markets work. It aims to have a substantial impact on the work of the FCA, and that influences the wider debate about how behavioural and data science can be used to improve both consumer financial protection and regulation more broadly. Behavioural economics is not about regulating more: it is about regulating smarter and more effectively.

Behavioural economics is relevant to all of our objectives as it helps us understand:

- how consumers behave and to identify where they might be being harmed/need protection
- why consumers might not be in a position to drive effective competition
- why individuals in firms and/or firms themselves may act in ways that pose threats to market integrity

We are using behavioural economics in a range of markets and issues that we face:

- informing our policy and supervisory decisions
- assessing and prioritising competition issues across markets
- designing and testing better interventions that target the real drivers of consumer mistakes
- focussed behavioural research including work completed so far on general insurance add-ons, general insurance auto-renewal, cash savings, structured deposits, pay day lending, credit cards and personal current accounts

As we develop our knowledge and capabilities we are further integrating our behavioural research, in particular testing of remedies, into our competition and policy processes.

> Simply having many firms in the market will not necessarily result in effective competition if consumers cannot exercise choice… therefore it is important to look at data and evidence in the round when considering competition insights

We also work collaboratively with other regulators. We have signed Memorandums of Understanding with the CMA,[11] the Payment Systems Regulator (PSR) and the PRA setting out how we will work together on common competition issues in the financial sector.[12] We co-ordinate closely with the CMA, for example, in its in-depth investigation of retail banking (summarised in more detail in Chapter 3).

We are also members of the UK and European Competition Networks, UK Competition Network (UKCN) and the UK Regulators Network (UKRN).

Contents of this report

Scope

This report should be read in conjunction with:

- our Annual Reports,[13] which contain information about our key activities throughout the relevant year
- our Business Plans,[14] which set out our planned activities for the relevant year, and
- the CMA's Annual Concurrency Report[15]

The UK Government's policy paper 'A better deal: boosting competition to bring down bills for families and firms'[16] issued in November 2015 also provides helpful context for proposed UK policy changes to improve competition in a number of areas, including financial products such as banking and motor insurance.

11. See http://www.fca.org.uk/fca-cma-consumer-protection-mou and also http://www.fca.org.uk/your-fca/documents/mou/fca-cma-concurrent-competition-powers-mou
12. https://www.fca.org.uk/your-fca/documents/mou/mou-boe-fca-psr-pra
13. FCA Annual Reports can be found at https://www.the-fca.org.uk/
14. FCA Business Plans can be found at https://www.the-fca.org.uk/
15. Published 28 April 2016 https://www.gov.uk/government/publications/competition-and-markets-authority-annual-concurrency-report-2016
16. https://www.gov.uk/government/publications/a-better-deal-boosting-competition-to-bring-down-bills-for-families-and-firms

Competition insight

There are over 100 separate economic markets embedded in the sectors we regulate.

In this report we cover some sectors and markets in greater depth, where we have undertaken specific work recently (e.g. credit cards). For others we highlight a range of 'sector competition indicators' – selected data and evidence gathered in the course of our work.

Introduction to sector competition indicators

There is no single 'metric' or measure that will show whether competition is working in a particular market. To understand competition, we need to look at a wide range of information to assess how well that market works, and whether it produces outcomes that are in consumers' interests.

For example, simply having many firms in a market will not necessarily result in effective competition if consumers cannot exercise effective choice. Similarly, firms' profits may be high at a particular point in time without necessarily indicating that competition is weak.

It is therefore important to look at data and evidence in the round when considering the competition insights in this report.

Sector competition indicators presented in this report

We give a brief explanation of the indicators presented in this report below.

Concentration

Concentration gives us an understanding of the number of providers and how much of the market they supply.

One common way of measuring concentration is the Herfindahl-Hirschman Index (HHI). This is the sum of the squared market shares of all firms in the market. The

CMA's Merger Assessment Guidelines indicate that a market with an HHI exceeding 1,000 may be regarded as concentrated, and an HHI exceeding 2,000 may be regarded as highly concentrated.[17]

A highly concentrated market could indicate a potential competition issue. For example, if a single or small number of firms have consistently high market shares over time then it may be under less pressure to compete, for example by cutting prices. However, high concentration may not necessarily show a competition issue but may instead reflect the success of particularly innovative or efficient firms. In some sectors, the threat of new entry can put enough pressure on existing firms to compete, and this could matter more than the number of competitors.

Low levels of concentration do not eliminate concerns about weak competition. For example, firms may possess point of sale advantages which can alter consumers' decisions and create poor outcomes. This can happen even when many firms supply the relevant service, as we saw with general insurance add-ons (see a summary of our work on this in Chapter 5).

Entry (and expansion)
New entrants – or even the threat of new entry – can put pressure on an existing firm and result in lower prices, higher quality and more choice for consumers. Expansion by an existing firm could also put pressure on other incumbent firms in a similar way.

So to understand how competition might be evolving it is important to find out if there are any barriers to entry and expansion in a market and, if so, how significant they are.

A simplistic but indicative way to assess ease of entry and expansion is to look at the number of firms that have entered a market over time. However, this should be interpreted with caution because one new firm does not mean that the barriers to entry are low, and an absence of entrants at any given time does not necessarily mean it is difficult for a firm to enter the market.

Consumer satisfaction
How the quality of products and services change can also indicate how competition might be evolving. One way to proxy this is by looking at consumer satisfaction data, such as survey evidence and complaints.

However, it is important to understand the context for this data. Where competition is not effective consumers may not perceive any difference in offerings and so cannot see any potential gains in switching. Here, high levels of consumer satisfaction may not necessarily mean that competition is working well.[18]

17. CMA, Merger Assessment Guidelines: CC2/OFT1254, Sept. 2010 paragraph 5.3.5. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf
18. See also Chapter 3 for further discussion of consumer inertia in retail banking.

Shopping around and switching
Consumers can drive effective competition by comparing different products and choosing or switching to the one that is the best value for them. To do this they must be able to access, assess and act on the right information to make informed choices.

How much consumers do this can be measured through survey evidence. However, what consumers look for in shopping around for is also important. For example, consumers may focus on certain aspects of the products and this can lead to poor outcomes if suppliers exploit such biases.

One simplistic and indicative way of measuring this is through switching rates (e.g. the estimated percentage of consumers who switched in the last twelve months).

However, we do not necessarily regard high switching rates as an ideal outcome. We want to ensure consumers have the ability to switch to better deals, but in an ideal situation they may not need to use this option because firms already compete effectively and provide high quality and low prices. Therefore, as with other measures, switching rates should be considered alongside other evidence.

Price, cost and profitability evidence excluded
Competition analysis typically includes assessing price, cost or profitability data. For example, with profitability we need to understand whether the levels of profitability are what we might expect in a competitive market – which would in turn require understanding firms' costs, investments and risks in detail – and if current trends are likely to continue in the near future. These assessments typically require detailed assessments of the market context. They also rely on commercially sensitive information from firms that would be inappropriate to publish, as well as detailed technical analysis and commentary. As a result, we have not included such evidence in this report.

Methodology note

The data presented in this report is drawn from a number of sources, including FCA publications, such as market studies and Quarterly Data Bulletins,[19] FCA consumer research[20] and third-party data.

19. http://www.fca.org.uk/your-fca/list?ttypes=Data+Bulletin&
20. This was undertaken in 2014-15 by GfK, and comprised seven sector surveys each of up to 2,000 respondents. This includes two views of the pensions and retirement market; and one each on retail banking (current accounts); savings and investment; credit and debt; mortgages and general insurance. Each survey comprised a blended internet-research Panel online survey, with data weighted to the general population.

2

Activities under concurrent competition powers

Key points

We have made significant effort to increase awareness of competition law, and our role in enforcing it.

We have opened our first investigation under the Competition Act 1998 (CA98). We have also issued two 'on notice' letters to firms and three advisory letters.

From April 2015, we have had powers to enforce the prohibitions under the CA98 and the Treaty on the Functioning of the European Union (TFEU) concurrently with the CMA in relation to financial services. These powers bring us into line with other sector regulators and strengthen our ability to ensure competitive markets for financial services that deliver good consumer outcomes. The CMA can also exercise these concurrent powers, although only one authority can exercise the functions for a given case at any one time.

We also received powers in April 2015 to conduct market studies under the Enterprise Act 2002 (EA02) and refer market investigations in the financial services sector to the CMA. Details of our activities under these concurrent powers are also given in the CMA's Concurrency Report.[21]

We can conduct market studies under either EA02 or the Financial Services and Markets Act 2000 (FSMA). We decide which route is most appropriate for a market study on a case by case basis. Depending on the circumstances, it may also be appropriate to proceed under a different power than the original one. For example, if a FSMA market study indicates that we should study firms or activities falling outside the FSMA regulatory perimeter, we may switch to using EA02 powers.

We have opened and continue to conduct a number of market studies using our powers under FSMA. We explain this work throughout this report.

21. Published April 2016 https://www.gov.uk/government/publications/competition-and-markets-authority-annual-concurrency-report-2016

22. FCA FG15/8: The FCA's concurrent competition enforcement powers for the provision of financial services July 2015 http://www.fca.org.uk/your-fca/documents/finalised-guidance/fg15-08

23. FCA FG15/9: Market studies and market investigation references July 2015 http://www.fca.org.uk/your-fca/documents/finalised-guidance/fg15-09

Guidance

Consulting and issuing guidance is an important tool for enhancing awareness of competition law and our role in enforcing it. In July 2015, we published guidance on how we intended to enforce our competition powers, namely guides:

- to our powers and procedures under the CA98;[22] and
- to our powers and procedures for conducting market studies and making market investigation references under the EA02[23]

At the same time, we published a legal instrument to make minor amendments to the FCA Handbook.[24] These reinforce the obligation under Principle 11 on authorised firms to report significant infringements of competition law to the FCA.

Since making these changes, we have seen a greater number of notifications under Principle 11 from firms relating to competition issues over this year than last, which may be attributable to this clarification.

In March 2016 we published finalised guidance[25] on voluntary redress schemes under the CA98.

Redress schemes under the CA98 give firms an opportunity to offer and administer redress to consumers affected by a breach of the competition prohibitions by firms and reduces the risk of lengthy and costly court proceedings.

24. FCA PS15/18: FCA Competition Concurrency Guidance and Handbook amendments: Feedback on CP15/01, finalised guidance and rules July 2015 http://www.fca.org.uk/your-fca/documents/policy-statements/ps15-18

25. FCA FG16/3: Guidance on voluntary redress schemes under the Competition Act 1998 March 2016 http://www.fca.org.uk/news/fg16-3-guidance-on-voluntary-redress-schemes-under-the-competition-act-1998

Related developments

Competition Act investigations

Since we obtained our powers under the CA98, we have and will continue to carefully consider a number of issues for potential action.

This year we have opened our first investigation under CA98. This sends a signal that we take competition law seriously alongside other regulatory enforcement actions; however, this is one of a number of tools that we can use to strengthen competition compliance. We do not have a target number of cases and the number of infringement decisions or indeed, the number of cases being considered is not in itself the best measure of activity in, or impact in that sector.

As we do not usually release details of enforcement cases in the early stages, we are currently unable to provide more details about our investigation.

On Notice letters

As part of the Retirement Income Market Study (RIMS), we reviewed a number of different pension providers' distribution arrangements and strategies. While we had no competition concerns with the majority of the arrangements we looked at, we needed a better understanding of some. In our Interim Report[26] we committed to engaging with a number of firms to obtain further information.

We sent letters to a number of firms putting them on notice of the potential for infringements of competition law, the first time we have issued such letters. These are similar to the CMA's warning letters. They are sent where evidence suggests a potential infringement of competition law by particular firms, but where the significance of the case, including its likely deterrent effect, impact on direct or indirect consumers, or other factors such as strength of the evidence does not warrant opening a formal investigation. These letters set out the behaviour of potential concern and give the firms involved an opportunity to exercise due diligence and to consider whether the activity of concern meets their obligations under competition law. In this context, firms are asked to inform us of the action they propose to take to address our concerns.

We subsequently met with these firms to better understand their proposed solutions. The firms have since undertaken a number of initiatives to strengthen their competition compliance.

Advisory letters

We have issued three advisory letters. These letters are educational and intended to increase awareness of competition law to achieve greater compliance by the firms in question.

Other activities

Liaison activities

Our commitment to our programme of CA98-related work also includes working closely with external agencies, other regulators and competition authorities, particularly the CMA under the concurrency arrangements. We signed a Memorandum of Understanding (MoU) with the CMA in December 2015 on the use of concurrent competition powers in the financial sector and a separate MoU in January 2016 on the use of concurrent powers under consumer protection legislation.[27]

We are also liaising with the EU Commission's Directorate-General for Competition on a number of cases.

26. FCA MS14/3.2 Retirement Income Market Study: Interim Report December 2014 https://www.fca.org.uk/your-fca/documents/market-studies/ms14-03-2
27. See http://www.fca.org.uk/fca-cma-consumer-protection-mou and http://www.fca.org.uk/your-fca/documents/mou/fca-cma-concurrent-competition-powers-mou

3
Retail banking

Key points

There are longstanding concerns about competition in retail banking. The Independent Commission on Banking found that this became significantly more acute in the aftermath of the financial crisis.

There have been a series of initiatives to boost competition in retail banking since the crisis, including: the divestment of TSB and planned divestment of Williams and Glyn; the launch of the Current Account Switch Service; the creation of the PSR and changes we've made to the authorisations process for new banks; most recently the creation of the New Bank Start-up Unit (NBSU) jointly with the PRA. We have also examined competition in the savings market and continue to work closely with the PSR on competition in payments.

We see some positive signs with some new entrants to the market, but we are also looking for the potential for disruptive innovation, and continue to work on increasing consumer engagement. In our next phase of work and following the CMA's market inquiry, we will undertake further work to improve competition in retail banking.

Background

Retail banking is a vital part of the UK economy. Nearly all consumers and businesses need to use retail banking services in their daily lives; to pay bills, receive wages and for a host of other daily transactions. The sector has already seen a number of in-depth competition reviews, including the ongoing CMA investigation into retail banking.

For the purposes of this report, the retail banking sector includes the following activities:[28]

- **transactional banking** which includes personal current accounts (PCAs), business current accounts (BCAs) and related payment services provided by deposit takers
- **cash savings** are the savings accounts provided by banks, building societies and credit unions[29]
- **non-bank payment services** and technology; provided by firms which are not deposit takers, such as money remittance, e-money, merchant acquiring[30] and other payments services[31]

Payment systems are a key element that underpins services, allowing funds to be transferred between individuals, businesses and institutions. Payment systems are regulated by the PSR, which is an independent economic regulator and competition authority for the payment systems industry. It became operational in April 2015.

Number of accounts 2015:

72 million personal current accounts

4.1 million business current accounts for SMEs

Source:GfK FRS 2015 data. Accounts held by British adults 16+ for PCAs; for BCAs, BBA's Better Business Finance data covering Barclays, HSBC, Lloyds Banking Group, Clydesdale & Yorkshire Banks, Royal Bank of Scotland Group, Santander and The Co-operative Bank.

28. Other activities (mortgages, loans, investment products, and corporate banking and other wholesale activities) are considered in subsequent chapters in this report.
29. Some banks have started offering reward current accounts. These accounts typically offer higher rates of interest and cash back on certain transactions in exchange for a monthly fees. They blur the distinction between PCAs and savings accounts, since they can offer higher interest rates than many savings products.
30. Retail lending and retail investments, including products primarily sold through retail banks, are discussed in Chapters 4 and 7.
31. These services allow businesses to accept credit and debit card payments from consumers.

While we do not cover payment systems specifically in this report the PSR has announced a number of market studies and interim findings on competition in payment services. These can be found on its website: www.psr.org.uk

Recent competition activity

This section outlines our competition-related activities in this sector, and gives a summary of more recent competition-related regulatory activity at the EU and UK level.

Due to longstanding concerns about competition, the retail banking industry has been the subject of a number of reviews, including the Cruickshank review of retail banking in 2000,[32] the Independent Commission on Banking (ICB) in 2011[33] and a number of OFT and Competition Commission (CC) reviews into PCAs.[34]

FCA competition activities

Joint FCA/CMA SME Banking Market Study

We conducted a market study into banking services for UK small and medium-sized businesses (SMEs) together with the CMA. This was focused on two core SME banking services – business current accounts (BCAs) and overdrafts, and business loans (excluding commercial mortgages). We found that competition is not working effectively for SMEs, particularly:

- the markets remain concentrated, with the largest four providers serving over 85% of BCAs and 90% of business loans
- barriers to entry and expansion were still significant, including the need to have a branch network
- many consumers see little difference in the services offered by the big banks, and
- SMEs have low levels of shopping around and switching, with only 4% of SMEs switching each year. Banks with the highest customer satisfaction may have gained very little market share in recent years as a result

The findings from this study were published in July 2014.[35] The study was our first collaborative project with the CMA, pooling resources and expertise from both authorities. In November 2014 the CMA referred both SME banking and personal current acounts (PCA) markets for in-depth investigation.

The Current Account Switch Service and account number portability

We published our findings from our review in March 2015.[36] We found that the Current Account Switch Service has made the switching process simpler and easier for consumers. However, awareness and confidence in the service was low.

We recommended measures to raise awareness and confidence in the Service and suggested improvements to manage operational issues. We also recommended that the PSR, which has the objectives of encouraging innovation and competition in payment systems, uses our findings on Account Number Portability as part of their future work.

Changes to authorisations and New Bank Start-up Unit (NBSU)

Over the last three years we have made changes to our approach to authorising new banks to improve their ability to compete in retail banking.

This work started with the implementation of the proposals from the joint Financial Services Authority (FSA) and Bank of England (BoE) review of requirements for firms entering or expanding in the banking sector.[37] The most significant of these were changes to the capital requirements for new banks and the introduction of the mobilisation option.

