Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Consultation by the High-level Expert Group on reforming the structure of the EU banking sector

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Transparency register identification number 65422627962-44

This is the response of the Financial Services Consumer Panel to the Expert Group's consultation on the banking sector.

1. **What impact do the current and ongoing financial regulatory reforms have on the availability and cost of financing and other retail customer services of banks (including access to basic payment systems)?**

1.1 Access to basic banking services

The Consumer Panel, in its response[1] to the 2010 consultation on basic payment accounts supported DG MARKT's proposals for the development of a harmonised framework with a minimum set of functions and services as a template for affordable basic payment accounts in all Member States, with matters of detail being dealt with at national level. The Panel believes that consumers should have a right to basic banking services. However, experience in the UK indicates that the imposition of a universal service obligation (USO) on individual banks must be supported by initiatives to stimulate demand for such accounts if it is to succeed.

In December 2004 the UK Government agreed a shared goal with the banking industry of halving the number of adults in the UK who were living in households without a bank account. The Financial Inclusion Taskforce was set up in February 2005 to monitor progress towards the shared goal. The baseline for the goal was the 2002-03 Family Resources Survey (FRS) which reported 2.8 million adults living in 1.8 million households without access to a bank account (defined as a current account, basic bank account or saving account).

The FRS data for 2007/08 showed that 0.89m people, in 0.69m households, did not have access to a bank account of any kind. This indicated that the shared goal had been met and meant that the proportion of unbanked households in the UK was among the lowest in Europe[2].

[1] http://www.fs-cp.org.uk/publications/pdf/dgmarkt_nov10.pdf
[2] http://www.fininc.eu/gallery/documents/other-documents/update-ofeurobarometer-tables.pdf

The Taskforce found that account opening was driven primarily by third party requirements – most prominently employers or landlords requiring an account for payment of wages or rent – rather than consumer demand.

The Taskforce argued that a voluntary approach to securing access to banking is preferable to a compulsory universal service obligation (USO) for a number of reasons:

- it is more likely to achieve active compliance by the banks and encourage innovation and a degree of competition in basic banking provision
- in countries with a USO in banking, levels of banking exclusion are much higher than in the UK
- a great deal of empirical evidence indicated that only a very small proportion of people without bank accounts were unbanked because they had been refused access to banking. By far the greatest barrier was a lack of demand for bank accounts, due to a strong preference for cash budgeting, followed by a mistrust of banks.
- the Taskforce also preferred to keep the threat of further regulation as a last resort, to encourage the banks to act responsibly.

This voluntary approach is in line with the approach of the Commission when it issued its Recommendation[3] in July 2011 setting out general principles applicable to the provision of basic payment accounts within the EU. However, the Panel is not aware of any evidence that the Recommendation has led to improved access to basic payment accounts, and therefore recommends a stronger obligation on the banks to provide such accounts, as appropriate, to those who wish to open them. However, this needs to acknowledge that there are those who do not wish to use banking services, who would not benefit from them, and who should not be forced to do so, and that alternatives to mainstream banking options should be investigated.

1.2 Stimulating demand and supporting access

In the UK, the success of increasing access to basic accounts has been partly due to a number of initiatives which have stimulated demand for such accounts. These include:

- The *Now Let's Talk Money* campaign in 2006/7, in which seconded experts provided training in how to identify and support financially excluded people, including use of extensive local advertising and a free national helpline.
- In 2008 this was replaced by the Financial Inclusion Champions, based in areas of high financial exclusion to coordinate local agencies' work in this area. The Financial Inclusion Champions initiative received funding of over £7m over three years.

It is unlikely that the level of banking inclusion seen in the UK would have been achieved without these programmes, both of which have now closed. The Panel believes that stimulation of demand for appropriate financial products is a constructive means of reducing financial exclusion.

