



HM Treasury

Banking for the 21st Century:

driving competition and choice

March 2015



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ISBN 978-1-910337-83-7

PU1769

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Executive summary and announcements

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1.1 Competition is at the heart of efficient, open and resilient economies. When markets are highly competitive, firms compete with each other to offer products and services that are better value, higher quality or more innovative than their competitors'. Highly competitive markets are marked by low barriers to entry and exit (so firms spotting opportunities can come into the market, and failed firms can leave it), level playing fields (so firms in the market can compete on equal terms) and high levels of customer engagement (so customers can find the best products and vote with their feet). Competitive markets help establish the right incentives for firms and deliver the best outcomes for consumers.

1.2 By increasing the level of competition in banking, the government aims to deliver tangible benefits for personal and business banking customers right across the country, such as:

- **lower prices**, e.g. lower monthly mortgage repayments
- **better access to products**, e.g. SMEs being able to get access to the finance they need to invest
- **more choice**, e.g. a wider range of current account products to suit different customer needs
- **new innovations**, e.g. new ways to make payments using a mobile phone
- **better service**, e.g. a better in-branch experience and quicker account opening.

By using competition to deliver these outcomes, instead of telling banks and other firms how to behave, customers can directly show the banks what they want, by voting with their feet. The more effectively customers are able to do this, the harder providers will have to work to win and keep their custom.

1.3 Given the importance of the banking sector to every person, family and business in the country, it is extremely important that our banking markets are as competitive as possible. When the current government took office in 2010, however, banking competition in the UK was at a historic low.

- during the financial crisis, a number of sizeable **challenger institutions had disappeared from the market**, both through failure (e.g. Northern Rock, Bradford & Bingley) and through merger (e.g. Lloyds-HBOS)
- conversely, the taxpayer-funded bailout of RBS and Lloyds had underlined the extent to which **too-big-to-fail banks were benefitting from an implicit government guarantee**, potentially putting them at a competitive advantage against smaller institutions
- **supply had contracted** significantly in key markets, most notably **mortgages and SME lending**, resulting in less intense competition for customers
- **customer switching rates in banking remained low**, both in absolute terms and relative to other industries

1.4 In order to address this unacceptable situation, this government has taken significant steps to increase competition in our banking sector, including:

- tackling too-big-to-fail by **legislating for ringfencing, introducing bail-in and overhauling the framework for prudential and conduct regulation** to remove the implicit government guarantee that gave too-big-to-fail banks an unfair competitive advantage. This has **lowered barriers to entry and levelled the playing field, by ensuring that the largest banks are not able to unfairly raise cheaper funding than their smaller competitors by relying on the implicit guarantee. It has also lowered barriers to exit, by ensuring that the largest banks are subject to normal competitive pressures and will never again be bailed out by the taxpayer**
- introducing a new challenger bank onto the High St through **carving out TSB from Lloyds**, with another to follow through the **RBS divestment of Williams & Glynn**. This has **increased competitive intensity by introducing more challengers onto the High St, and giving consumers a wider choice**
- **giving the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) a strong competition focus**, resulting in them creating a new mobilisation option so banks in development can be given a restricted authorisation (allowing them to raise capital, make investments etc. with greater certainty they will be given full authorisation), and lower initial capital and liquidity requirements for new banks. This has **lowered barriers to entry by making the authorisation process, and the early days of operation smoother and cheaper for aspiring new banks**
- **creating a new Payment Systems Regulator (PSR)**, as recommended to the previous government in 2000, to ensure challenger banks and non-bank players can gain access to the payment systems on fair terms, and that the payment systems embrace innovation in the interests of consumers and businesses. This will **lower barriers to entry and level the playing field by ensuring that small banks and non-bank challengers, including financial technology firms (FinTechs), can access the central payment systems on fair and transparent terms**
- reaching agreement with the banks to **allow bank customers to access their current account transaction data (“midata”)** in a format they can use to work out which account is best for them. This will **increase customer engagement by helping decide what is the best account for them, so banks will have to make better offers to their customers**
- **introducing a new 7-day Current Account Switch Service (CASS)** to help customers vote with their feet, and welcoming the FCA’s report on potential improvements to CASS for the banks to take forward, and options for making switching accounts even easier via account number portability, which the government expects the new PSR to consider as part of its work. This has **increased customer engagement by making it easier for customers to switch, meaning that banks have to work harder to win and keep customers**
- legislating to require the big banks to **refer on SMEs they turn down for finance, and share SMEs credit data** with designated platforms, from which peer-to-peer lenders, crowdfunders, challenger banks and other alternative finance providers can gain access to firms seeking finance, and the information they need to lend to them effectively. This will **lower barriers to entry and level the playing field by giving smaller players access to vital SME contacts and information, currently held by the big incumbent banks**