Mobilisation sees the new bank authorised at an earlier stage, for example, to help it secure further investment, recruit staff, invest in IT systems and commit to third-party suppliers, with the certainty of being authorised. In return, the regulators limit the amount of business the new bank can undertake until it is fully operational.

Most recently, we launched the NBSU in conjunction with the PRA in January 2016. The NBSU aims to further stimulate competition by helping new, prospective banks enter the market and support them through the early days of being an authorised firm. The NBSU has not relaxed our authorisation standards; rather it supports new banks through the process as they enter the market. Post-authorisation, new banks will also benefit from focused supervisory support during their early years.

Cash Savings Market Study

This is discussed later in this chapter.

UK competition and regulatory activity

Outside of the FCA, the CMA retail banking market investigation and creation of the PSR is likely to have a significant effect on how competition will function in this sector in the near future.

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32. Competition in UK Banking: A Report to the Chancellor of the Exchequer March 2000 http://webarchive.nationalarchives.gov.uk/20050301195359/http:/hm-treasury.gov.uk/documents/financial_services/banking/bankreview/fin_bank_reviewfinal.cfm . The report found competition problems in all of the markets it investigated, including 'retail banking' as defined in this chapter as well as retail and SME lending. Contains public sector information licensed under the Open Government Licence v3.0.

33. The Independent Commission on Banking Sept. 2011 found that 'there were some positive signs of competition increasing in the UK over the past decade, notably through the activities of 'challenger' banks. The financial crisis has reversed some of the gains of the past decade by leading to a significant increase in concentration in retail banking markets, and by sharply reducing the number of challengers.' Final report, paragraph 7.3. http://webarchive.nationalarchives.gov.uk/20131003105424/https:/hmt-sanctions.s3.amazonaws.com/ICB%20final%20report/ICB%2520Final%2520Report[1].pdf Contains public sector information licensed under the Open Government Licence v3.0.

34. The OFT and CC are the CMA's predecessors. They were brought together to form the CMA in April 2014.

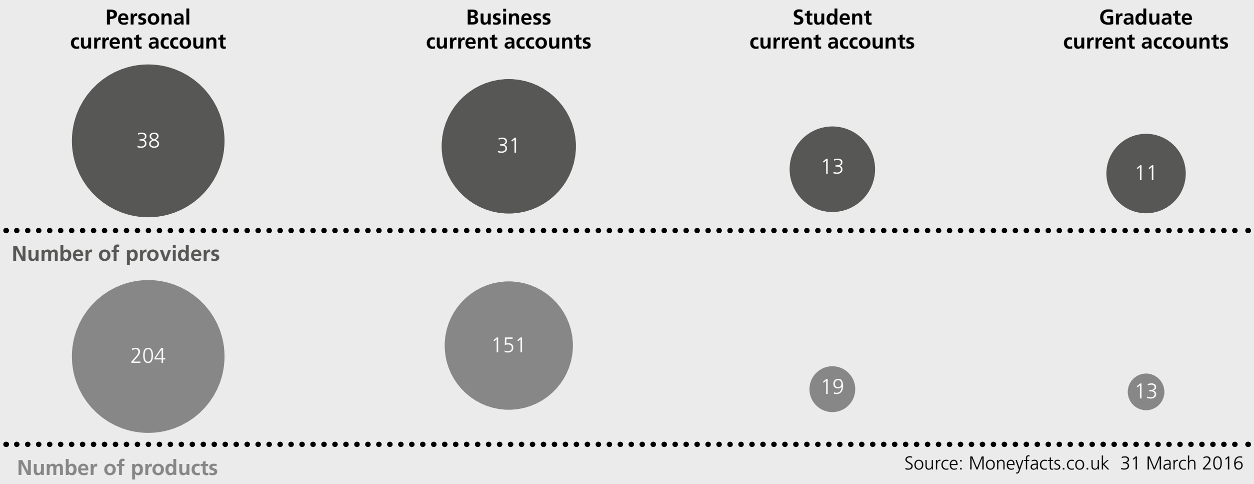
35. FCA Joint FCA/CMA SME Banking Market Study http://www.fca.org.uk/news/market-studies/joint-fcacma-sme-banking-market-study

36. FCA: Our review of the Current Account Switch Service and account number portability http://www.fca.org.uk/about/what/promoting-competition/current-account-switch

37. Review of requirements for firms entering or expanding in the banking sector, FSA and Bank of England, March 2013: www.fca.org.uk/static/documents/barriers-to-entry.pdf

Background facts:
Personal and business current accounts

Number of personal current account providers and products:



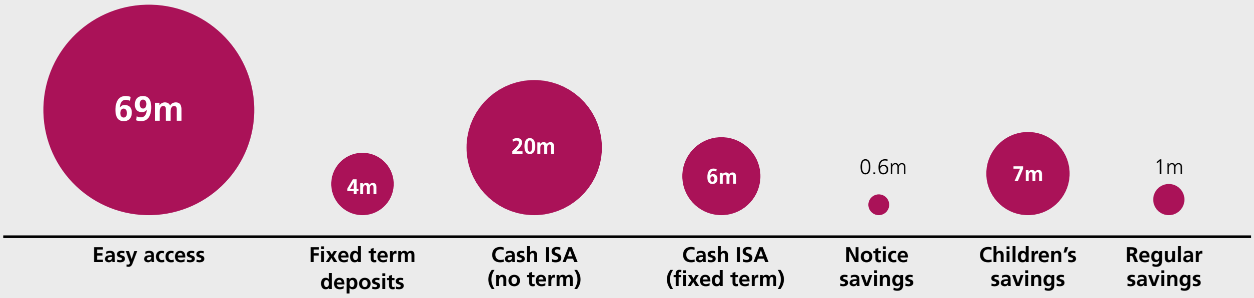
Source: Moneyfacts.co.uk 31 March 2016

% of consumers who obtain additional products from their provider:

Source: GfK, 'Personal Current Account Investigation: A Report for the Competition and Markets Authority' by GfK NOP, April 2015, para 84 and Figure 13.

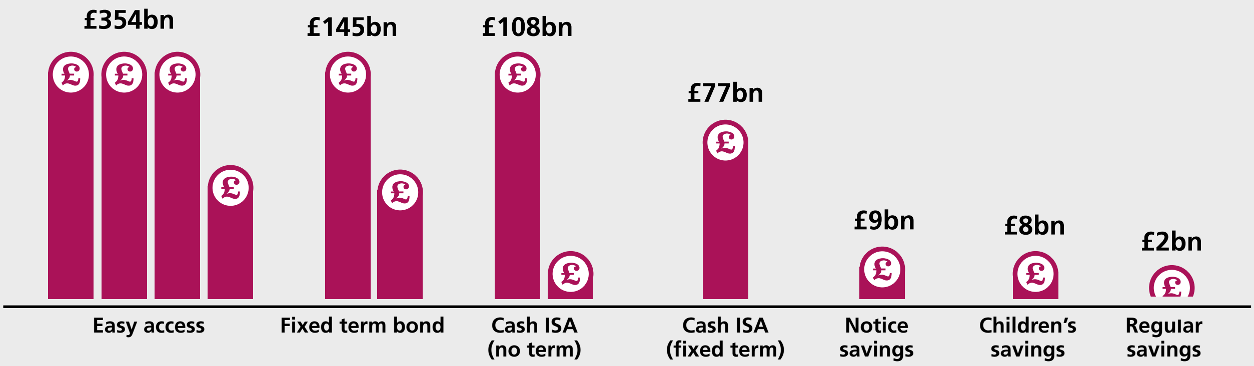
Cash savings accounts

Number of cash savings accounts:



Source: FCA Cash Savings Market Study Final Findings, p17-19

Balances of cash saving:



Source: FCA Cash Savings Market Study Final Findings, Figure 1

CMA retail banking market investigation

In their in-depth investigation, the CMA provisionally found features that cause adverse effects on competition in the markets for PCAs, due to:

- low levels of customer engagement
- barriers to searching and switching accounts, and
- large banks' incumbency advantages in holding the majority of accounts

The CMA also provisionally found adverse effects on competition in the market for BCAs, due to a combination of low customer engagement, barriers to searching and switching, product linkages (where 51% of start-up SMEs go to their PCA provider for a BCA[38]) and incumbency advantages.

The CMA published its Provisional Decision on Remedies in May 2016[39] and we published our response to this in June 2016.[40]

The CMA's final report is due in August 2016.[41] Once the CMA's investigation is concluded and the final remedies are confirmed, we will publish a response to the CMA's final report. This will set out details of the work we intend to undertake to develop and implement the relevant remedies, taking into account our statutory objectives and obligations.

We will also take into account ongoing work that is beyond the scope of the CMA's investigation and will consider the implications of the proposed remedies across related products and services and the fit with other regulatory initiatives.

We agree with the CMA that it is important that remedies result in the right outcomes for customers and firms and intend, where necessary, to do research and testing to inform remedy development.

We will continue to work closely with the CMA whilst its investigation remains ongoing.

Ringfencing

After the financial crisis, the Government decided to ring-fence core banking activities from other activities. The PRA is lead regulator for implementing the ring-fencing legislation; however we have been working closely with them in order to achieve this. We have key responsibilities for implementing the regime effectively and we will continue to work with firms as they finalise their plans for ring-fencing. We are engaging with the firms affected on their plans for implementing the ring-fence to ensure that it is done in a manner which is most compatible with the promotion of competition in the UK banking industry. This is in addition to the work being done with the PRA to help achieve the ring-fencing objectives of promoting the resilience and resolvability of ring-fenced banks and protecting core banking services.

Midata, Open data and Application programming interfaces (API)

The UK Government's Midata and API initiatives will help facilitate competition as it allows bank consumers to access and compare current accounts using their own personal transaction data.[42]

As part of its retail banking market investigation the CMA has proposed a number of remedies covering the introduction of an open API banking standard to share data, publication of service quality data and the introduction of prompts for customers to consider their banking arrangements.[43]

De-risking in the sector

We are aware of a number of issues that affect competition in non-bank payment services. A key issue is de-risking, where some banks are no longer offering financial services to entire categories of consumers that they associate with higher money-laundering risk. This could particularly affect money remittance and e-money firms. We have previously set out our expectations on money-laundering risk management, and we are clear that effective money-laundering risk[44] management need not result in wholesale de-risking. While the decision to accept or maintain a business relationship is ultimately a commercial one for the bank, we think that there should be relatively few cases where it is necessary to decline business relationships solely because of anti-money laundering requirements.

We now consider whether firms' de-risking strategies could lead to competition issues during our anti-money laundering requirements work. The PSR also discusses de-risking in their market study on indirect access.

Sector competition indicators

We outline a number of sector competition indicators in retail banking in this section. These are intended to provide high-level insight into some aspects of competition in the sector, rather than being a definitive competition analysis.

Insight into current accounts

Markets for PCAs and BCAs are concentrated…

The four largest banks (Lloyds Banking Group, HSBC Group,

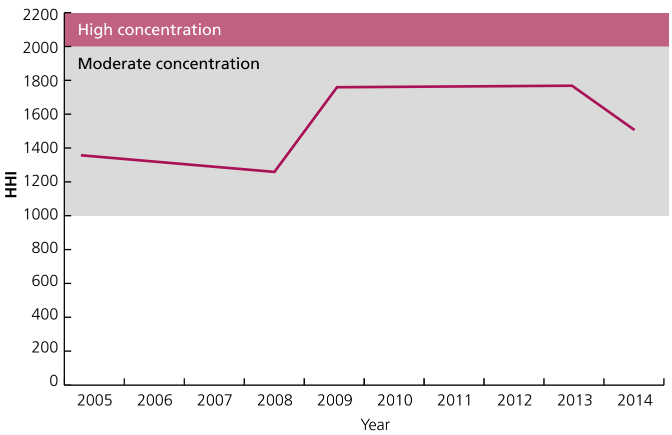
38. This point applies more widely to retail consumers who go to their PCA provider for other financial products such as credit cards and cash ISAs.
39. CMA Retail banking market investigation Provisional decision on remedies 17 https://assets.digital.cabinet-office.gov.uk/media/573a377240f0b6155900000c/retail_banking_market_pdr.pdf
40. FCA Press relesease June 2016 https://www.fca.org.uk/news/response-to-cmas-provisional-decision-remedies-retail-banking-market-investigation
41. CMA Update on the retail banking market investigation May 2016 https://assets.digital.cabinet-office.gov.uk/media/5744573140f0b6036900000a/banking-investigation-update-may-2016.pdf
42. APIs, or 'application programming interfaces', are technical rules allowing pieces of software to interact. This could enable bank consumers to grant access to their bank data.
43. CMA Retail banking market investigation provisional decision on remedies, May 2016 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/523755/retail_banking_market_pdr.pdf Section 3.
44. See FCA statement 'Derisking: managing money-laundering risk' https://www.the-fca.org.uk/money-laundering-and-terrorist-financing/derisking-managing-money-laundering-risk?field_fcasf_sector=unset&field_fcasf_page_category=unset and FCA Research into the issue of de-risking May 2016 https://www.fca.org.uk/news/fca-research-into-the-issue-of-derisking

RBS Group and Barclays) in Great Britain (GB) accounted for approximately 70% of active PCAs and 80% of active BCAs in 2014.[45]

The four largest banks (RBS Group/Ulster, Danske, Santander and Allied Irish Bank) in Northern Ireland similarly account for approximately 70% of active PCAs while RBS Group/Ulster, Danske, Bank of Ireland and Allied Irish Bank account for over 80% of active BCAs in NI in 2014.[46]

Estimates of market concentration (based on the HHI) show that the market for PCAs is concentrated.

Figure 2: HHI for PCAs



Source: CMA provisional findings for Great Britain.
Note: The CMA's Merger Assessment Guidelines indicate that a market with an HHI exceeding 1,000 may be regarded as concentrated. See section 1 for a further explanation of HHI.

Concentration was moderate before 2008, but increased sharply during the financial crisis, as the number of 'challenger' banks reduced.[47]

…despite some new banks

Concentration fell in 2014 following the divestiture and flotation of TSB from Lloyds Banking Group. Concentration is likely to fall further with the separation of Williams & Glyn from RBS planned for 2017.

Other new retail banks have entered the market in recent years, including Metro Bank as an organic entrant and a number of other providers offering PCAs, including the Post Office, Virgin Money and Tesco Bank.[48]

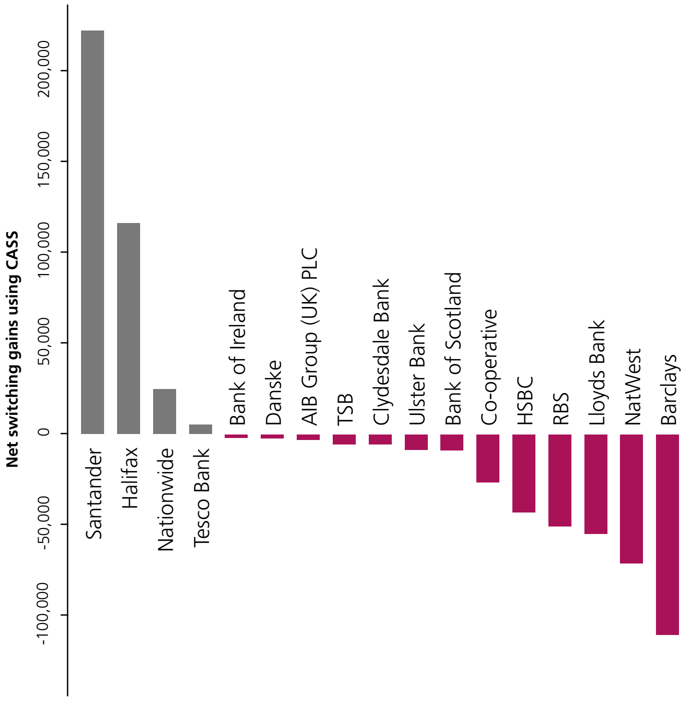
Following our changes to the authorisation process in 2013, a number of banks have also recently been, or are in the process of being, authorised. The CMA's market investigation into retail banking provisionally found that the authorisation process is no longer a barrier to entry for banks.[49]

Increasing digitalisation of retail banking can also enable new entry.[50] The UK now has one of the highest rates of mobile banking in the world, with UK consumers logging in 10.5 million times a day to transfer £2.9bn each week.[51] The increasing use and importance of digital banking has meant that some banks (for example Atom) have entered the market as digital-only, and other digital banks are in the process of trying to secure their banking licence.

However, new entrants' share of active PCAs remains low. Overall market shares in PCAs appear to be moving relatively slowly due to the low levels of searching and switching, as discussed further below.

At a firm level, published data on switches using the Current Account Switch Service show that, over the four quarters to Q3 2015, Santander and Halifax were the main brands that consumers were switching to.

Figure 3: Net switchers using the Current Account Switching Service by brand, cumulative for quarters to Q3 2015:



Source: BACS participant data, published on behalf of Current Account Switch Service participants who have consented to its disclosure.
Note: This data includes personal consumers, small businesses and small charities. These figures are for consumers receiving the Current Account Switch Service guarantee only and may not represent a complete picture of the current accounts acquired or lost by the banks.