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[3] Commission Recommendation on access to a basic payment account C(2011) 4977/4

1.3 The Credit Union Current Account

In 2006 the Association of Credit Unions Ltd (ABCUL) introduced a current account specifically to meet the needs of low-income members. One of its objectives was to help customers who may have been put off opening a bank account because of fears about cost, or of dealing with an organisation with which they did not feel comfortable. The account provides access to payment services, ATM's and debit cards, in exchange for a monthly or weekly fee. Research[4] into the use of the account indicated that it has contributed to an increase in financial inclusion amongst its target audience.

2. What are the views of retail customers with respect to structural reform of banking in general and in particular with respect to the structural reform proposals to date (e.g. US Volcker Rule, UK ICB proposal)? What structural reforms would be desirable from their point of view?

From a consumer perspective, the Panel welcomes the UK Government's commitment to take forward the ICB's recommendations which it believes will lead to improvements in the UK banking sector. However, it believes regulatory action is also needed to deliver the ICB's vision fully. It is keen for the regulatory structure to help deliver greater banking competition, more choice and fairer, transparent true cost banking for consumers.

The ICB's report identifies a number of specific problems in the retail banking sector The Panel is concerned that these failures are preventing the market working effectively for consumers in the UK. They include:

- the high market concentration with the largest four banks dominating the retail banking market. The financial crisis led to further market concentration following the acquisition of HBOS by Lloyds TSB and Nationwide and Santander absorbing smaller rivals;
- a lack of new market participants which has been exacerbated by ineffective market competition and difficult funding conditions;
- the biggest banks have become so fundamental to the UK economy and society more generally that they are considered too big to fail;
- low levels of market competition, with weaknesses in both supply and demand, which reduces firms' incentive to innovate and increase their efficiency;
- banks have become reliant on a small number of income streams to subsidise their wider service proposition. This includes high overdraft charges and the inappropriate cross-selling of high margin products; and
- a lack of transparency around the true cost of banking services which creates weaknesses in consumer demand by restricting people's ability to shop round and assess whether they are receiving value for money.

Many of these failures are interlinked and require changes to the UK's retail banking model to ensure the market is working effectively for consumers. For this reason, the Panel supports the ICB's key recommendations.

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[4] *The Credit Union Current Account A research study into low-income consumer expectations of the operation and charging structure of the Credit Union Current Account*. Liverpool John Moores University, April 2008.

3. What are the main concerns of retail customers in their relationship with their bank?

3.1 Personal Current Accounts (PCAs)

The Panel has identified a number of issues in the UK PCA market. It believes problems in the retail banking sector have particularly manifested in the free-if-in-credit PCA market. Once a revolutionary concept, the domination of this model has led to market stagnation and ineffective competition. This does not benefit consumers or the banks that offer these services

Such stagnation, along with wider problems in the retail banking sector, has created a number of failures which prevent the PCA market working effectively for consumers. These include:

- The misconception among consumers that there are no costs associated with using a PCA - providing they remain in credit.
- The true cost of PCAs falls disproportionately on financially vulnerable consumers who are subsidising the free-if-in-credit model.
- The structure and level of overdraft charges prevents consumers who find themselves in difficulty from regaining control of their finances.
- The current free-if-in-credit model threatens the wider financial inclusion objectives - nearly two-thirds of consumers without a bank account were previously account holders, but fell out of the system due to the penalty charges levied[5].
- A rise in the number of packaged bank accounts which may not be offering value for money.
- Barriers to entry for new firms and operating models.
- Lack of switching within the PCA market as consumers perceive switching PCA providers to be time consuming, risky and not worth the effort, given how little differentiation there is in the market.

3.2 Disclosure of charges

The Panel recognises that steps are being taken by the industry to help improve the retail banking market for consumers. This includes providing customers with an annual statement detailing how much they paid for their PCA over the previous 12 months. While the Panel welcomes this initiative, it does not believe increasing transparency alone will tackle the failures identified. Evidence from other financial markets, such as the retail investment sector, has demonstrated that disclosure largely fails to create informed consumers.