- taking action to **level the playing field for peer-to-peer lenders** and other alternative finance providers, to allow SMEs to look beyond the big banks for the lending they need to grow. **This has lowered barriers to entry and levelled the playing field for non-bank lenders**
- **supporting community development finance institutions (CDFIs)** in providing finance to viable smaller businesses that are unable to access finance from mainstream providers. This government has created a £60m fund for CDFIs to lend to businesses from deprived areas and disadvantaged groups, and the British Business Bank is commissioning new research into the sustainability of the CDFI sector. **This will help CDFIs to provide small businesses with a competitive alternative to bank lending**

Taken together, this government's record represents the most significant, sustained programme to deliver lower barriers to entry and exit, level the playing field, and increase consumer engagement in banking for many years and, at the very least, since the mid-1980s.

1.5 This focused action is feeding through into strong positive signs of increased competition in banking, for example;

- since May 2010, **eight completely new UK banks** (One Savings Bank, Cambridge and Counties, GE Capital Bank, Virgin Money, Paragon, Hampden & Co, Charter Savings Bank, and OakNorth) have been authorised by regulators. The first seven are now up and running, with OakNorth looking to follow suit in the near future. This compares to just one new authorisation of a UK bank in the preceding five year period. Additionally, under this government **four more new UK banks have entered the market via a change in control** (Shawbrook, Hampshire Trust, Tungsten and Bank & Clients). We have seen **other new names build their position on the High St**, such as Metro and TSB. And the **pipeline for more potential new UK banks** is also strong: around 10 are currently going through the regulators' pre-application stage
- **the Payment Systems Regulator is about to open for business on 1 April 2015**, and intends to take control of the strategy development and setting process for payment systems, launch market reviews into the ownership and competitiveness of payment system infrastructure and indirect access to payment systems, and ensure that access to payment systems is open, transparent and fair. New firms such as Transferwise, Azimo and Coinjar are offering more choice in this space
- **current account switching figures were up 22%** in the first full year of the 7-day Current Account Switch Service's operation. New players, such as Tesco and Virgin Money have entered the current account market and existing players are offering more varied products
- **on business lending, new banks are expanding** with total business lending increasing from new players such as Aldermore (£1.69bn), Shawbrook (£1.4bn) and Metro (£0.7bn). We have also seen **strong growth in peer-to-peer (P2P) and crowdfunding** with average annual growth rates from 2012-2014 of 250% for P2P business lending, 410% for crowdfunded equity and 117% for crowdfunded debt. 17 new P2P platforms launched in 2014, with a further 8 expecting to launch imminently

1.6 While welcoming these positive signs, the government remains committed to improving the level of competition in banking. Delivering on this, it has today announced a package of measures building on existing work to help impose even greater competitive discipline on the banking market, to help consumers and businesses.

- the government is today announcing its intention to apply anti-money laundering regulation to digital currency exchanges in the UK, to support innovation and prevent criminal use. The government is also launching a new research initiative which will bring together the research councils, Alan Turing Institute and Digital Catapult with industry in order to address the research opportunities and challenges for digital currency technology, and will increase research funding in this area by £10 million to support this. Finally, the government will work with the British Standards Institution and the digital currency industry to develop voluntary standards for consumer protection. **This will increase competitive intensity by supporting the growth of technology that can be adopted by banks and non-bank providers, allowing them to compete to offer new products and existing products delivered in cheaper or more efficient ways**
- the government's **midata** initiative will launch on 26 March, along with a Gocompare current account comparison tool, enabling customers to get detailed comparisons of which personal current account is best for them based on how they use their bank account. **This will increase consumer engagement by making it easier for customers to see where they could get a better deal, meaning banks will have to work harder to win and retain customers**
- the government is today announcing its intention to deliver an **open Application Programming Interface (API) standard** in UK banking. HM Treasury will work closely with banks and financial technology firms to take the design work forward and will set out a detailed framework for an open API standard by the end of 2015. **This will further increase consumer engagement by making it even easier for customers to see where they could get a better deal, meaning banks will have to work harder to win and retain customers. It will also increase competitive intensity by supporting the growth of technology that can be adopted by banks and non-bank providers to compete to offer new products**
- the Council of Mortgage Lenders and Which? have today published their interim report on mortgage lenders' plans to standardise, and improve the transparency of, **mortgage fees and charges**. The CML and Which? will publish firm conclusions in July and the government expects the majority of the industry to have made the necessary changes by the end of the year. **This will further increase consumer engagement by making it even easier for customers to see where they could get a better deal, meaning banks will have to work harder to win and retain customers**
- the British Business Bank will shortly be inviting expressions of interest from Credit Reference Agencies and finance platforms that wish to be designated by HM Treasury to receive **SME data from banks** under powers contained in the Small Business, Enterprise and Employment Bill currently before parliament. **This will lower barriers to entry and level the playing field by allowing small banks and non-bank providers access to potential SME borrowers and the information held on them by the big banks, so they can compete more effectively**
- the government welcomes a Bank of England study which will quantify the economic benefit of improving **access to credit data for trade creditors**. The results of the study are expected in the autumn and if, as expected, this demonstrates significant potential benefits, the government expects that industry will quickly make the necessary changes to allow these benefits to flow to businesses. **Improved access will level the playing field by allowing trade creditors access to the information they need to compete more effectively. This will lower barriers to entry**