Consumers seem to report satisfaction, but relatively few consumers search and switch to a better deal

Consumers generally report satisfaction with PCAs providers, with over 85% of respondents in our consumer research very or fairly satisfied with their provider. This

45. CMA provisional findings October 2015 paragraph 16 https://assets.publishing.service.gov.uk/media/563377e8ed915d566d00000f/Retail_banking_market_investigation_-_PFs_V2.pdf
46. As above.
47. The Independent Commission on Banking Report, chapter 7 http://webarchive.nationalarchives.gov.uk/20131003105424/https:/hmt-sanctions.s3.amazonaws.com/ICB%20final%20report/ICB%2520Final%2520Report[1].pdf Contains public sector information licensed under the Open Government Licence v3.0.
48. This is a trading name of Tesco Personal Finance plc.
49. CMA provisional findings October 2015 paragraph 105 https://assets.publishing.service.gov.uk/media/563377e8ed915d566d00000f/Retail_banking_market_investigation_-_PFs_V2.pdf
50. Although they may see relatively higher costs such as customer acquisition costs.
51. CMA retail banking market investigation provisional findings, paragraph 30(a) https://assets.publishing.service.gov.uk/media/563377e8ed915d566d00000f/Retail_banking_market_investigation_-_PFs_V2.pdf

looks in line with reported satisfaction for other products from our consumer research.[52]

However, complaints to the Financial Ombudsman Service (FOS) have risen since 2012, particularly about packaged bank accounts - we are currently conducting a supervisory review of packaged bank accounts which we expect to complete in Q3 2016.[53]

Moreover, evidence shows that relatively few consumers search and switch to a better deal in PCAs, and the CMA provisionally found gains from switching. Consumers may find it difficult to access and assess information on better deals, or do not take advantage of them due to the perceived hassle of switching.

Could the Current Account Switching Service help?
In 2015 we carried out research among consumers exploring their behaviours and attitudes to financial services through specific sub-sectors.

94% of consumers who switched **thought switching was either very or fairly easy**

Source: FCA consumer research 2015.

Consumers who have switched before seem to find it relatively easy and would consider doing it again. Given this, consumers may be held back by perceived difficulties in switching rather than actual issues encountered when doing so.

Our review of the Current Account Switch Service in March 2015 demonstrated that although it appears to meet the needs of consumers, making it simpler and easier to switch, consumers' awareness of the service and how it affects their perceptions of switching continues to be low.[53]

Cash Savings Market Study
In January 2015, we published the final findings of our cash savings market study and our proposed remedies.[55] We found that the cash savings market is not working well for many consumers.

The market for cash savings does not appear particularly concentrated…
In cash savings, six providers held roughly two-thirds of all cash savings balances in 2014, although there were over 100 savings providers in the market.[56]

52. FCA Consumer Research 2015.
53. Financial Ombudsman Service annual review 2015/16 current account complaints data http://www.financial-ombudsman.org.uk/publications/annual-review-2016/types-of-problems.html#C1
54. FCA The effectiveness of the Current Account Switch Service (CASS) and evidence on account number portability March 2015 https://www.fca.org.uk/your-fca/documents/research/cass-report
55. FCA Cash Savings Market Study Report: Part 1: Final findings Part II: Proposed remedies January 2015 https://www.fca.org.uk/static/documents/market-studies/cash-savings-market-study-final-findings.pdf
56. As above, p.15.

Current account switching

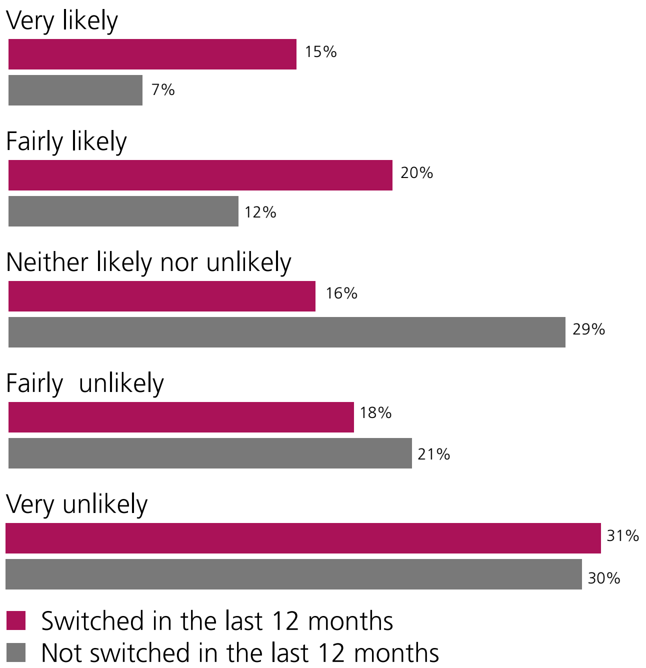
18% searched for a new current account

3% switched current account to a different bank in the last year

over 50% had been with their main PCA provider for 10 years

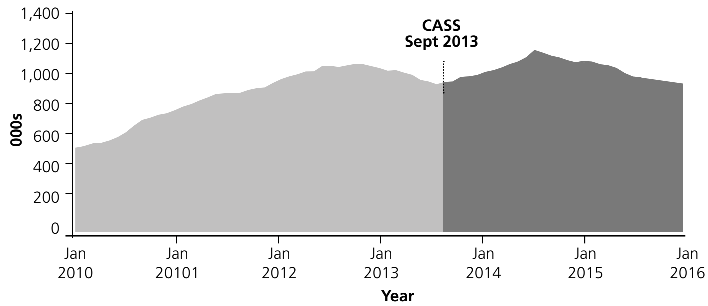
Source: CMA provisional findings retail banking market investigation.

Figure 4: How likely do you think you are to open a new current account or switch your current account in the next 12 months?



Source: FCA consumer research 2015.

Figure 5: Switching volumes for Current Account Switch Service (CASS) and its predecessor switching service (ToDDaSO), rolling annual totals (000s)

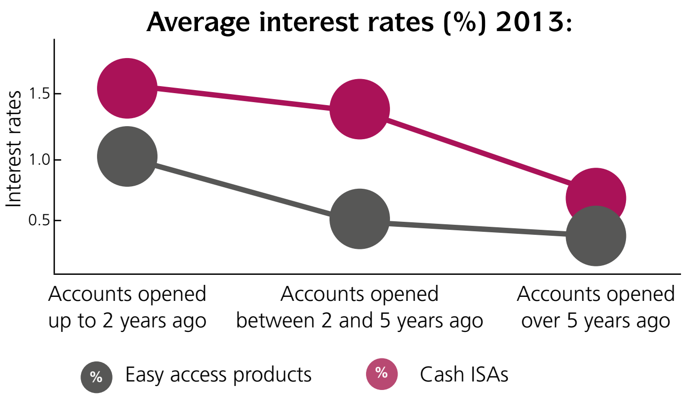


Source: BACS Current Account Switching Service statistics monthly data.

Estimates of market concentration (based on the HHI) suggest that the cash savings market is not particularly concentrated,[57] although this does not necessarily mean that competition is functioning effectively in this market.

... but accounts opened more than five years ago pay lower interest rates than those opened more recently

Many consumers have not considered switching and have remained with the same account for a long time. For example, we found that around a third of balances in easy access accounts are held in accounts opened more than five years ago; this is despite savings providers on average paying lower interest rates on older accounts.



Source: Cash Savings Market Study Final Findings, Figures 21 and 22.

Providers need to improve the transparency of their practices

We found that providers gave consumers little information about alternative products. When coupled with an abundance of products, it is difficult for consumers to know whether or not they are getting a good deal on their existing savings account.

Consumers are put off switching by expected hassle and low perceived gains...

Some consumers do not switch or do not consider switching as the potential benefit is low due to low balances and/or small differences in interest rates available in the current low interest rate environment.

Some consumers' perception that switching will be a hassle is partly due to significant differences between providers in how easy they make this, although opening a new savings account can, in many cases, be fairly straightforward.

... and the large PCA providers have considerable advantages

We found that the four largest PCA providers on average pay materially lower interest rates on easy access accounts than other providers.

Consumers value the convenience of access to their accounts, which seems to be a significant reason for using the same provider for their PCAs and savings accounts. In order to compete, challenger firms have to offer materially higher interest rates.

Other findings

We had initial concerns about introductory bonus rates (so-called 'teaser rates'), but found that many consumers switch reasonably soon after the bonus rate expires.

Our trials showed that simple changes in content and timing of communications to consumers could significantly increase shopping around and switching.

Our remedies

In December 2015, we confirmed a number of remedies (to come into effect at the end of this year) designed to make the cash savings market work better for consumers,[58] including improvements in:

- consumer communications by firms, providing easy-to-understand information up front to enable customers to easily compare accounts as well as timely reminders of interest rate reductions
- the switching process, to make this easier for consumers to move to a better rate offered by their existing provider

We have also published data on firms' lowest-paying easy access cash savings accounts and easy access cash ISAs. We have called this publication a 'sunlight' remedy because we are shining a light on firms' strategies to reduce rates over time for longstanding customers. Holders of these accounts stand to lose out by not switching to a different account, even within the same firm. Publishing these rates should encourage firms to offer better value products to customers, especially those holding products which are no longer on sale.

We continue to see the benefits of reducing barriers to solutions that enable consumers to manage savings and other accounts in one place - even if these are with different providers. We have worked with the industry and aggregators as part of the Open Bank Working Group Initiative. We will continue to take this convenience remedy forward through the implementation of PSD2.

Finally, we have also completed a number of 'real life' trials of remedies designed to prompt customers to consider their choice of account and provider.

Looking ahead

The CMA will publish its final report on competition in retail banking this year. As reflected in our 2016/17 Business Plan,[59] we expect this to be a key element of our work in the coming year.

As a follow up to our Cash Savings Market Study and following completion of real-life trials, we will consult on a second package of remedies this year to improve transparency and increase shopping around and switching.

57. HHI ranged between 1050 – 1150, 2010-2014.
58. FCA PS15/27: Cash savings remedies: Feedback and Policy Statement to CP15/24 and next steps December 2015 https://www.fca.org.uk/news/ps15-27-cash-savings-remedies.
59. FCA Business Plan 2016/17 https://www.fca.org.uk/static/documents/corporate/business-plan-2016-17.pdf

4
Retail lending

Key points

In April 2014, we took over the regulation of around 50,000 firms providing consumer credit.

The mortgage market has undergone significant reforms over recent years that have significantly changed the way that industry operates. We have undertaken a Thematic Review of the quality and suitability of mortgage advice provided by firms following implementation of the Mortgages Market Review (MMR), a Call for Inputs on competition in the mortgage sector, published the findings of our Responsible Lending Review and announced a market study to be launched later this year.

Our credit cards market study provisionally found competition is working fairly well for most consumers. However, we are concerned about the scale of potentially problematic debt. We are working with stakeholders to agree how best to address these issues.

For high-cost short-term credit (HCSTC) and debt management, we have taken action against practices that could, or do cause significant harm to consumers. In implementing the price cap for HCSTC, we chose the most pro-competitive option while still achieving the key regulatory aim.

Background

The retail lending sector meets the borrowing needs of consumers and SMEs, helping them manage debt and obtain credit. The sector offers products that cover everything from day-to-day expenses to property purchases.

Broadly, the retail lending sector is split into mortgages, consumer credit (secured[60] and unsecured[61]) and credit and debt services.[62] The sector is central to the UK economy: total lending to individuals reached £1.45tn in outstanding balances in December 2015, with mortgages accounting for the vast majority at £1.27tn.[63]

60. For example loans secured against an asset other than land or real estate, such as pawnbroking and logbook loans.
61. Such as motor finance and payday loans.
62. Including credit referencing, debt collection, debt management and debt advice.
63. Bank of England, Bankstats Tables A5.2, A5.3, A5.6. http://www.bankofengland.co.uk/statistics/pages/bankstats/current/default.aspx

Recent competition activity

FCA competition activity

Our key recent competition activities in this sector include:

Credit Card Market Study
See the 'sector competition indicators' section below.

Mortgages Call for Inputs and Responsible Lending Review (RLR)
See the 'sector competition indicators' section below.

FCA work on high-cost short-term credit (HCSTC)

We have been keenly aware of both competition and consumer protection concerns in HCSTC since taking over the regulation of consumer credit firms in April 2014. We are also conscious that many consumers find high-cost short-term credit products and services valuable.

We aim to be proportionate in our regulation, promoting effective competition while ensuring that consumers have the protections they need. Where we have had to take action to protect consumers, such as imposing a price cap (see below), we have sought to do so while preserving the existence of the sector and in the most pro-competitive way possible.

Background facts:
Mortgages and consumer credit

Retail lending, value of outstanding balances and gross lending

	Mortgages	Credit cards	Other consumer credit
Value of outstanding balances (total at March 2016)	£1,292bn	£64bn	£118bn

Source: BoE Statistical Tables A5.2 and A5.6.

Examples of consumer credit products

	Overdrafts	Peer-to-peer
Value of outstanding balances (total at dates below)	£8bn	£2bn

	Motor finance	Personal loans	Payday
Gross lending (total at dates below)	£37bn	£35bn	£2.5bn

	Pawnbroking	Home collected credit
Firm revenues (total at dates below)	£0.5bn	£0.9bn

Sources: Overdrafts at March 2016, BoE Bankstat Table A4.3. Estimated personal loans in 2015, Mintel report "Unsecured loans UK" Jan 2016 p.8. Peer-to-peer at Q1 2016, P2PFA website. Pawnbroking at Aug 2015, Apex Insight Report, lending to individuals, "Pawnbrokers & High-Street Loan Stores: UK Market Profile and Forecasts 2015", Aug 2015, Figure 7. Payday loans at 2013, FCA CP14/10, "Proposals for a price cap on high cost short term credit", July 2014, p.6. Motor finance FLA Motor Finance summary, combined figure for new lending to both consumers and businesses as at December 2015. Home collected credit at Sep 2015, Apex Insight Report "Home Credit: UK Market Profile and Forecasts 2015", Sep 2015, Figure 6.

Price cap on HCSTC

Following a legislative change, we implemented the price cap primarily for consumer protection reasons and recognise that price caps are not generally a pro-competitive regulatory tool. Nonetheless, we chose the option most likely to enable competition while benefitting consumers when choosing how to implement the price cap. We will review the cap in 2017.

CMA payday lending market investigation and remedies, and the FCA's response

In February 2015, the CMA concluded that some features of the payday lending market created an adverse effect on competition.[64] The CMA required a number of remedies, including requiring that:

- online payday lenders publish product details on at least one price comparison website regulated by the FCA, and
- lenders provide existing consumers with a summary of the cost of borrowing

The CMA also recommended that we implement additional standards for payday loan price comparison websites (PCWs) and welcomed our moves to:

- review our requirements for PCWs comparing HCSTC and use our regulatory tools to raise standards
- take steps to improve the disclosure of late fees and other additional charges
- work with lenders and other market participants to help customers shop around without unduly affecting their ability to access credit
- take further steps to promote real-time data sharing between lenders
- support the CMA in monitoring compliance with its requirement for a statement summarising the cost of borrowing
- take steps to increase transparency in relation to the role of lead generators

In October 2015 we consulted on proposals[65] in response to the CMA's final report into payday lending.[66] We published our feedback and final rules in May 2016.[67]

Wider regulatory context

EU legislation that may impact on competition in the retail lending sector includes the:

Mortgage Credit Directive (MCD)

This Directive introduces an EU-wide framework of conduct rules for mortgage firms to protect consumers. Our final rules[68] to implement this Directive came into effect in March 2016.

Sector competition indicators

In this report, we provide:

- high-level insight into the mortgages sector as we carry out further competition work in this area
- a special feature on our credit cards market study interim findings

Mortgages Call for Inputs and Responsible Lending Review (RLR)

In October 2015, we issued a Call for Inputs (CfI)[69] to help identify potential areas where competition may not be working well and could be improved. We published the associated Feedback Statement in May 2016.[70]

The responses to the CfI can be categorised into four main themes:

- consumers face challenges in making effective choices, particularly when it comes to assessing and acting on information about mortgage products, with intermediaries being key to the process
- there are opportunities to make more effective use of technology in the provision of information and advice
- commercial relationships between different players in the sector's supply chain - in particular the use of panels - might give rise to competition concerns
- certain dimensions of the regulatory framework might have a negative impact on competition

We considered these stakeholders' views together with the FCA priorities for 2016-17 and our ongoing and planned work, as well as market intelligence (see below for some high level comment on some salient market features). We announced our intention to undertake a programme of competition related work in the mortgage sector. This includes a targeted market study to be launched in Q4 2016, focused on consumers' ability to make effective choices.

The market study will consider the following questions:

- do the available tools for helping consumers make choices (such as price comparison websites, best-buy tables, advice) effectively meet their needs?
- what is the impact of increased intermediation in the mortgage sector on consumer outcomes?
- what is the impact of panel and other commercial arrangements between lenders, brokers and other players in the mortgage supply chain?

