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Our ref: Banking

Dear Sirs

Review of Barriers to Entry, Expansion and Exit in Retail Banking

This is the Financial Services Consumer Panel's response to the OFT call for evidence to the review of barriers to entry, expansion and exit in retail banking.

The Panel is pleased that the OFT is undertaking this review and we note that it is intended to be short and focused with a tightly defined scope. We do not believe, however, that such a limited review can fulfil all the objectives set out in the paper and have suggested a number of areas for research which the OFT could also find helpful. In addition we are mindful of the need to take particular account of regional issues and would like the OFT to focus on the retail banking sector in Scotland, which is currently dominated by only two banks, as well as the market in Northern Ireland.

We are surprised to see that the OFT is covering some of the same ground that it covered two years ago, including for example account switching. On this particular issue there have been further reports published since 2008 (including the BACS Family Finance Tracker and data released by The Co-Operative Bank) and it is unclear to the Panel why this area is being covered again at this stage.

We have provided further detailed information below. The Panel is not in a position to address all of the specific questions within the paper, however.

Q1: Do you agree with the proposed scope laid out in paragraphs 2.2 to 2.10 for the purposes of reviewing barriers to entry, expansion and exit in banking within the UK?

Q2: Do these themes capture the most important elements of barriers to entry, expansion and exit?

Our response to these two questions is that we do not think that the proposed scope is broad enough and that there are important barriers to entry that are not covered. We refer the OFT to the Which? Future of Banking Commission Report¹ which sets

¹ The Report was published on 16 June 2010 and is available at commission.bnbb.org

out a number of recommendations and reasoned commentary, backed by evidence, on the future of the banking sector. The Report contains a great deal of useful information on a range of issues, including competition. It refers for example to the implicit Government subsidy of banks that are “too big to fail” distorting competition by weakening the ability of small or new entrants to become challengers and we view this as an important consideration.

Pricing of banking services, including so-called “free banking”, is a major consideration for potential new entrants to the market. Discriminatory pricing policies by banks that cross-subsidise new customers at the expense of existing customers act as a potential barrier to entry. There is also a perception that the erroneously named “free banking” model for personal current accounts has become a fundamental customer and market expectation. In the Panel’s view this has the potential to restrict the development of different models and that it could therefore act as a barrier to new entrants. Expectations of traditionally high returns on bank equity are also an issue for potential new banking businesses. The Future of Banking Commission Report sets out informative data on this point.

Although there is some acknowledgement of the issue of regional monopolies in the paper – the OFT has identified the market in Northern Ireland to be different to that in Great Britain - the OFT does not seem to have commented on the special position of the retail banking market in Scotland. Currently, banking in Scotland is dominated by just two banks – Lloyds TSB and RBS, having over 800 branches between them. Even the proposed sale of parts of RBS could result in only six branches transferring to another bank. We urge the OFT to take a particular and urgent interest in competition issues in Scotland as well as those in Northern Ireland.

Q3: How does the licensing process for deposit-taking activities and the capital and liquidity requirements affect the ability of firms to enter into the provision of banking services or expand their provision of banking services?

The Panel believes that building societies and other mutuals, including smaller businesses, provide valuable services to many consumers. From a regulatory perspective it may be that supervising a large number of smaller institutions such as credit unions, local building societies and co-operatives might present particular challenges, but this should not be a barrier to entry for these businesses if they can provide services and products that meet consumer needs. We understand the need for businesses to be sufficiently well capitalised, but post-crisis we would not wish to see unnecessarily high capital requirements imposed that would impact on the viability of small mutuals.

Q18: How has the financial crisis affected trust in banks in general and incumbent banks in particular? How does this affect the ability of new entrants to join the market or smaller providers to expand in retail banking?

We refer again to the Which? Future of Banking Commission Report, which comments on the loss of confidence in banks, particularly by SMEs. We recommend that the OFT also look at the growth in credit unions and co-operatives since the

financial crisis as a potential indicator of low levels of trust in more 'mainstream' banks and consumers' appetite for simple, ethical banking services.

Yours faithfully

Adam Phillips
Chair
Financial Services Consumer Panel