and level the playing field by allowing trade creditors access to the information they need to compete more effectively

- the government wants all customers to be able to deposit as well as withdraw cash from **intelligent cash machines**, and is working with LINK and its Members to explore how required changes can be made to LINK Scheme Rules. **This will lower barriers to entry and level the playing field, by allowing banks with smaller (or no) branch networks to provide a more comprehensive service for their customers**
- the government can confirm that the new **Payment Systems Regulator** will become fully operational from 1 April 2015. **This will lower barriers to entry and level the playing field by ensuring that small banks and non-bank challengers, including financial technology firms (FinTechs), can access the central payment systems on fair and transparent terms**

1.7 As a result of these changes, it is now significantly easier for new players to enter the banking market and compete with the big, incumbent banks. Thanks to the measures this government has taken:

- **new entrant banks** will now be able to get authorised quicker and easier, raise capital more competitively, gain access to the payment systems on fairer and more transparent terms, have personal current account customers switch to them more easily and access potential SME borrowers and the information held on them by the big banks to lend to them more effectively
- **peer-to-peer and crowdfunding platforms** will be able to compete with traditional lenders on fairer terms, raise funding more efficiently, and, alongside other alternative finance providers, access potential SME borrowers and the information held on them by the big banks to lend to them more effectively
- **FinTech payment firms** will be able to gain access to the payment systems on fairer and more transparent terms

1.8 The strong action that the government has taken, and continues to take, is delivering good results. However, given the importance of competition in banking, and the extent to which this had been allowed to decline in the years before this government came into office, the government welcomes the in-depth investigation of the personal current account and SME banking markets by the Competition and Markets Authority (CMA). This independent inquiry is expected to reach its final outcome in spring 2016, and **the government stands ready to take further action as appropriate, once the CMA has reached its overall findings.**

1.9 The remainder of this document sets out in more detail the history of banking competition in the UK, the nature of the banking market this government inherited in 2010, the actions the government has taken since then – and continues to take - to drive banking competition, and the positive outcomes that the UK is beginning to see. The government is determined to continue along this path, and will not rest until competition is functioning as effectively as possible in UK markets, delivering the best outcomes for families and businesses across the country.

Banking competition in the UK

2

2.1 In 1960, UK retail banking was dominated by the 16 London and Scottish clearing banks and a building society sector made up of more than 700 societies. The 50 years to 2010 saw significant consolidation, to the point that of the 16 clearing banks from 1960, 15 were owned by just four UK banking groups: RBS, Barclays, HSBC and Lloyds, which, together with Nationwide and Santander, had come to account for 80% of the stock of UK customer lending and deposits. Over this period, the consolidation in the building society sector was even more marked, with just over 50 still in operation by 2010.

2.2 Despite this overall story of consolidation, however, a number of factors in the second half of the twentieth century contributed to - and exhibited - increasing competitive intensity in UK banking.

2.3 A series of innovations provided new ways for banks to compete by offering improved services to their customers. For instance, Barclays Bank issued the first UK credit card in 1966, and installed the first UK ATM the following year at Enfield, North London.

2.4 In 1971, the Bank of England introduced Competition and Credit Control, which aimed to promote competition within the banking sector and between banks and other financial sector institutions. These reforms aimed at ending collusion on interest rates and broadening the scope of bank activities. Among other things, the measures allowed deposit banks to participate freely in the wholesale market and allowed banks to maintain lower liquidity holdings.