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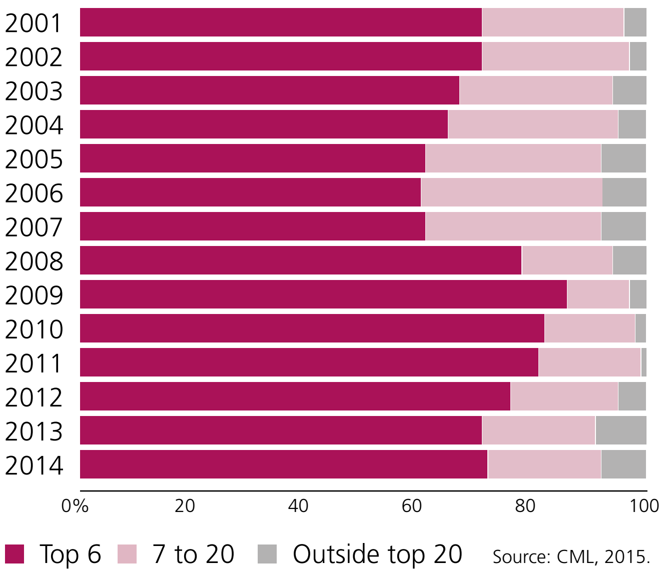
64. These include a lack of price competition between lenders, which led to higher costs for borrowers. Many borrowers also did not know that lead generators were simply intermediaries not lenders.
65. FCA CP15/33: Consumer credit: proposals in response to the CMA's recommendations on high-cost short-term credit. https://www.fca.org.uk/news/cp15-33-high-cost-short-term-credit
66. CMA Payday lending market investigation final report August 2015 https://www.gov.uk/cma-cases/payday-lending-market-investigation
67. FCA PS16/15 Feedback on CP15/33, Consumer credit: proposals in response to the CMA's recommendations on high-cost short-term credit May 2016 http://www.fca.org.uk/news/ps16-15-consumer-credit-proposals-in-response-to-cma-recommendations-on-high-cost-short-term-credit
68. FCA PS15/20 https://www.fca.org.uk/news/ps15-20-implementation-of-the-mortgage-credit-directive
69. FCA Call for Inputs on competition in the mortgage sector October 2015 http://www.fca.org.uk/news/call-for-inputs-competition-mortgage-sector
70. FCA FS 16/03 Call for Inputs: competition in the mortgage sector May 2016 http://www.fca.org.uk/your-fca/documents/feedback-statements/fs16-03

The RLR was complementary to our mortgages CfI. Its purpose was to assess the impact of our new mortgage affordability rules on firms, consumer outcomes and competition in the marketplace. We published the final review in May 2016.[71] For wider context, the following indicators are worth noting, as they highlight high-level trends that offer a perspective on market dynamics (see Chapter 1 for how to interpret sector competition indicators).

Top six firms continue to have high market shares
The top six firms' share of gross lending has broadly returned to pre-crisis levels at around 70% in 2014, falling from 86% during the crisis. Overall, the top six firms saw growth in lending activity of 17% in 2014.

Although certain lenders ranked between 7th and 20th experienced significant growth between 2013 and 2014 (with a handful increasing their gross lending by more than half), the market share of this category overall has fallen to below pre-crisis levels (20%). This reflects similar trends in concentration for personal and business current accounts (see Chapter 3 for further discussion).

Figure 6: Gross lending market concentration, 2001-14



Source: CML, 2015.

The market is becoming more intermediated
Intermediation is playing an increasing role in the sector, and therefore in the decisions consumers are making. Intermediated mortgage sales, which had decreased to around 50 per cent in 2009/10 following the financial crisis, increased to 71 per cent by value and 67 per cent of the number of sales in Q2 2015.[72]

The number of mortgage products is increasing
Approximately 3,600 mortgage products were available to consumers in April 2016.[73] This has been steadily increasing since 2009, when the total number of residential mortgage products dipped to approximately 1,500. Pre-crisis, the number of products available was in excess of 10,000.

The aggregate trend is driven by an increased number of products available in each loan-to-value (LTV) band between 2009 and 2016. However, consumers in high risk cohorts (95% LTV) still have the least choice by number of products, with access to around half the number (approximately 200) at any given time relative to other LTV bands.[74]

Credit Card Market Study

Credit cards are an important retail lending product. It is a large and important market and, if it functions well, can deliver significant benefits to consumers.

We published our interim report in November 2015.[75] We analysed 34 million consumers' credit card accounts, surveyed approximately 40,000 consumers and received input from 24 firms in relation to business models and product details as part of this market study.

The market is moderately concentrated, but there has been new entry
As at October 2015, credit cards were issued by 24 firms (at the group level) in the UK, and four firms held approximately two-thirds of all credit card balances.

We have seen some entry into the credit card market in recent years. Firms have entered in a number of ways, including by working with an existing credit card issuer through a joint venture or co-brand partnership, and then buying their partner's stake.

Credit cards: background facts

30 million

credit card holders in the UK

60% of UK adults
hold at least one credit card
over 40% have two or more credit cards

Source: FCA Credit Cards Market Study: Interim Report, p. 22.

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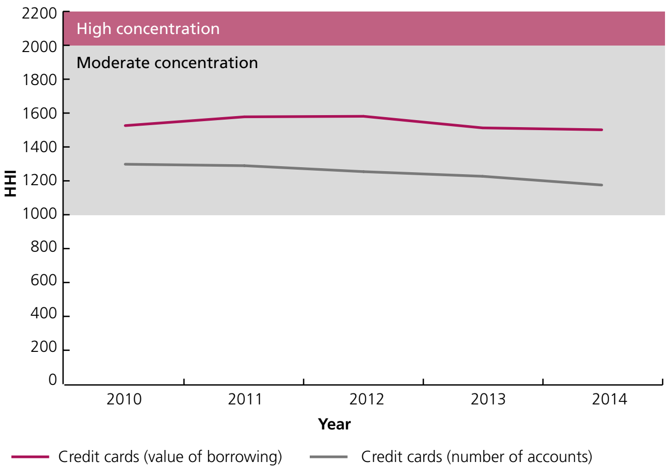
71. FCA TR 16/4 Embedding the Mortgage Market Review: Responsible Lending Review May 2016 http://www.fca.org.uk/news/tr16-04-responsible-lending-review
72. FCA Call for Inputs on competition in the mortgage sector October 2015 http://www.fca.org.uk/news/call-for-inputs-competition-mortgage-sector p10, paragraph 2.5
73. Moneyfacts, April 2016 see FCA FS16/3: Feedback Statement on competition in the mortgage sector https://www.fca.org.uk/your-fca/documents/feedback-statements/fs16-03 p. 9.
74. Moneyfacts.co.uk October 2015
75. FCA MS14/6.2: Credit Card Market Study: Interim Report November 2015 http://www.fca.org.uk/your-fca/documents/market-studies/ms14-6-2-ccms-interim-report

Figure 7: Market concentration in credit cards



Source: FCA Credit Cards Market Study: Interim Report, Figure 5.
Note: The CMA's Merger Assessment Guidelines indicate that a market with an HHI exceeding 1,000 may be regarded as concentrated. See Chapter 1 for a further explanation of HHI.

Consumers are engaged and willing to switch
Consumer survey and account-level data point to a large number of active consumers.

Over half of consumers who took out a new credit card in the last 12 months had shopped around, i.e. compared at least two credit cards before choosing. PCWs play an important role in the credit card market.

PCWs are used by 66% of consumers who shopped around, with 27% saying they had used two or more PCWs. PCWs can help consumers to navigate complex products, however, our review has highlighted some limits to how effective PCWs can be, for example, showing headline rate offers that may not account for eligibility.

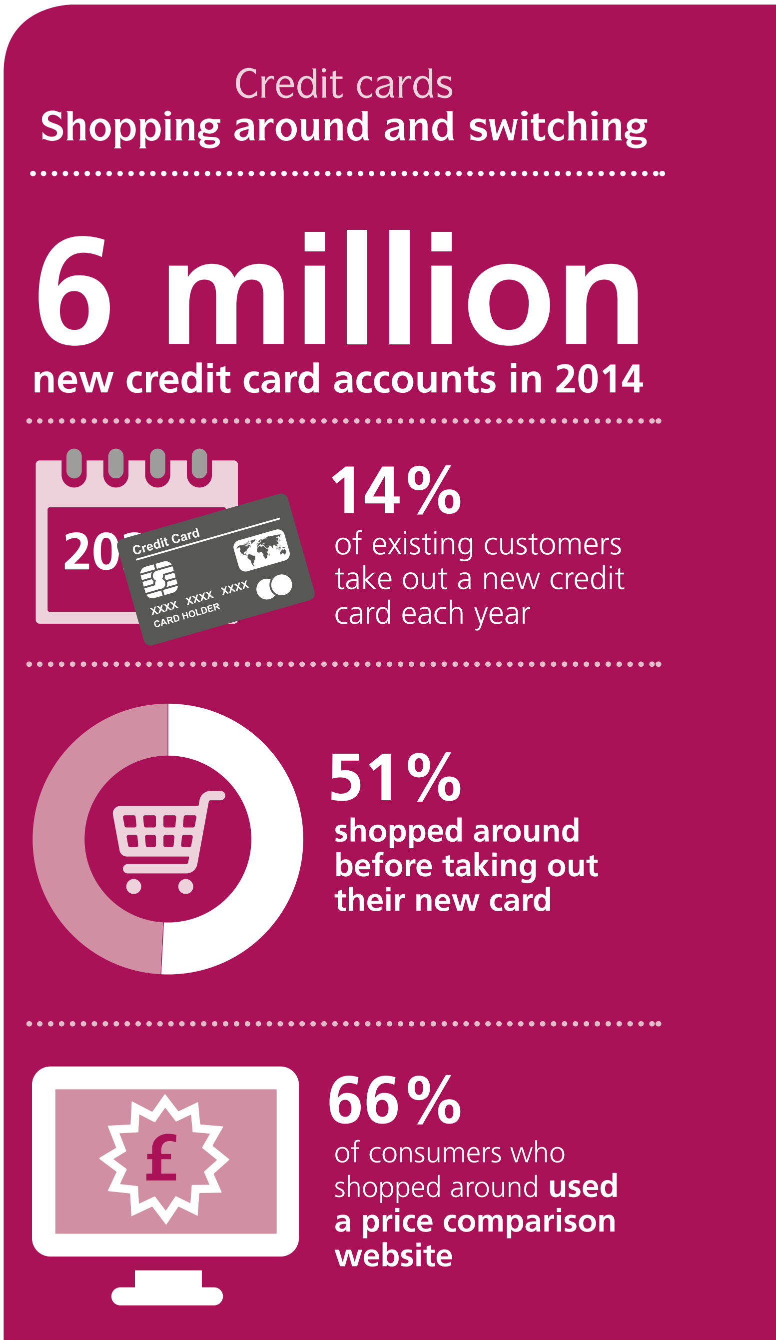
Since consumers can hold multiple credit cards, we estimated levels of switching by looking at new credit cards opened.

Most consumers do not find there are material barriers to switching between credit cards.

But consumers may not end up choosing the best card for themselves
Consumer surveys show that many consumers believe credit cards are easy to understand (65%) or compare (50%). However, there is also evidence that many do not know important features of their credit card. Some respondents stated they incurred unexpected or higher than expected charges.

We found that firms compete strongly – but focused primarily on introductory promotional offers and rewards. There is less competitive pressure on interest rates outside of these offers, and also less competitive pressure on other fees and charges.

Higher credit risk consumers have a more limited choice of providers and products
Higher risk consumers are served almost entirely by four firms and are therefore highly concentrated.



Source: FCA Credit Cards Market Study: Interim Report, p.40 and 45.

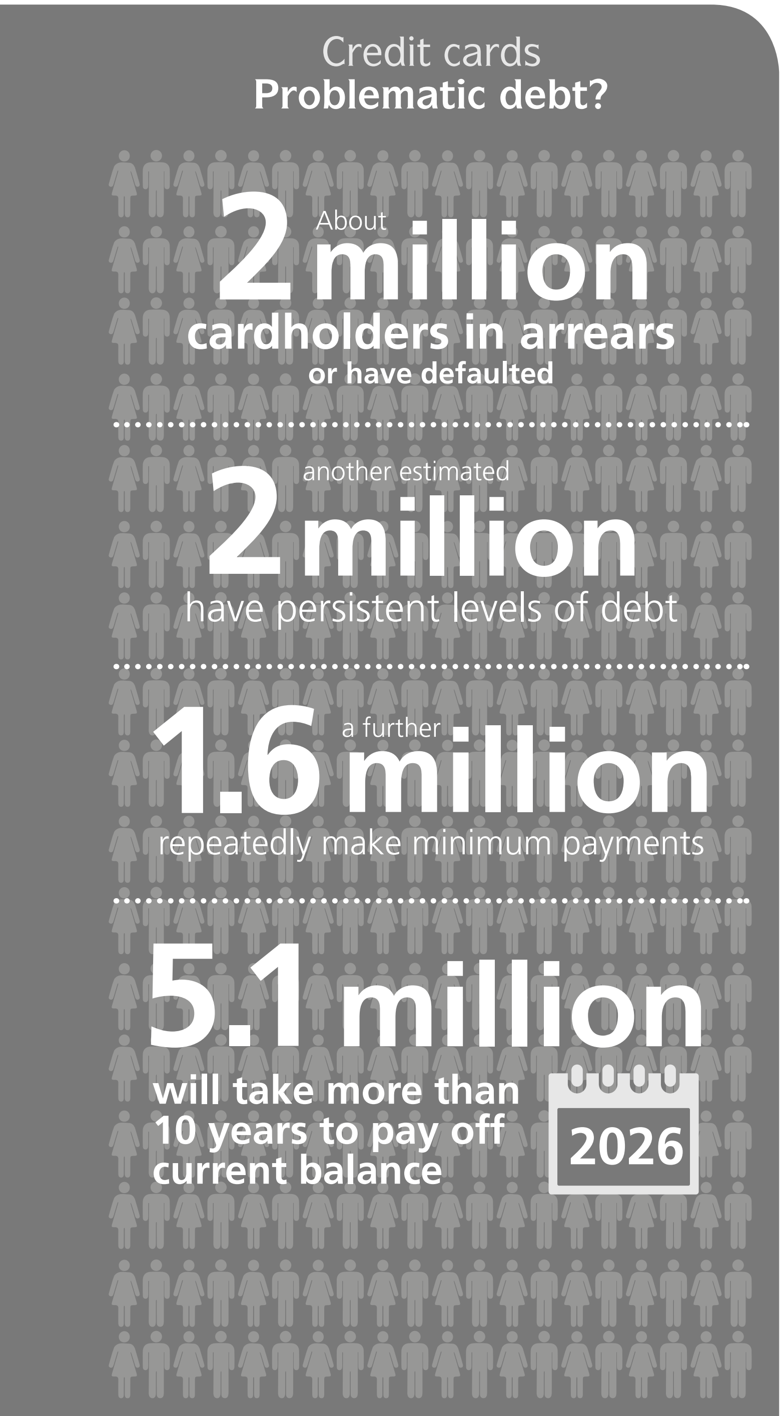
Higher risk consumers also have a more limited choice of products. They are likely to be offered lower initial credit limits and may be offered products with higher interest rates and shorter, or no, promotional offers,[76] so-called 'low and grow' products.

Some higher credit risk consumers are also less willing to shop around
Some consumers with higher risk profiles are less willing to shop around for their credit card for fear of affecting their credit record. Making multiple credit card applications in a short period of time can impact credit rating, which may discourage effective shopping around and switching.

76. For example, many have advertised annual interest rates starting around 30% and typically an initial low credit limit (often £150-500), which can then be increased over time based on the consumer's behaviour.

We are concerned about the scale of potentially problematic debt
All lending activity carries default risk. However, we are concerned about the scale of potentially problematic debt in this market, including for consumers who are just above the default level.

We found that consumers in default are extremely unprofitable and firms are active in contacting consumers who miss payments and triggering forbearance at this point. However, consumers with persistent levels of debt or who make minimum payments are profitable. Firms therefore have fewer incentives to address these levels of debt and we found that most firms do not routinely intervene to address this behaviour of making minimum repayments. We consider that there is more firms could do to help those with persistently high credit card debt to reduce debt burdens before they become problematic, and to prompt those repeatedly making minimum payments to repay quicker when they are able to. We believe the incentives for firms in this market can be realigned.



Source: FCA Credit Cards Market Study: interim report, p.40 and 45.

In conclusion
Overall, we provisionally found that competition is working fairly well for most consumers. We also have some initial views on potential remedies to make the market work better for consumers, including measures to address issues in shopping around and switching to reduce over-borrowing and encourage earlier repayment.

Looking ahead

Later this year we expect to publish our final report on our credit cards market study and will launch a mortgages market study in Q4 2016.[77]

Alongside the market study, we will also be undertaking three smaller pieces of follow-up work to the CfI:

- contributing to the next phase of the Council of Mortgage Lenders and Which? work on the transparency of mortgage fees and charges
- acting on specific aspects of our current regulatory regime where there is a case for change to improve competition, either as part of the market study or our policy work. For example, lifetime mortgages can play an important part in serving older consumers who represent an increasing proportion of the UK population. We are keen that our regulatory requirements do not place unintended barriers to growth and innovation of the range of these products and services
- working with industry to increase competition law awareness in the sector

77. As announced in Feedback Statement 16/03 Call for Inputs: competition in the mortgage sector http://www.fca.org.uk/your-fca/documents/feedback-statements/fs16-03

5

General insurance and protection

Key points

We have focused our competition work to date on a number of issues that affect consumers in retail general insurance markets: add-ons; renewals pricing; and big data.

We found that competition in general insurance add-on markets is not effective. Our new rules to make these markets work better for consumers have recently come into force, including a ban on opt-out selling.

We are addressing concerns that some consumers pay higher prices if they stay with the same insurer, particularly for a long period of time. We are implementing policies that will prompt consumers to shop around, cancel or negotiate their policy at renewal.

Background

Insurance is essentially a promise to pay an agreed sum if a specified event occurs. Consumers pay a premium for this promise in order to cover potential losses to them, their dependents or businesses from uncertain adverse events such as car accident or property damage. Consumers' needs can either be discretionary or driven by a mandatory requirement to hold insurance.

Insurance products can range from personal lines (retail general insurance products) sold to retail consumers to large scale commercial lines for corporate consumers. The value chain in this sector can be long and complex, but includes (among other types of firms):

- reinsurers: insurance companies purchase further insurance to transfer some financial risk to another company, the reinsurer
- underwriters: this includes commercial insurers in the Lloyd's and London Market, which typically underwrite large commercial and wholesale specialty risks, as well as personal lines insurance, and
- distributors: there is a wide range of intermediaries and distributors in the insurance sector. PCWs play a significant role in this sector for some retail general insurance products, such as motor insurance

We consider non-investment life and protection products to fall within this sector but recognise that they have differences compared to general insurance, for example being longer term in nature and typically having different distribution channels.