3.3 Switching

The UK industry has also pledged to introduce a new free guaranteed seven-day switching service by September 2013. Again, the Panel welcomes this initiative. It hopes this will tackle both the perception among consumers that switching providers is cumbersome, complicated and risky and the reality that where consumers do

[5] Anna Ellison, Claire Whyley and Rob Forster on behalf of HM Treasury and the Financial Inclusion Taskforce, *Realising banking inclusion: The achievements and challenges,* August 2010

switch providers, many experience problems. This is demonstrated by research undertaken by Consumer Focus in 2010 which found that 44% of consumers who switched PCA providers experienced difficulties, with the transfer of Direct Debits the most common cause of problems[6].

3.4 Experiences of the newly banked

Following the work around the UK Government's goal for increasing banking inclusion (see the answer to question 1 above), 1.1m people were moved into banking, almost 600,000 of whom were in the lowest income quintile, but many have experienced problems with their accounts.

- The majority of both the newly banked and those remaining unbanked are not new to the banking system. More than half of the newly banked and almost two thirds of the remaining unbanked had previously been banked but have fallen out of banking. The primary reason for this level of churn in banking inclusion is exposure to charges for failed direct debits and overdraft fees on accounts.
- Around half of the newly banked had been exposed to fees and charges, six in ten of them having paid charges within the last twelve months. Those who incurred charges tended to be charged multiple times, averaging 5.6 times p.a., with one in three of the newly banked incurring more than five charges in the previous year.
- Charges associated with over limit fees and failed credit direct debits amounted to around £35m p.a., borne disproportionately by those on the lowest incomes.
- Although banking had led to savings gains for some, the tendency to cash money management and the impact of penalty charges undermined overall gains.
- Savings on utility payments of some £69m p.a. achieved through the shift to electronic payment were reduced to a net £20m as a result of penalty charges resulting from failures on the associated direct debits. All of these savings accrued to those on higher incomes with those in the lowest income quintile suffering a small net loss.

4. What are retail customers' recent experiences in terms of access to credit and savings and investment? Do they identify differences according to bank type (specialised bank, universal bank, etc.)?

The Panel does not collect its own data but highlights some of the findings of the Financial Inclusion Taskforce[7] referred to above. These include:

- Amongst the 1.1m people moved into banking services by 2007/8, banking inclusion did result in some take up of new financial services but at a lower level than other people who already have access to banking services. A little over one in ten (11%) had opened a savings account and 14% an overdraft facility. Just over one in ten (12%) of the newly banked on higher incomes had

[6] Oliver Morgans on behalf of Consumer Focus, *Stick or twist?: An analysis of consumer behaviour in the personal current account market,* 2010 see http://www.consumerfocus.org.uk/files/2010/10/Stick-or-twist-for-web1.pdf
[7] Ellison, Whyley and Forster, HMT 2010

acquired a credit card and 5% had taken on a mortgage, with few of those in the lowest income quintile doing so.

- There was little movement away from high cost credit as a result of the move into banking. Just 4% of the newly banked had taken on a loan repaid from their bank account, while penetration and usage of home credit loans among the newly banked remained at a similar level to those outside banking.
- There was also a significant increase in debt among the newly banked, resulting in an overall increase in spend on debt servicing despite gains from access to cheaper credit. Overall increased spend on debt servicing was around £87m p.a. set against an increase of sums owed to lenders of £1,100m, of which almost £700m was accounted for by those on higher incomes, being largely revolving credit debt.
- Around 12% of accounts had been closed with net failures rising to close to one in five (19%) if lapsed accounts no longer used because compromised by penalty charges were included. Net account failures were estimated to be around 0.21m accounts. Account failures are concentrated in the previously banked (85%), credit users (80%) and those on the lowest incomes (65%). The major driver of account failure is penalty charges on failed direct debits and over-limit fees.

These experiences highlight that the needs and habits of customers who move into the banking system are identifiably different from those who already have access to banking products, and therefore this should be taken into account if designing a regulatory regime to reduce the numbers of the unbanked. Additionally, research into the experience of consumer expectations of the Credit Union Current Account[8] confirmed that transaction services offered to people on low incomes, or who experience financial exclusion, are not likely to succeed unless they are designed specifically to respond to their needs, wants and circumstances.

[8] *Op. cit.*