2.5 The Banking Act of 1979, which first established a regime of banking supervision in the UK, created a two-tier system of banks and licensed deposit-takers. While the new supervisory regime created some new barriers to entry in banking, the net effect of these reforms was to increase competition for UK banks, both from foreign banks and non-bank institutions.

2.6 The “Big Bang” of 1986 radically liberalised practices at the London Stock Exchange and sought to put the London financial markets on an equal competitive footing with international competitors, particularly the United States. This reduction in regulatory restrictions allowed banks to diversify into new activities, increasing competition in multiple markets.

2.7 Around the same time, the effective monopoly of the building societies over mortgage lending was brought to an end, significantly increasing competition in that market. Shortly afterwards, the building society sector began to experience a sharp contraction, due to a series of demutualisations, as some building societies sought to exploit the greater freedom of action that came from bank status. Ultimately, by 2010, none of these demutualised former building societies survived as independent entities, having either failed or become part of larger banking groups.

2.8 By the end of the 20th Century, the government of the day was sufficiently concerned about the competitiveness of UK banking markets to commission a study into the issue, headed by Sir Donald Cruickshank. The Cruickshank review issued its Final Report in 2000, which identified major problems with banking competition and suggested various remedies including:

- the establishment of an independent economic regulator of payment systems
- a pro-competition regulatory framework

- better information and access to banking services for personal customers
- a full competition investigation into SME banking

While the then-government accepted Cruickshank's findings, most of his recommendations were not ultimately acted upon.

2.9 During the financial crisis of 2007-10, the competitiveness of the UK banking market suffered a sharp decline. The failures of Northern Rock, Bradford & Bingley and the Dunfermline Building Society, reduced the number and scale of retail banking competitors. The government of the day allowed the merger of Lloyds and HBOS, despite the Office of Fair Trading's clear concerns that this could have significant negative effects on competition. The taxpayer-funded bailout of RBS and Lloyds, which followed shortly afterwards, laid bare the extent of the implicit government guarantee that had been in operation for too-big-to-fail banks, and the attendant distortive effects this had been exerting on banking competition. As many of the institutions that remained standing looked to re-build their balance sheets, they drew back heavily on discretionary lending, particularly to homebuyers and SMEs. One factor to weigh against this, although a small one, was the granting of a banking licence to Metro in early 2010, allowing it to enter the market as a new retail bank.

2.10 In May 2010, the government therefore inherited a UK banking system with unprecedented levels of concentration, which afforded unfair competitive advantages to the dominant players, and where many of the surviving institutions were so weak they could not compete with any level of vigour in key product segments, to the detriment of the real economy. It was therefore clear that improving the situation for banking competition would need to be a key part of the government's long-term economic plan.

3 Tackling too big to fail

3.1 Given the experience of the Financial Crisis, the government was clear that tackling too-big-to-fail was its most important priority in financial services. While this was obviously required both to reduce the unacceptable level of risk to the stability of the financial system and the wider economy, as well as to protect taxpayers from the risk of having to bail out banks in the future, it was also of profound importance in creating a level playing field in the provision of banking services.

3.2 In order to address these issues, the government commissioned Sir John Vickers to chair the Independent Commission on Banking (ICB). In its Final Report, the ICB argued that the removal of implicit government support is important for competition: “If one bank is seen as more likely to receive government support than another this will give it an unwarranted competitive advantage”. The Report points to the fact that, globally, support was more likely to be provided to larger banks than smaller ones in distress during the crisis, and the fact that larger banks are assumed by the ratings agencies to have a higher level of government support in their ratings than smaller ones as evidence for the reality of the implicit subsidy. In the UK of course, the fact that the smaller Northern Rock, Bradford & Bingley and Dunfermline were allowed to fail, while the much larger RBS and Lloyds were not, also speaks to this phenomenon.

3.3 Ultimately, the ICB recommended a package of measures, consisting of ring-fencing vital banking services, increasing banks’ loss-absorbency, introducing bail-in and taking more targeted steps to increase competition in the banking sector. The government accepted these recommendations, with a clear statement that all banks should be subject to normal competitive market forces, meaning that they must be able to fail safely without relying on a government guarantee and without putting the provision of critical services at risk. The government legislated to implement this package of reforms via the Financial Services (Banking Reform) Act 2013.