Recent competition activity

FCA competition activity

Big Data Call for Inputs (CfI)
The use of big data is developing across financial services. Our focus on retail general insurance reflects how extensively data is already used in the sector and its significance for consumers. To better understand how big data affects the sector, we published a CfI in November 2015.[78]

We will publish a Feedback Statement in Q3 2016.

General insurance add-ons market study
This is discussed in the 'sector competition indicators' section below.

Increasing transparency and engagement at renewal in general insurance markets
This is discussed in the 'sector competition indicators' section below.

UK competition activity

Payment Protection Insurance (PPI)
PPI has become one of the biggest cases of financial mis-selling in recent years. Competition and consumer protection issues with PPI are longstanding, for example the consumer body Which? first highlighted issues back in 1998. In 2009, the Competition Commission (CC) introduced remedies prohibiting the sale of PPI at the same point as the associated credit product.

78. FCA Call for Inputs: Big Data in retail general insurance November 2015 https://www.fca.org.uk/your-fca/documents/call-for-inputs-big-data

Background facts : General insurance and protection products

The UK is the third largest insurance and long term savings industry in the world and largest in the EU based on gross written premiums

Source: ABI Key Facts 2015

£57bn in gross written premiums for general insurance

Source: S&P SynThesys 2015. UK regulated insurers only, including reinsurance excluding EEA firms and Lloyd's of London

£27bn Lloyd's of London gross written premiums

Lloyd's of London Annual Report 2015, p5

Retail general insurance Sum of gross written premiums

£26bn

Private motor	Household	Accident and health	Personal finacial loss
33%	24%	27%	16%

Commercial insurance (excluding reinsurance) Sum of gross written premiums

£23bn

Liability	Property	Commercial motor	Marine, aviation and transit	Commercial financial loss
39%	29%	15%	13%	4%

Source: S&P SynThesys 2015. UK regulated insurers only, excluding EEA firms and Lloyd's of London.
Note: UK regulated insurers only, excluding EEA firms and Lloyd's of London. Includes short-term protection products only.

PPI sales fell dramatically after early 2009, and as at June 2016 £24.2 billion of redress had been paid out to consumers since 2011.[79]

CMA Private motor insurance market investigation
The CMA found there were certain features of the motor insurance market that restricted competition and led to higher car insurance premiums overall.[80]

CMA published final findings in 2014[81] and a final order in 2015[82] with remedies including a ban on certain agreements between PCWs and insurers that stop insurers from making their products available more cheaply on other online platforms.

Sector competition indicators

Different insurance products can face very different competitive conditions

There are a large number of retail and commercial insurance products, with a wide variety of providers, consumers and competitive conditions.

Our focus for this report is themes that are common across a number of retail general insurance products. In particular, we outline selected findings from work we have carried out on:

- general insurance add-on products, where we carried out a market study, and
- insurance renewals

General insurance add-ons

General insurance add-ons are general insurance products sold alongside another 'primary' product. These primary products include financial products, such as home or motor insurance, credit cards and bank accounts, or retail products, such as holidays, cars or phones.

We published the final findings of our market study in July 2014, which investigated five add-on products.[83] We found that competition is not effective and can lead to poor consumer outcomes.

79. FCA's monthly PPI refunds and compensation as at 15 June 2016 http://www.fca.org.uk/consumers/financial-services-products/insurance/payment-protection-insurance/ppi-compensation-refunds
80. These included certain contract clauses with price comparison websites that prevent insurers from making their products available more cheaply on other online platforms and consumers finding it difficult to compare the costs and benefits of motor insurance add-on products.
81. CMA Private motor insurance market investigation Final report September 104 https://assets.digital.cabinet-office.gov.uk/media/5421c2ade5274a1314000001/Final_report.pdf
82. CMA The Private Motor Insurance Market Investigation Order 2015 https://assets.publishing.service.gov.uk/media/5509879f40f0b613e6000029/Order.pdf
83. We chose to look at five different types of add-ons in our study: home emergency, guaranteed asset protection ('GAP'), personal accident, travel and gadget insurance. FCA MS14/1 General Insurance Add-Ons: Final Report – Confirmed Findings of the Market Study https://www.fca.org.uk/static/documents/market-studies/ms14-01-final-report.pdf

In particular, we found that buying an insurance product as an add-on, rather than as a standalone product, has a clear impact on consumer behaviour. Add-on buyers are less likely to shop around. Buying an insurance product as an add-on also makes consumers' decisions less effective when they do shop around (for example, add-ons make it more difficult for them to calculate the total component costs of the overall purchase), and less sensitive to price.

The seller's point of sale advantage is increased by this kind of consumer behaviour.

Furthermore, we found that many consumers are getting poor value not just from some add-on products, but also from standalone purchases. We found that there is a lack of transparency and comparability about the value provided by general insurance products more generally.

In order to make these products work better for consumers, we:

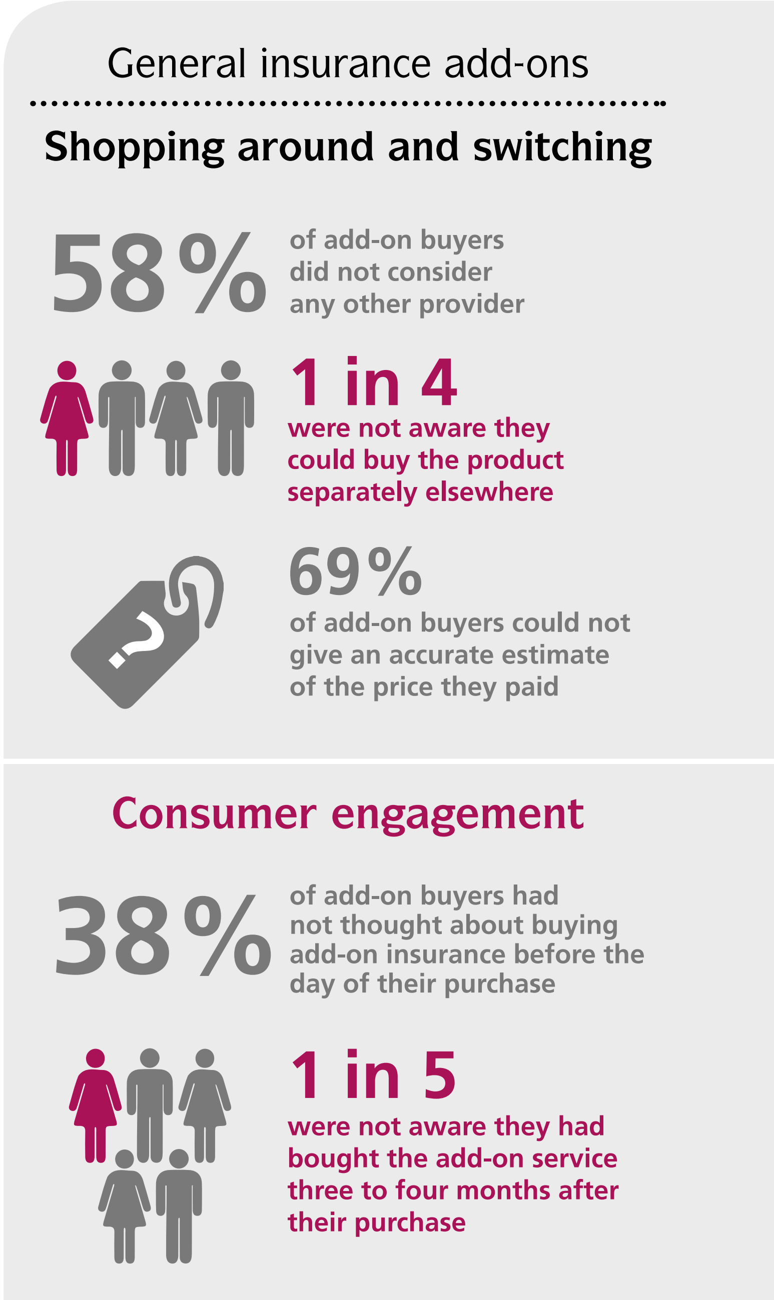
- introduced a deferred opt-in for Guaranteed Asset Protection insurance[84]
- banned opt-out selling[85]
- are improving the information provided to consumers on buying add-ons,[86] and
- are intending to pilot the publication of a scorecard of claims frequencies, claims acceptance rates, average claims payouts and potentially average retail premiums for general insurance products[87]

Increasing transparency and engagement at renewal

We are addressing concerns that some consumers pay higher premiums when they renew their insurance policies, even though cheaper options are available, and that there is a lack of transparency about these price changes.

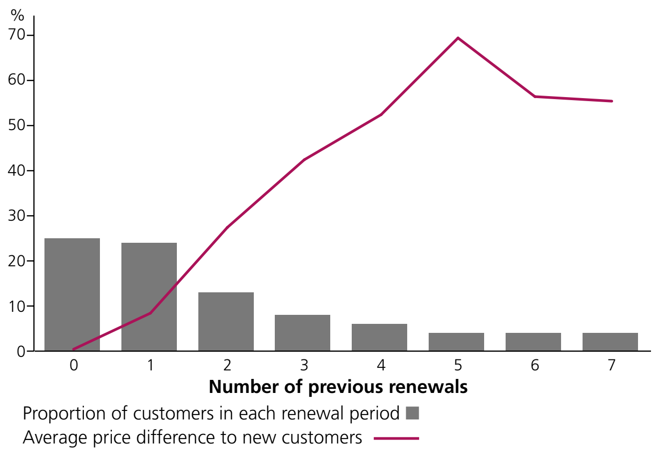
Based on findings from our research,[88] average home insurance premiums increase materially over five years until they level out. This is despite data suggesting the cost of claims for home insurance customers does not increase with the length of enrolment.

Consumers may be sensitive to price when they first purchase an insurance product, but many consumers renew policies without considering other offers, giving firms incentives to discount prices for new customers and offer higher prices at renewal.



Source: FCA General Insurance add-ons market study: Provisional findings and proposed remedies, p.7.

Figure 8: Home insurance renewal price differences (average of three firms)



Source: FCA Occasional Paper No.12: Encouraging consumers to act at renewal – Evidence from field trials in the home and motor

84. FCA PS15/13: Guaranteed Asset Protection insurance: competition remedy June 2015 https://www.fca.org.uk/your-fca/documents/policy-statements/ps15-13
85. FCA PS15/22: General Insurance Add-Ons Market Study – Remedies: banning opt-out selling across financial services and supporting informed decision-making for add-on buyers, including feedback on CP15/13 and final rules and guidance September 2015 https://www.fca.org.uk/news/ps15-22-general-insurance-add-ons-market-study-remedies
86. As above.
87. FCA Press release: FCA to publish claims scorecards March 2016 https://www.fca.org.uk/news/fca-to-publish-claims-scorecards
88. FCA Occasional Paper No. 12 Encouraging consumers to act at renewal: Evidence from field trials in the home and motor insurance markets; http://www.fca.org.uk/news/occasional-paper-no-12

We are enhancing disclosure to increase consumer engagement and prompt greater competition at renewal.[89]

Our consumer survey[90] suggests that the home insurance consumers tend to underestimate the benefits from shopping around and overestimate the amount of time it takes.

Many insurance consumers could therefore gain from shopping around and switching at renewals.

We conducted research on how to better engage consumers who renew their policies, including a large scale randomised controlled research project with over 300,000 consumers from one home insurance and two motor insurance providers. We trialled four different disclosure options to see whether this can help consumers become more engaged at renewal.

Based on this research, we found that disclosing last year's premium was the most effective way to prompt consumers to shop around, cancel or negotiate their insurance policy.

This disclosure caused the equivalent of **11-18% more consumers to switch or negotiate their home insurance policy**,[91] where consumers were offered a price increase of over 5% on average at renewal.

Given this, we are in the process of enhancing disclosure, including by:

Benefits to shopping around

Home insurance

Source: FCA Occasional Paper No.12: Encouraging consumers to act at renewal – Evidence from field trials in the home and motor insurance markets (December 2015), Figure 4.

- requiring firms to disclose the previous year's premium on renewal notices
- requiring additional disclosure for longstanding consumers, and
- guidance on how firms can improve their processes around renewals

Commercial insurance and reinsurance markets

We regulate commercial insurance and reinsurance markets, including Lloyd's of London.

Effective competition in these markets is essential to ensure commercial consumers receive insurance against their risks. Whilst we have not carried out specific competition work in this area, we have undertaken work relating to the Insurance Block Exemption Regulation (IBER).

The IBER establishes that certain agreements, commonly found in the insurance sector, meet the conditions for being acceptable under competition law.[92] The IBER expires on 31 March 2017.

We have carried out informal consultations with several UK market participants to understand the extent to which the UK insurance industry relies on IBER and the likely impact in the UK of its non-renewal.

In March 2016 the European Commission preliminarily concluded that the IBER should not be renewed. We continue to liaise with the European Commission as they develop their thinking.

Looking ahead

We will be launching a pilot of the publication of value metrics including claims frequencies, claims acceptance rates, average pay-outs and potentially average retail premiums for a sample of general insurance products. This will help test the impact ahead of any potential consultation on the remedy.

We are currently implementing our renewals disclosure remedies and intend to publish final rules and guidance in due course.

We will publish our feedback statement on our big data CfI in Q3 2016.

89. FCA CP15/41 Increasing transparency and engagement at renewal in general insurance markets, December 2015 http://www.fca.org.uk/news/cp15-41-increasing-insurance-renewal-transparency-and-engagement
90. Of 4,000 consumers at one home insurer and one motor insurer.
91. FCA CP15/41 Increasing transparency and engagement at renewal in general insurance markets, December 2015, paragraph 2.8 http://www.fca.org.uk/news/cp15-41-increasing-insurance-renewal-transparency-and-engagement
92. These agreements include: (i) joint compilations, tables and studies; and (ii) co-(re)insurance pools.

6 Pensions and retirement income

Key points

Auto-enrolment has fundamentally changed the way people save into their pension. However, these consumers tend not to make active decisions about their pension savings until they start accessing their fund. The consumers auto-enrolled in workplace pensions have been protected from excessive charges when saving for a pension by a charge cap.

Pension freedoms reforms have brought consumers increased choice and flexibility, but also greater responsibility for making decisions about accessing pension savings. Consumers now need to consider issues such as investment risk, charges and sustainability of income. At the same time, they show a range of well-known behavioural biases, including overconfidence that income will be sufficient to cover them in retirement.

Consumers and providers are still responding to the reforms. Firms have developed their business models and product offerings, and consumers have increasingly chosen income drawdown products instead of annuities. Regardless of which products they choose, many consumers tend to stay with their existing pension provider when they access their pension.

Background

There are two main activities consumers undertake in the pensions and retirement income sector: accumulation (saving into a pension) and decumulation (spending or otherwise accessing those pension savings). Some firms only participate in one of these activities, while others participate in both.

For consumers the line between accumulation and decumulation is becoming less distinct following the introduction of the pension reforms. These reforms mean consumers no longer have to convert their accumulated pension savings through a one-off decision at a specific point in time.

Recent competition activity

FCA competition activities

The focus of this section is on our completed retirement income market study. Advice and guidance is a key aspect of the pensions sector – our work on the Financial Advice Markets Review (FAMR) is discussed in Chapter 7.

“Pension freedoms reforms have brought consumers increased choice and flexibility, but also greater responsibility for making decisions about accessing pension savings”

Retirement Income Market Study (RIMS)

In February 2014, we published a thematic review of annuities which found that the annuities market was not working well for many consumers.[93] Based on these findings, we launched a market study of the wider retirement income market.

The market study was completed in March 2015 and proposed a number of remedies and recommendations to support consumer choice in this market, particularly following the introduction of the pension reforms.[94] The key findings of this study are included in the 'sector competition indicators' section below.

We are carrying out behavioural research to assess how to make retirement income products work better for consumers and if required, will look to consult on any rule changes later this year.

Fair treatment of long-standing consumers in the life insurance sector

Our thematic review, published in March 2016,[95] assessed the treatment of closed-book consumers. We found mixed practices across our sample of firms. We found particular problems with some firms' communication to consumers about exit and/or paid up charges. Some consumers may have been unaware that they would have to pay, have paid or are paying such a charge. Our report sets out proposed guidance for firms and consumers. We expect that as a whole, the increased transparency and enhanced consumer protection will result in more effective competition.

Wider regulatory context

This section considers some of the key wider regulatory changes that may impact on competition in this sector.

Pension reforms - changes to our rules and guidance

The new pension rules mean that consumers can access their pension savings through a range of options from the age of 55. Our Policy Statement[96] on pension reforms set out our expectations about how our existing rules and guidance operate in the new pension environment.

In 2015 HM Treasury announced changes to the Secondary annuities market.[97] We are working with HM Treasury to develop the policy for this market, and have published a consultation paper on this topic.[98]

93. FCA TR14/2 Thematic Review of Annuities February 2014 https://www.fca.org.uk/news/tr14-02-thematic-review-of-annuities Annuity: consumers use their pension pot to buy an insurance policy that provides a guaranteed income for life or for a set number of years.
94. FCA MS14/3.3: Retirement income market study: Final report March 2015 https://www.fca.org.uk/news/market-studies/retirement-income-market-studysector March 2016 https://www.fca.org.uk/news/tr16-02-fair-treatment-of-long-standing-customers-in-the-life-insurance-sector
95. FCA TR16/2: Fair treatment of long-standing customers in the life insurance sector March 2016 https://www.fca.org.uk/news/tr16-02-fair-treatment-of-long-standing-customers-in-the-life-insurance-sector
96. FCA PS16/12: Pension reforms – feedback on CP15/30 and final rules and guidance April 2016 https://www.fca.org.uk/news/ps16-12-pension-reforms
97. Proposals include removing certain tax barriers to help consumers to assign their income stream to a third party in return for a cash lump sum by April 2017.
98. FCA Press release April 2016 http://www.fca.org.uk/news/secondary-annuity-market-consultation

Auto-enrolment

Under the Pensions Act 2008, every employer in the UK must put certain staff into a pension scheme and contribute towards it. Auto-enrolment of employees into workplace pension schemes began in 2012, with the intention to complete the staged process by 2018. Auto-enrolment aims to get nine million more people saving, or saving more, in a workplace pension scheme.

OFT market study into defined contribution (DC) workplace pensions

In September 2013 the OFT published a report identifying a number of competition problems, and developed a package of remedies to address these issues.[99]

We accepted an OFT recommendation to consult on these remedies and we published new rules for Independent Governance Committees (IGCs) in February 2015.[100] As a result of these rules, IGCs have a duty to act solely in the interests of pension scheme members (i.e. consumers) and operate independently of the pension provider. Our rules came into force on 6 April 2015.

Pension Exit charges

In July 2015 HM Treasury launched a consultation seeking views on the question of early exit charges on accumulation products, in particular, whether early exit charges are a barrier to consumers accessing the new freedoms.

In January 2016 the Chancellor announced that the government would introduce legislation to place a new duty on the FCA to cap early exit charges in certain pension contracts.[101] By limiting early exit charges, we will reduce barriers to consumers accessing their pension.[102]

In May 2016 we published a Consultation Paper proposing a 1% cap on exit charges in existing contracts, with a ban on exit fees in future contracts.[103]

Sector competition indicators

A focus on decumulation

Given the profound changes to the retirement income sector the focus of much of our competition work has been on decumulation. In this section we draw on our analysis from the RIMS and the data we collect from retirement income providers. The latter data covers Q4 2015, only the third quarter after implementation of pension reforms, and so may not reflect longer term trends.

99. OFT Defined contribution workplace pension market study September 2013 http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505
100. FCA PS15/3: Final rules for independent governance committees, including feedback on CP14/16 February 2015 http://www.fca.org.uk/news/ps15-03-final-rules-for-independent-governance-committees
101. We will be given both the power and duty to cap exit fees by Parliament once the relevant section in the Bank of England and Financial Services Act 2016 comes into force.
102. The Department for Work and Pensions (DWP) and The Pensions Regulator (TPR) will implement a corresponding cap on early exit charges for trust based schemes.
103. FCA CP16/15: Capping early exit pension charges May 2016; https://www.fca.org.uk/your-fca/documents/consultation-papers/cp16-15

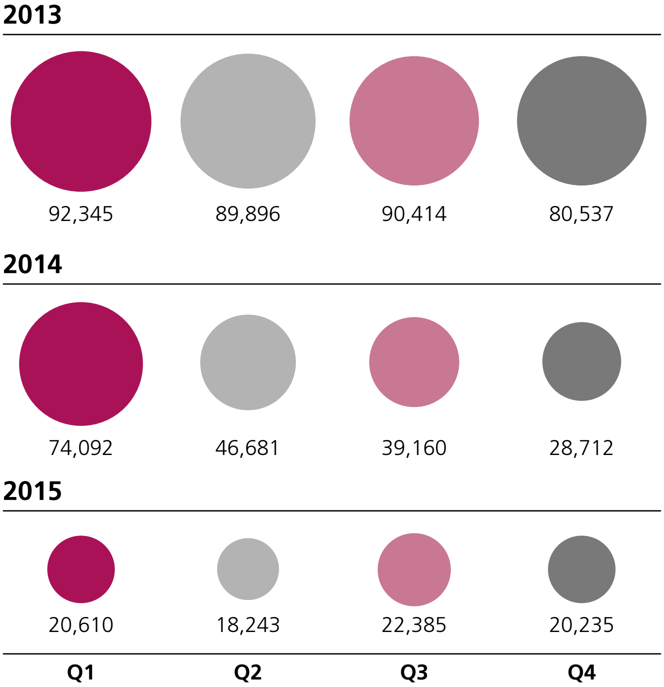
This section considers indicators for the main types of decumulation products: annuities, income drawdown and uncrystallised funds pension lump sum (UFPLS) cash withdrawals.[104]

A significant shift has occurred in how consumers access their pensions

Annuities were previously the main product consumers chose to access their pension savings. In 2013, there were over 353,000 sales of annuities with a total value of £11.9bn, compared with sales of income drawdown products – the main alternative to annuities – of 22,000 with a value of £1.2bn.[105] In 2015, following the pension reforms, annuity sales were over 81,000 for the year.[106]

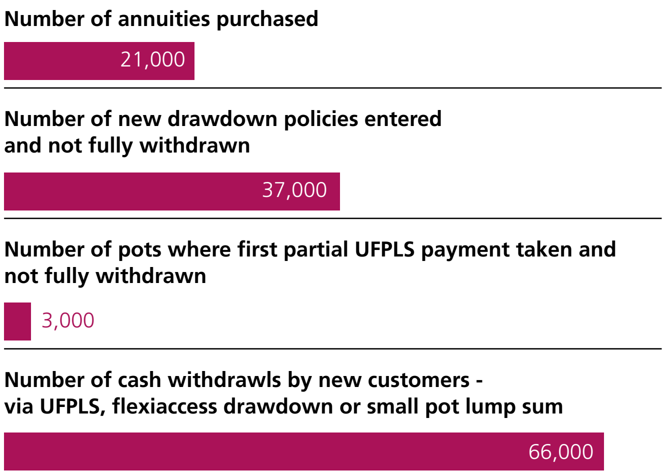
The main choices for accessing pensions in Q4 2015 were various forms of UFPLS and income drawdown.

Figure 9: Sales of pension annuities



Source: ABI, 'Q4 2015 quarterly pension annuities by age of annuitant and fund size' table.

Figure 10: Pensions accessed by product in Q4 2015



Source: FCA Data Bulletin supplement: April 2016 - Retirement Income Market Data.

Concentration in these subsectors seems to be moderate

For decumulation, the retirement income value chain can be broadly split into three elements:

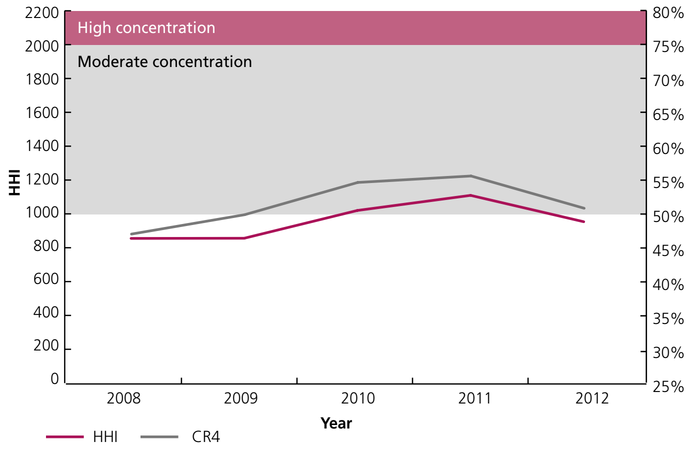
- product providers: includes those who only operate on the open market, those who only serve their existing consumers, and those who offer both services
- intermediaries: provide a range of services to consumers, from basic price comparisons through to financial advice
- reinsurers: offer specialist underwriting expertise to annuity providers, allowing them to insure against the longevity risk when selling products to consumers

At a high level, concentration estimates for the provision of income drawdown and annuities seem moderate.[107] For example, based on our data for Q4 2015,[108] we estimated that:

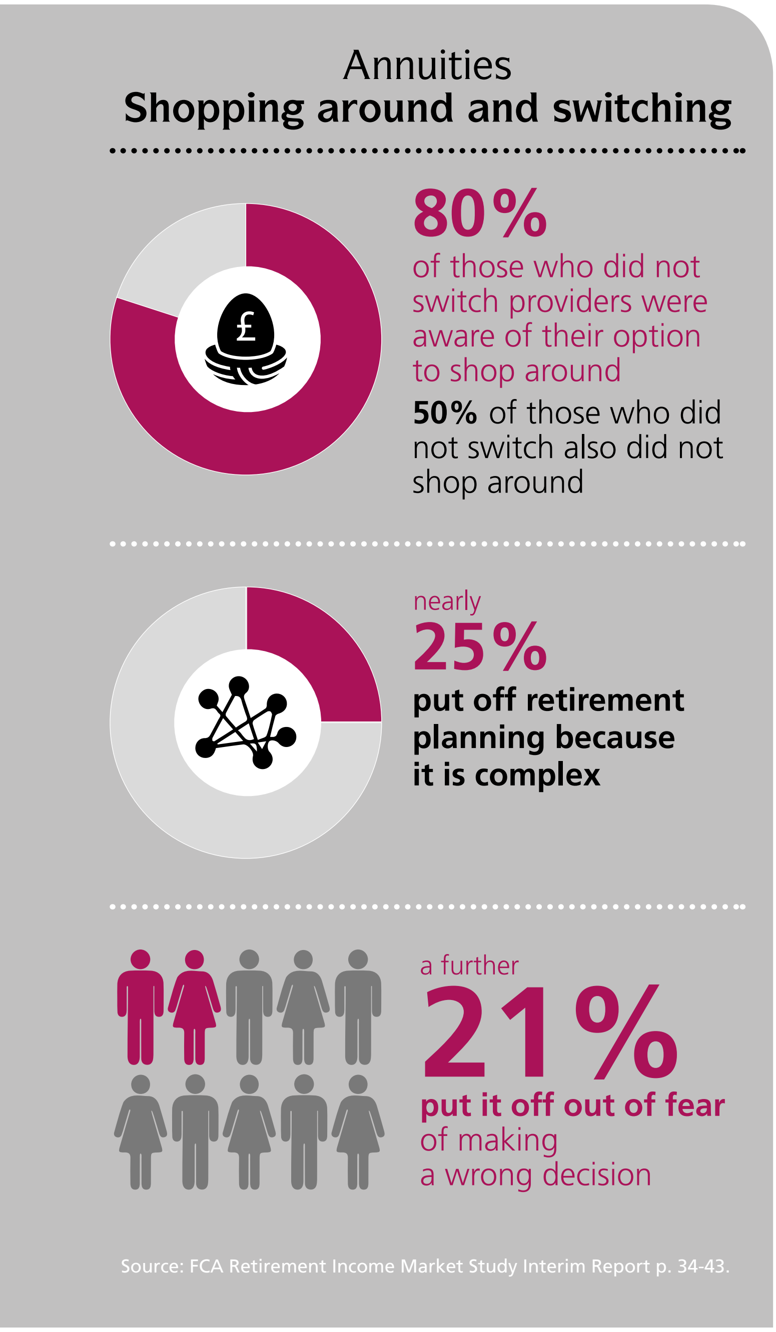
- for income drawdown, an HHI estimate of around 600 suggests this subsector is relatively unconcentrated;
- for annuities, an HHI of around 1,400 suggests this subsector is moderately concentrated

104. Where a consumer withdraws sums of cash i from their pension pot until it runs out. Alternatively, consumers may decide to withdraw their pension savings in full.
105. FCA MS14/3.2 Retirement Income Market Study: Interim Report December 2014 page 10. https://www.fca.org.uk/your-fca/documents/market-studies/ms14-03-2
106. Based on ABI data ('Q4 2015 quarterly pension annuities by age of annuitant and fund size' table), also presented in the figure below.
107. Consumers are likely to choose between annuities, income drawdown and UFPLS products to some extent, and how each 'market' is exactly defined would affect concentration estimates (see further discussion on this general point in section 1). We note that in the CMA's decision on the Just Retirement/Partnership merger, the CMA considered on a cautious basis that the supply of annuities forms a separate frame of reference, but acknowledged the parties will face significant constraints from providers of other retirement income products following the impact of pension reforms.
108. FCA Pension freedoms data, 2015 Q4. These estimates should be interpreted with caution, since data covers approximately 95% of defined contribution contract-based pension schemes assets, rather than all providers. Some trust-based assets which are managed by life insurers are also included in these estimates. The CMA's Merger Assessment Guidelines indicate that a market with an HHI exceeding 1,000 may be regarded as concentrated. See section 1 for a further explanation of HHI and C4 ratio.

Figure 11: HHI and C4 analysis for annuities, 2008-2012



Source: FCA Retirement Income Market Study Interim Findings, Figure 10.
Note: The CMA's Merger Assessment Guidelines indicate that a market with an HHI exceeding 1,000 may be regarded as concentrated. See Chapter 1 for a further explanation of HHI.



We also found that concentration was moderate over time for annuities in our RIMS, although these estimates are not directly comparable.[109]

In RIMS we noted that there had been limited new entry into the decumulation market in recent years. Since that report, there has been some consolidation in the sector – for example, Aviva and Friends Life merged in 2015, and Just Retirement and Partnership completed their merger in April 2016. There have been no significant new entrants into the retirement income sector in recent years.

Since the introduction of the pension reforms, the number and variety of drawdown products has increased, and retirement accounts have been launched offering both capital and income guarantees, although many of the firms offering these are linked to existing life insurance companies.

Most consumers stayed with their existing pension provider

Over half of consumers stayed with their existing pension provider when they accessed their pension, regardless of which product they chose to use.

Our data suggests that 57% of annuity purchases and 53% of drawdown purchases made by consumers were from their existing pension provider in Q4 2015.[110]

A tendency of consumers to buy from their existing pension provider can affect competitive dynamics.

In RIMS, we were concerned that incumbent annuity providers feel less pressure to offer competitive rates to their existing customers and that challengers find it difficult to attract a critical mass of annuity consumers.

We are seeking to address this issue for annuities through an annuity comparison tool.

Consumers give various reasons for not switching

The consumer research carried out for RIMS[111] found that consumers purchasing annuities may choose not to switch for a variety of reasons.

These include: difficulties in knowing where to start; reluctance to commit the time/effort involved; an unwillingness to provide detailed personal information to get a quote; as well as major life events that make time a key factor in decision making.

On the other hand, some consumers make an active decision to stay with their existing pension provider when purchasing their annuity. This may be due to loyalty, a

109. Our RIMS estimates are based on the value of annuity sales in each year, whereas our Q4 2015 estimates are based on the value of annuity payments in that quarter.
110. See our Data Bulletin supplement: April 2016 - Retirement Income Market Data.
111. We are aware that other sources of research provide slightly different estimates (including our previous thematic review), with a higher proportion of consumers not shopping around. This difference may be explained by the fact that GfK's research also includes consumers buying annuities through a panel or a tied provider; hence GFK's finding (that 60% of consumers buy an annuity from a different provider) does not necessarily reflect the proportion of people that shop around and switch provider, by our definition.

Examples of biases

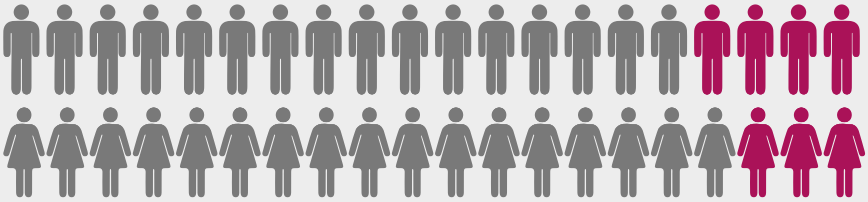
Present bias

- Most are aware that inflation can 'eat away' at income; but
- Most are unwilling to receive lower initial payments to inflation proof their income for tomorrow

Overconfidence

Consumers estimate 50%
of those who retire at 65 in good health will live to 80

In reality it is 80% of men, 85% of women



Source: FCA Retirement Income Market Study Interim Report p. 45.

belief that gains from switching would be small and would not justify the effort of shopping around (since consumers rarely consider the savings over their lifetime), as well as the value they placed on a trusted brand.

A substantial proportion of consumers also describe the retirement information they receive from providers as generally difficult to navigate. We are seeking to address this through trialling better information in wakeup packs.[112]

Consumers also display well-known biases in relation to their pensions

Behavioural economics shows that consumers do not always behave and make choices in a calculated and rational way. In the context of retirement income, consumers now need to give more consideration to issues such as investment risk, charges and sustainability of income, but their decisions may be influenced by a range of well-known biases, including:

- present bias, where they disproportionately favour present over future income; and
- overconfidence that their income will sustain them in retirement, particularly because they underestimate how long they are likely to live

Looking ahead

In our 2016/17 Business Plan,[113] we identified pensions as one of our seven priority themes. We will look across the sector to ensure our policies support fair treatment of consumers and encourage competition. We will also target resources to raise consumer awareness, disrupt scams and take enforcement action against unauthorised businesses.

We are carrying out behavioural research to assess how to make retirement income products work better for consumers, which address concerns identified in our market study. The results of the behavioural testing will be published later this year.

We will also be launching the Retirement Income Review. Our review is a follow-up to RIMS and will consider the impact of the pension reforms on competition in the market.

We are consulting on proposals to cap early-exit charges to ensure that consumers are able to use their pension freedoms and transfer their pensions more freely without barriers. The consultation will close in August 2016.[114]

112. This is information sent to consumers before they decide which retirement income products to purchase.
113. FCA Business Plan 2016/17 https://www.fca.org.uk/static/documents/corporate/business-plan-2016-17.pdf
114. FCA CP16/15: Capping early exit pension charges May 2016; https://www.fca.org.uk/your-fca/documents/consultation-papers/cp16-15

7

Retail investments

Key points

The Retail Distribution Review (RDR) introduced sweeping changes to the retail investment industry in 2012. Our first post-implementation study suggests RDR has a positive effect on competition, for example with consumers more likely to shop around, less product bias in adviser recommendations and falling product prices.

We subsequently undertook the Financial Advice Markets Review (FAMR) with HM Treasury and have since launched the Advice Unit.

We are undertaking a market study into the asset management sector (see Chapter 8), which may have implications for retail investments. We continue to follow developments in retail investments distribution more generally, including the growth of direct-to-consumer platforms.

UK consumers hold over **£1.75 trillion in retail investments**

Background

The retail investment sector aims to enable individuals to grow the value of their assets or obtain an income by making investments.[115] Typically investors seek higher returns than available from cash savings, but they also bear the risk of the investment return not meeting their expectations. Consumers tend to buy retail investment products after choosing saving options like pensions, property and cash.

The sector broadly covers three main activities: manufacturing and providing investment products; services that provide access to, and ongoing administration of, those products; and providing regulated advice and guidance to help consumers select which products and services to buy.

For the purposes of this report, the retail investments sector covers the retail consumer's journey to purchasing investment products, including distribution and retail advice. We distinguish this from investment management in this report, which covers the suppliers of investment products and institutional investors (see Chapter 8).

The retail investments sector is closely linked to other sectors, in particular investment management and pensions and retirement income. For example, advisers and platforms provide advice on pension accumulation and decumulation as well as non-pension investments.

The retail investment products with the largest amounts of assets invested are: collective investment schemes; direct holdings of shares; and insurance-based investment.

115. Please note that, for the purposes of this report "retail investments" include any financial instruments that can be used by retail consumers with the aim of satisfying their need of growing their assets or obtaining an income from investments. This is wider than the FCA Handbook definition of "retail investment".

Crowd funding and peer-to-peer lending products are fast-growing categories, but they remain small components of the sector.

Some consumers may choose to seek advice on which products to hold. They may choose to do so for all their financial products including investments, or only in specific circumstances.

Consumers can buy retail investment products through different distribution channels. This includes buying through their advisers, as well as through web-based platforms.

Recent competition activity

FCA competition activity

Addressing potential pricing distortions and cost transparency issues

Retail Distribution Review (RDR)

The RDR was launched by our predecessor, the Financial Services Authority (FSA), in 2006 to make the retail investment market work better for consumers. The RDR raised the minimum level of adviser qualifications, improved transparency of charges and services, and removed commission payments to advisers and platforms by product providers. The majority of our rules were implemented at the end of 2012.

Our first post-implementation review[116] showed encouraging signs that the RDR was on track in many areas, for example:

- product prices had been falling post-RDR
- the vast majority of advisers were qualified to the new minimum standards
- removing commission paid by providers to advisers and platforms had reduced product bias from adviser recommendations, and
- consumers were shopping around and driving competition in the direct-to-consumer platform market

We undertook an extensive review of the way that firms and advisers were implementing the RDR from 2013 to 2015. Initially we found there was scope for further improvement in the disclosure of adviser charges and services. However, following a range of measures including the publication of good and poor practice examples,[117] there was a material improvement in standards in this area.

Following RDR, we also published additional rules in January 2014 banning other types of referral payments, and requiring complaints against individual advisers to be reported to us.[118]

We will publish the next post-implementation review in 2017.

Platform service providers and cash rebates

Our revised rules for platform services limit a product provider's influence over how products are distributed and how the platform is remunerated, as well as making the services offered by firms to consumers clearer. It is important that consumers trust platforms and can make choices without bias otherwise competition would be distorted. The rules came into effect in April 2014.

Clarifying the boundaries between advice and non-advised sales

We published guidance to help clarify the different types of retail investment sales models, the boundaries between them and the associated regulatory requirements on retail investment advice.[119] This guidance was informed by our thematic review in July 2014, which found that firms wanted greater clarity about how they could help their consumers make informed decisions without providing a personal recommendation.[120]

Developments in advice: Financial Advice Markets Review (FAMR)

FAMR launched a CfI in October 2015 to identify ways to make the UK's financial advice market work better for consumers.[121] It explored the supply and demand sides of the market for financial advice and guidance, and any barriers to providing these services.

As recommended by FAMR, HM Treasury will consult on amending the definition of regulated advice to make the boundary between advice and guidance clearer. Following this, the FCA will consult on new guidance to support firms offering services that help consumers making their own investment decisions without a personal recommendation.

As a whole, FAMR's recommendations seek to improve access to the advice market for firms and consumers. It also recommended that we build on the success of Project Innovate by establishing an Advice Unit to support firms seeking to offer low cost automated advice. Firms eligible for support will be able to receive feedback on their advice models.

The FCA launched the Advice Unit in May 2016. Please see our 2015/16 Annual Report for further information on FAMR.[122]

Helping consumers to navigate complexity and risk

Crowd-funding

This is a new innovative source of finance with potential benefits to competition. We issued a policy statement in March 2014 outlining our regulatory approach to crowd-

116. FCA Post-implementation review of the Retail Distribution Review - Phase 1 December 2014 https://www.fca.org.uk/your-fca/documents/post-implementation-review-of-the-retail-distribution-review-phase-1
117. FCA TR14/21 Retail investment advice: Adviser charging and services December 2014 https://www.fca.org.uk/your-fca/documents/thematic-reviews/tr14-21
118. FCA PS14/1: Distribution of retail investments: referrals to discretionary investment managers and adviser complaints reporting January 2014 https://www.fca.org.uk/news/ps14-01-distribution-of-retail-investments
119. FCA January 2015 http://www.fca.org.uk/your-fca/documents/finalised-guidance/fg15-01
120. F120. FCA TR14/10 Developments in the distribution of retail investments: Purchasing investments without a personal recommendation or with simplifies advice July 2014 https://www.fca.org.uk/static/documents/thematic-reviews/tr14-10.pdf
121. Financial Advice Market Review (FAMR) Call for input October 2015 https://www.fca.org.uk/your-fca/documents/famr-cfi
122. www.fca.org.uk/annual-report-2015-16

funding. We have since intervened to improve consumer protection in crowd-funding, for example, by specifying that only appropriate investors could invest and that financial promotions must be clear, fair and not misleading.

Structured deposits

In our Occasional Paper (No. 9)[123] we showed that retail consumers generally struggle to understand the complex features common to many structured products and frequently overestimate the potential returns they will get from them. Our Thematic Review[124] identified weaknesses in the way some firms approach product design and governance for structured products.

We continue to engage with industry to promote clarity in the disclosure of both the risk and reward of structured products; to support a competitive environment that works in consumers' interests.

Sector competition indicators

Focus on distribution and advice in this report

Due to the large number and wide range of investment products, services and providers, this report focuses on how consumers buy their retail investment products, also referred to as product distribution channels. This consists of two closely-related aspects:

- how they choose what investment products to buy, including whether or not to take financial advice. In the retail investments sector, consumers who choose to take financial advice often also purchase their products through their adviser; and
- the means by which they buy the investment product[125]

Growth in direct-to-customer (D2C) platforms

£145bn
AUM at 31 March 2015

9.7%
Growth in D2C market
between October 2014 and March 2015

New retail investment business done through platforms

Source: FCA Asset Management Market Study: Terms of Reference, p.19-20.

Developments in distribution

Platforms are growing rapidly

Typically, most UK retail consumers buy investment products through intermediaries, such as financial advisers and, more recently, through online platforms.

Platforms are online services that allow investors to buy a range of funds from different providers and hold them together in one account.

Broadly, there are two types of platforms – those that are aimed at:

- retail consumers – known as 'direct-to-consumer' or D2C platforms
- intermediaries such as advisers.

D2C platforms in particular have seen rapid growth in assets under administration (AUA) and are now an important part of the investment market.

Concentration is moderate for D2C platforms, but there are still a few large providers

Despite new entrants in recent years,[126] this part of the sector still remains moderately concentrated, with the top three D2C platforms accounting for 55% of D2C AUA. We continue to follow developments in competition between platform providers and how consumers choose to use them.

Additionally, many platforms operate in more than one stage of the value chain – for example, some are integrated with an investment manager or an advisory firm. We are exploring the impact of platforms on competition between investment managers and how funds are purchased as part of our asset management market study (outlined further in Chapter 8).

Looking ahead

We identified advice as one of our seven priority themes in our 2016/17 Business Plan.[127] We will continue to work on implementing the recommendations from FAMR throughout the year, as well as developing clear policies to support the development of the advice market.

123. FCA Occasional Paper No. 9: Two plus two makes five? Survey evidence that investors overvalue structured deposits, March 2015 https://www.fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-9
124. TR15/2: Structured Products: Thematic Review of Product Development and Governance March 2015 https://www.fca.org.uk/news/tr15-02-structured-products
125. While we focus on distribution in this report, we note that consumers' choice of products and channels tend to influence each other: choosing a specific channel might restrict the choice of products (e.g. insured bonds are not normally accessed or administered through platforms), while consumers can only access some products through specific channels (e.g. crowdfunding products have so far been only available on dedicated platforms).
126. For example, Strawberry Invest launched a platform in 2014 and Aviva launched a direct-to-consumer platform in 2015.
127. FCA Business Plan 2016/17 https://www.fca.org.uk/static/documents/corporate/business-plan-2016-17.pdf

8

Investment management

Key points

The UK investment management industry is the largest in Europe.
It has a significant impact on a vast number of consumers – either directly through their pension funds or retail investments, or indirectly through insurance premiums. It is therefore essential that competition works effectively for these services.

We are currently undertaking a detailed market study into asset management, a vital part of this sector.

Background

The UK investment management sector has evolved to service the needs of individuals and institutions who want to grow the value of their assets or future income by making investments.

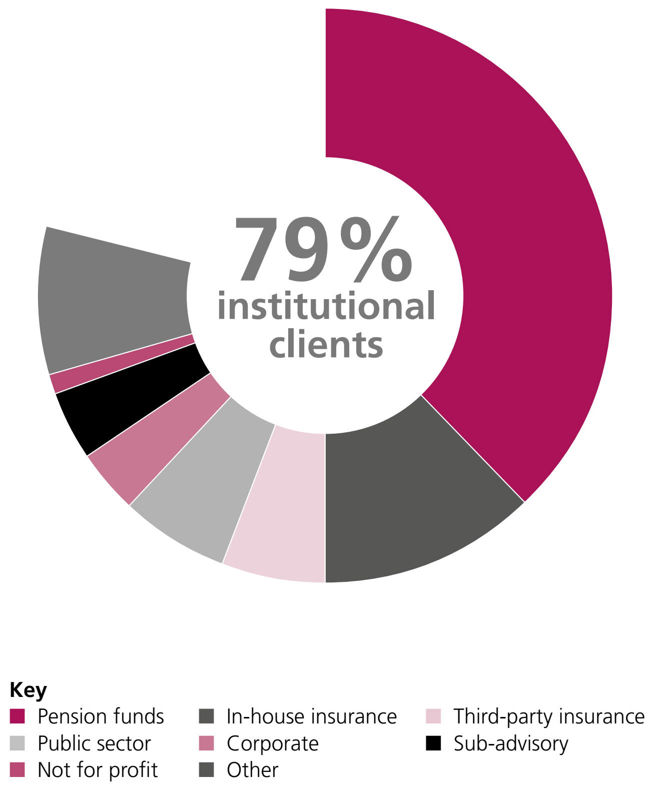
This sector is closely linked to others, in particular retail investments and pensions and retirement income.

The UK asset management industry, a subset of this sector, is the largest in Europe and second only to the US globally in terms of assets under management. The Investment Association (IA) estimates that the UK industry managed around £6.6 trillion of assets in 2014-2015.[128]

As part of this sector, asset managers provide an important economic function in bringing together those with money to invest with governments and companies who need that capital. Asset managers also act as the representatives of capital owners and, in this role, can provide oversight and stewardship of the investments they make.

Institutional investors account for nearly 80% of the asset management client base (by assets under management, or 'AUM'). Pension funds are the largest single institutional client type with £2.1 trillion AUM. However, separating out retail and institutional investors is not straightforward, since retail investors are the ultimate beneficiaries of many institutional investments.

Figure 12: Assets managed in the UK by client type, 2014 (%):



Source: FCA Asset Management Market Study: Terms of Reference, Figure 3.

128. Asset Management in the UK 2014–2015, The Investment Association Annual Survey (September 2015) www.theinvestmentassociation.org/assets/files/research/2015/20150914-ams2014-2015-fullsurvey.pdf

> We have carried out wider work relating to distribution, charges and commissions, and ancillary and outsourced services in this sector, which could affect competition

Recent competition activity

FCA competition activity

We are currently carrying out an **asset management market study (AMMS)** – see further details below.

We have carried out wider work relating to distribution, charges and commissions, and ancillary and outsourced services in this sector, which could affect competition. We summarise some key work in this area below.

Distribution

Retail Distribution Review – explained in Chapter 7 'Retail investments'.

Managing conflicts of interest

Our 2014 thematic review[129] found that generally, firms recognised the potential risks to their consumers from conflicts of interest when using in-house investment products, and had taken steps to manage them.[130]

Charges and commissions

Clarity of Fund Charges

It is important for investors to be able to understand and compare charges. Our 2014 thematic review found that some firms referred to different charge figures across different marketing material and documents, rather than using a consistent combined charge figure (the ongoing charges figure), which makes effective comparisons difficult. This review set out our expectations in this area and we continue to follow up on this issue.

The use of dealing commissions

We have also considered and contributed to the debate around changes to rules on dealing commissions (paid by asset managers to brokers). Our Feedback Statement[131] set out our support for the European Securities and Markets Authority's (ESMA's) proposals for the revised Markets in Financial Instruments Directive (MiFID II, see below).

Wider regulatory context

The main EU and UK developments that may impact on competition in this sector include:

Packaged retail and insurance-based investment products (PRIIPs)

This regulation aims to help investors better understand and compare the key features, risks, rewards and costs of different PRIIPs. It comes into force on 31 December 2016.

MiFID II

MiFID II aims to promote the integration, competitiveness and efficiency of EU financial markets more widely, but some of its provisions will apply to asset managers. The revised regulation is expected to improve investor protection, for example through conditions for providing independent investment advice and disclosing costs and charges. It is currently expected to come into force in January 2018.[132]

Undertakings for Collective Investment in Transferable Securities Directive V (UCITS V)

UCITS V applies to investment funds that can be sold to EU retail investors. It introduces remuneration and new disclosure requirements for managers of UCITS. These requirements came into force on 18 March 2016.

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129. FCA TR14/19 Wealth management firms and private banks Conflicts of interest: in-house investment products November 2014 http://www.fca.org.uk/static/documents/thematic-reviews/tr14-19.pdf

130. We provided individual feedback to the firms that we assessed in detail and required them to address any issues raised.

131. FCA FS15/1 Feedback statement on DP14/3-Discussion on the use of dealing commission regime February 2015 https://www.fca.org.uk/static/documents/feedback-statements/fs15-01.pdf

132. On 10 February 2016, the European Commission proposed a one year extension of the MiFID II implementation date from January 2017 to 3 January 2018.

The European Securities and Markets Authority (ESMA) issued a consultation in July 2015 for the remuneration guidelines required by UCITS V.[133] ESMA finalised these guidelines in March 2016.[134]

Fair and Effective Markets Review (FEMR) – this is discussed in Chapter 9.

Sector competition indicators

Our work on the asset management market study is still ongoing, so we cannot comment on findings about competition in this sector until our work is complete. In this report, we summarise the three main topics that we are exploring in our market study, as set out in our market study Terms of Reference.[135]

Topic 1: How do asset managers compete to deliver value?

Current market structure
How the asset management market is structured could affect the way in which investors and asset managers behave, and therefore impact how competition works in the sector.

Potential for concentration
Looking at the sector as a whole, the asset management industry does not appear to be particularly concentrated.

Sub-sectors of the industry can be highly concentrated

Source: Asset Management Market Study: Terms of Reference, p.14.

However, it is possible that certain parts of the sector may have areas of higher concentration, for example in the UK market for Liability Driven Investment (LDI)[136] mandates.

Our market study aims to understand whether there are any barriers to entry and expansion. This includes any barriers resulting from investor activity or regulation.

Vertical integration
A firm is vertically integrated if it operates both distribution and product manufacturing operations in the supply chain – for example, where an asset management firm also advises on its own products (see Chapter 7 on retail investments for discussion of platforms).

Vertical integration could potentially benefit end investors by increasing the firm's efficiency, which may be passed on to those investors. It might also allow the firm to understand the market better and so develop better products for end investors.

However, in some circumstances vertical integration could make it more difficult for competing firms to enter the market and create conflicts of interest in certain business models. We are exploring the impact of vertical integration in this market.

How investors choose asset managers

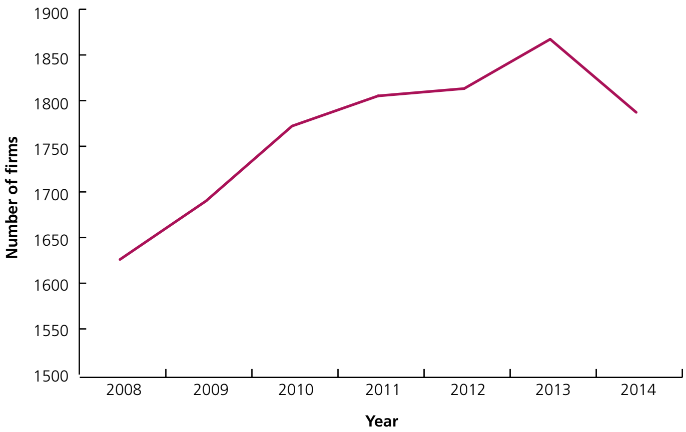
We are investigating the extent to which different types of investors are able to access, assess and act on the right information to make informed choices and we will consider how investor decision-making affects incentives of asset managers to compete.

Retail and institutional investors can drive effective competition if they are able and willing to compare different products and choose or switch to the one that represents the best value for them.

Lack of clarity around charges may not just affect retail investors or products – the Financial Services Consumer Panel noted that even institutional investors of multi-billion pound pension funds may not know the full costs of investing.[137]

133. ESMA Consultation Paper July 2015 https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1172_cp_on_ucits_v_u_aifmd_remuneration_guidelines.pdf
134. ESMA Final report Guidelines on sound remuneration policies under the UCITS Directive and AIFMD March 2016 https://www.esma.europa.eu/sites/default/files/library/2016-411_final_report_on_guidelines_on_sound_remuneration_policies_under_the_ucits_directive_and_aifmd.pdf
135. FCA MS15/2.1 Asset Management Market Study: Terms of Reference November 2015 https://www.fca.org.uk/your-fca/documents/market-studies/ms15-02-1-asset-management-market-study-tor
136. A liability driven investment is a mandate where the investment strategy is based on the requirement for cash flow to meet both current and future liabilities as they fall due (this requires that the future cash flows can be predicted). It is commonly used to describe a range of investment strategies designed for situations where future liabilities can be predicted.
137. Financial Services Consumer Panel - Investment costs –more than meets the eye November 2014 https://www.fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf

Figure 13: Number of asset management firms with positive AUM



Source: FCA Asset Management Market Study: Terms of Reference, Figure 4.

Barriers to entry and expansion

Publicly available data shows that the number of asset managers has increased over recent years, apart from between 2013 and 2014.

Pricing and profitability analysis

We are analysing charging structures and underlying costs for providing asset management services to help understand why certain groups of investors might pay more for products and services than other groups.

We are also considering the profitability of the asset management sector. Where firms in a sector or industry generate profits above a normal rate for that activity over a sustained period, it may indicate that competition is not working effectively for those services. Any assessment of profitability will be indicative only and cannot be considered in isolation, but will form part of our wider assessment of the way the market is working.

Topic 2: Are asset managers willing and able to control costs and quality along the value chain?

Asset managers commonly outsource some ancillary services, such as custody banking, securities lending and fund administration services. Asset managers may also purchase some products and services from third party providers which are typically needed to carry out their investment management function e.g. market research, benchmarking data or trade execution services. Some of these services are paid for by the fund investors, while other costs are borne by the asset management firm.

We want to understand the extent to which asset managers are willing and able to control and scrutinise costs when purchasing these services. We also want to explore whether this differs depending on the nature of the cost, the service provider, the type of end investor and the information about the cost which asset managers provide to investors.

Topic 3: What impacts do investment consultants have on competition for institutional asset management services?

Investment consultants play a significant role in the market for institutional asset management; from providing benchmarking data on fund managers to advising pension funds on their asset allocation as well as providing fund management or fiduciary management services.[138]

Given this role, we want to assess the ways in which investment consultants affect competition for institutional asset management.

Looking ahead

We will publish an interim report on our asset management market study in Q3 2016. This will set out our analysis and preliminary conclusions and, where practicable and appropriate, possible remedies to address any concerns identified. We will publish our final report in 2017.

138. Fiduciary management is where the manager may accept responsibility for the selection of underlying asset managers, and may have discretion to deviate from the original asset allocation decision specified by the client.

9 Wholesale financial markets

Key points

Wholesale financial markets are a central pillar of the global economy and are critical for driving economic growth; the UK plays a key role as a leading international financial centre. It is therefore important that competition works effectively within them.

We conducted a Wholesale Sector Competition Review in 2014 to identify any areas where competition may be weak or not be working properly in these markets. As a result, we decided to launch a market study on investment and corporate banking services.

In that market study, we provisionally found that universal banking and cross-subsidies seem to work well for large corporate clients, but may not work as well for some small and medium-sized ones. We also had concerns about the initial public offering ('IPO') process, IPO allocations, and the credibility of league tables. We proposed a targeted package of potential measures to improve competition in the sector.

Wholesale markets are one of our seven priority themes in our 2016/17 Business Plan. We will continue our work on investment and corporate banking services, as well as follow developments relating to potential competition issues in markets and market infrastructure.

Background

Wholesale financial markets are a central pillar of the global economy and are critical for driving economic growth; the UK plays a key role in global wholesale financial markets as a leading international financial centre. It is therefore important that competition works effectively within them. These sectors support economic activities and other financial services, including allowing firms to raise finance and enabling financial institutions to manage risk.

There are many subsectors and markets within wholesale financial sectors, and these can be defined in a number of ways. One possible split is as five interconnected subsectors:

Transaction services: these meet short-term transactional needs. Transaction services provide cash flow management, local and cross-border payments, and trade financing services for wholesale market users

Lending: this serves the financing needs of a wide range of wholesale market participants, including those who cannot access traded capital markets

Equity and debt primary and secondary markets: these facilitate fund raising and the allocation of capital between providers of that capital (investors) and users (financial institutions, other companies and public entities). Tradeable instruments on these markets can be used to create portfolios for investments

Derivatives: these are markets for risk (distinct from capital allocation) providing participants with the ability to tailor their risk profile by offloading or taking on financial risk

Foreign exchange and commodities cash markets: these allow end-users to meet or hedge business needs through buying and selling currencies and commodities. They also allow end-users and intermediaries to invest in currencies and commodities. Instruments traded on these markets are deemed 'non-financial products' but are traded by financial institutions and can impact regulated markets

Recent competition activity

FCA competition activity

Our key competition activities include:

Wholesale sector competition review
In July 2014 we launched a review of competition in this sector to gather views on areas that might warrant further investigation through an in-depth market study. The review focused primarily on competition in wholesale securities and investment markets, including:

- markets and market infrastructure
- investment banking
- corporate banking
- asset management

In February 2015 we concluded our review and published a feedback statement summarising the responses.[139] As part of this, we also announced our intention to undertake a market study into the investment and corporate banking sector.

Investment and Corporate Banking Market Study
This is discussed in 'sector competition indicators' below.

Wider regulatory context

There are wider regulatory activities that may impact on competition in the wholesale sector.

MiFID II – this is covered in Chapter 8 'Investment Management'.

Implementation of the Market Abuse Regulation
We consulted on the rule changes[140] required to implement these new regulations and published final rules in April 2016.[141] These changes underpin efforts to promote fair and effective competition in wholesale markets.

Capital Requirements Directive IV (CRD IV)
As part of the response to the financial crisis, CRD IV covers prudential rules for banks, building societies and investment firms. It aims to ensure that firms are able to meet their liabilities as they fall due and minimise the negative effects of firms failing. The bulk of the rules contained in the legislation applied from 1 January 2014.

Fair and Effective Markets Review (FEMR)
FEMR was led by the Bank of England, and co-chaired by the FCA and HM Treasury. Established in 2014, FEMR looked to conduct a comprehensive and forward-looking assessment of the way wholesale financial markets operate, help to restore trust in those markets in the wake of a number of recent high profile abuses, and influence the international debate on trading practices.

FEMR published a final report in June 2015 with twenty-one recommendations.[142] These included measures to strengthen the regulation of Fixed Income Currency and Commodities (FICC) markets in the UK and an extension of the Senior Managers and Certification regime to the asset management sector. This aims to raise standards, professionalism and accountability of individuals.

As part of the review, we issued a summary of the competition law framework written in conjunction with the CMA to all firms with wholesale permissions.

Ring fencing – this is discussed in Chapter 3 'Retail banking'.

Sector competition indicators

Investment and Corporate Banking Market Study Interim Findings
Primary markets play a vital role in the economy matching investors with corporates and public bodies which need to raise finance. The UK is a leader in equity capital markets (ECM), debt capital markets (DCM) and merger and acquisition (M&A) activity.

$17bn
the approximate total gross fees in primary markets generated by investment banks' UK operations in 2014

Source: Investment and Corporate Banking Market Study: Interim Report, p.4.

139. FCA FS15/2: Wholesale sector competition review 2014-15 February 2015 https://www.fca.org.uk/your-fca/documents/feedback-statements/fs15-02
140. FCA CP15/35: Policy proposals and Handbook changes related to the implementation of the Market Abuse Regulation (2014/596/EU) https://www.fca.org.uk/news/cp15-35-implementing-market-abuse-regulation
141. FCA PS16/13 Implementation of the Market Abuse Regulation https://www.fca.org.uk/news/ps16-13-implementation-of-the-market-abuse-regulations
142. Fair and Effective Markets Review Final Report June 2015 http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf

Following our wholesale sector competition review, in May 2015 we launched our Investment and Corporate Banking market study, (ICB) focusing on primary market and related activities provided in the UK. This examined issues around:

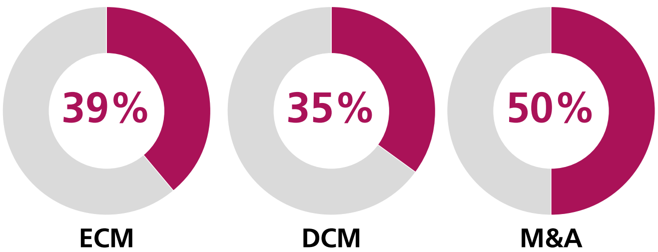
- choice of banks and advisers for clients
- transparency of the services provided by banks, and
- bundling and cross-subsidisation of services

We published an interim report in April 2016.[143]

Universal banking and cross-subsidies seem to work well for large corporate clients, but may not work as well for some small and medium-sized ones
There is a wide range of banks and advisers active in primary market services. There are often between 20 and 40 banks active in any particular sector and for different types of client – sovereigns, supra-nationals and agencies, financial institutions and corporate clients.

Lending and corporate broking are typically supplied at a low rate of return or below cost in exchange for a flow of transactional business, which is typically more lucrative. Nearly three-quarters of DCM primary market roles are awarded to a bank with whom the client has an existing corporate banking or lending relationship, however the link is significantly weaker for initial public offerings (IPOs).

Concentration ratios are not so high – the largest four firms account for these shared of the value of transactions:



Source: FCA Investment and Corporate Banking Market Study: Interim Report, p.7.

From a client perspective, this model seems to work well for large corporate clients, who typically have a wide range of lending banks or joint corporate brokers that compete against each other for transactional mandates.

However, medium-sized corporate clients (those of a size equivalent to the UK FTSE 250) and small corporate clients,[144] who typically have fewer banking relationships, may feel the need to 'reward' a lending bank or corporate broker with transactional business even when that bank would not otherwise have won a mandate. Pressure to award transactional business to a lending bank or corporate broker can be exacerbated by the widespread use of contractual clauses in client engagement letters restricting future choice of supplier.

Investment and Corporate Banking market study

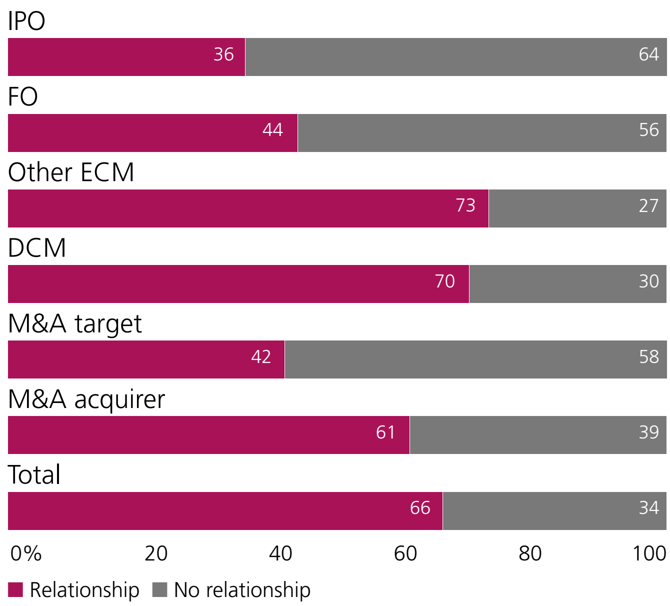
Since launch on 22 May 2015 we:

analysed over 10,000 ECM, DCM, M&A and corporate loan transactions

issued requests for information and received responses from over 90 stakeholders

met with over 100 stakeholders

Figure 14: Proportion of roles awarded to banks which have and have not provided lending or other corporate banking services in the two years prior to the transaction, Jan 2014 - May 2015



Note: Other ECM comprises mainly convertible debt. Source: Investment and Corporate Banking Market Sstudy: Interim Report, Figure.1.

143. FCA MS15/1.2 Investment and Corporate Banking Market Study: Interim Report April 2016 https://www.fca.org.uk/your-fca/documents/market-studies/ms15-1-2-interim-report
144. Those of a size equivalent to the UK FTSE Small Cap and AIM.

> Only 1 out of 169 IPOs we examined featured unconnected research published during the IPO process

Source: Investment and Corporate Banking Market Study: Interim Report, p.11.

The provision of cheap lending and corporate broking makes it harder for those banks providing only transactional services to compete. While boutique advisers have successfully entered in M&A, entry and expansion as book-runners in ECM and DCM has been mainly by banks that also lend. We saw little evidence of emerging technology-driven disruption or disintermediation of primary market activities.

We also had concerns about the IPO process, IPO allocations, and the credibility of league tables
We looked at a range of market practices to assess whether they restrict or distort competition and adversely affect outcomes for clients. These issues, and the possible improvements to the IPO process under consideration, are set out in detail in the discussion paper published alongside the ICB Interim Report.

We published Occasional Paper 15[145] at the same time as these interim findings. One of the paper's findings was that some banks make favourable allocations to investors from whom they generate greatest revenue elsewhere in their business, most notably brokerage commission.

Potential remedies
Based on the findings published in the interim report, we proposed a targeted package of potential measures.[146]

Whilst doing so we are mindful that it is crucial that the market remains open to entry and innovation.

We continue to follow developments relating to potential competition issues in markets and market infrastructure
Our Wholesale Sector Competition Review Feedback Statement[147] stated that competition may not be working effectively in markets and market infrastructure.

However, we decided not to prioritise a market study into this area since ongoing and forthcoming regulation, particularly MiFID II, is expected to affect how competition works for these services. We will continue to follow developments.

Looking ahead

The Chairs of the Fair and Effective Markets Review will provide a full implementation report to the Chancellor of the Exchequer and the Governor of the Bank of England in July 2016.

In the coming year, we will undertake a number of pieces of work to help ensure the UK's primary markets continue to remain clean, competitive and effective. A couple of examples include:

- working with market participants to examine options for improving information availability in the UK initial public offering process, and
- reviewing the structure of listed markets to ensure they continue to best serve the needs of the modern economy.

We will also publish our ICB Final Report in Q3 2016 and look to implement any appropriate remedies.

145. FCA Occasional Paper No. 15 Quid pro quo? What factors influence IPO allocations to investors? April 2016 https://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-15.pdf
146. As this is outside of scope for this report covering activities up to 31st March 2016 this will be covered in further detail in a future report.
147. FCA FS15/2: Wholesale sector competition review 2014-15 February 2015 https://www.fca.org.uk/your-fca/documents/feedback-statements/fs15-02

Closing remarks

This report has summarised the work that the FCA has carried out to promote competition in the markets we regulate since its inception three years ago.

Crucially, our objective is to promote effective competition in **consumers' interests**. This can take many different forms. When it works well, consumers are empowered as well as informed – they can make sense of the information they are given and can take their business elsewhere if they are not happy. In turn, firms strive to win custom on the basis of service, quality, price and innovation. This helps generate better outcomes for consumers, and for the economy. Markets are open to entry and innovation, and successful, innovative firms thrive and unsuccessful firms change or exit.

But there are many ways in which it can go wrong. For example, firms may exploit the difficulties that consumers have making the right choices about – often complex – services. To understand the extent and nature of competition concerns we have so far completed or started eight market studies as well as undertaking a number of other studies, covering the range of sectors that we regulate.

The nature and extent of the concerns we have identified in the studies we have so far undertaken are different in each of the markets we have investigated. This emphasises the need to undertake bespoke analysis of the issues, and to design the remedies we implement carefully to ensure they are as effective as possible, while also being focused on the identified concerns and proportionate.

But there is more to our work promoting competition than is reflected in the market studies. For example, we have not only sought to make sure that our regulatory procedures do not create barriers to entry into retail banking, but we have also sought to open the markets we regulate to innovation.

While we have made significant progress in a number of markets, there are no quick fixes. Concerns about weak competition in financial services have existed for a significant period of time, and it will take time to address the various features of the different markets we regulate. We set out our focus for the coming year in our 2016/17 Business Plan.[148]

148. FCA Business Plan 2016/17 https://www.fca.org.uk/static/documents/corporate/business-plan-2016-17.pdf

Abbreviations used in this report

API	application programming interfaces
AUA	assets under administration
AUM	assets under management
BCAs	business current accounts
CA98	Competition Act 1998
CfI	call for input
CP	consultation paper
CMA	Competition and Markets Authority
D2C	direct to consumers
DC	defined contribution
EA02	Enterprise Act 2002
ECM	equity capital markets
EEA	European economic area
ESMA	European Securities and Markets authority
FAMR	Financial Advice and Markets Review
FCA	Financial Conduct Authority
FEMR	Fair and Effective Markets Review
FS	feedback statement
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
HCSTC	high cost short term credit
HHI	Herfindahl-Hirschman Index
IBER	Insurance Block Exemption Regulation
IPOs	initial public offerings
M&A	mergers and acquisitions
MAS	Monetary Authority of Singapore
MCD	Mortgage Credit Directive
MoU	memorandum of understanding
MS	market study
NBSU	New Bank Start-up Unit
OFT	Office of Fair Trading
PCAs	personal current accounts
PPI	payment protection insurance
PRA	Prudential Regulatory Authority
PS	policy statement
PSR	Payment Systems Regulator
RDR	Retail Distribution Review
RLR	Retail Lending Review
RIMS	Retirement Income Market Study
ToR	terms of reference
TPR	The Pensions Regulator
UKCN	UK Competition Network
UKRN	UK Regulatory Network

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Competition Report 2013-2016

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