3.4 Alongside this, the government took steps to improve the system of financial services regulation, via the Financial Services Act 2012, replacing the discredited tripartite system with two new, focused regulators: the Prudential Regulation Authority (PRA), focusing on firm-level stability, and the Financial Conduct Authority (FCA), focusing on conduct. Additionally, the role of the Bank of England in addressing system-level stability risks was widened, including by the creation of the Financial Policy Committee. Since their statutory creation in April 2013, these new regulatory bodies have worked towards creating a financial system that is less likely to result in disorderly failure, less likely to draw on taxpayer funds, and less likely to operate against the interests of its own customers with impunity.

3.5 Additionally, following the ruling of the European Commission, the government has taken action to reduce the size of the two large banks that required taxpayer assistance during the Financial Crisis via divestments. The government asked the Office of Fair Trading (OFT) to review the impact the two divestments would have on competition and to consider what more could be done; as a result of their recommendations, the government agreed with Lloyds that the balance sheet of the divested bank would be strengthened, and that key services provided by Lloyds would not restrict the divested bank’s ability to compete effectively. Lloyds have since successfully separated and floated TSB, which is now operating as an independent challenger on the High Street. RBS are proceeding with their plans to float Williams and Glynn, which will launch by the end of 2016.

3.6 While ringfencing will not be fully implemented until 2019, the government has put in place a regime so that taxpayers will never again have to bail out banks. Since 2010, no UK financial institution has had to be bailed out with taxpayer funds, and the government has been able to begin reducing its legacy bank holdings from the Financial Crisis. The credibility of this position was reinforced by the decision by the ratings agency Standard and Poors' decision in February 2015 to remove the uplift they had applied to the largest UK banks to reflect the implicit government subsidy. The government is determined to see its programme of reform through to the end; among other important aims, this is vital to securing a properly competitive banking sector.

4 Creating a pro-competition regulatory framework

4.1 As the Cruickshank Review highlighted in 2000, a pro-competition regulatory framework is vital to a competitive banking sector. The government has taken a number of steps to deliver this.

4.2 Each component of the new regulatory architecture the government has put in place has competition concerns at its heart:

- the FCA has an operational objective to promote effective competition in the interests of consumers in the markets it regulates. It also has a competition duty to promote effective competition when addressing its consumer protection or integrity objectives
- the PRA has a secondary competition objective so that, when discharging its general functions in a way that advances its primary objectives, it must, as far as reasonably possible, act to facilitate effective competition in the markets it regulates
- the Payment Systems Regulator (“PSR”) has a competition objective to promote effective competition in the markets for payment systems and associated services in the interests of actual or likely end-users. (For more on the PSR, see Section 6, below)

As a result, each of these three bodies will need to consider carefully the impact of any of their decisions on competition in the relevant markets.

4.3 The government has also acted to ensure that the competition law regime is appropriately set up to create more competitive markets across the economy, including in banking. The government created a new competition authority, the Competition and Markets Authority (CMA), as the successor to the Office of Fair Trading and the Competition Commission. From its launch on 1 April 2014, the CMA was given a range of new powers and responsibilities to ensure it meets its mission of making markets work well for consumers, businesses and the economy. These include tighter timetables for investigations and a reformed legal framework for prosecuting individuals involved in criminal cartel activity. Immediately before its launch, the government announced that the CMA would have additional funding to deliver its remit.

4.4 The CMA has acted quickly to consider potential competition problems in UK banking, by launching an in-depth competition investigation into the personal current account and SME banking markets. The CMA expects to come forward with its interim findings in autumn 2015, followed by its final decision in spring 2016. Should the CMA find significant competition problems, it has strong powers to remedy these, from behavioural remedies ordering the banks to do or stop doing something, to making recommendations to government, right through to structural remedies breaking up banks.

4.5 In addition to this, the government has given both the FCA and the PSR concurrent competition enforcement powers. This means that, from 1 April 2015, both bodies will be able to act within the sectors they regulate to enforce the Competition Act 1998 prohibitions against anti-competitive agreements and abuse of a dominant position, and will be able to make Market Investigation References, requiring the CMA to carry out an in-depth review of a particular market. This will support competition in these sectors, because these regulators are closer to the

sector, so are more likely to pick up features of the market that may be restricting competition. The sectoral regulators are also well placed to decide how it will be most effective to tackle problems from within their own suite of regulatory and competition powers.

4.6 As a result of these measures the UK banking sector now has a new regulatory system up and running, with competition as one of its central concerns. A far-reaching CMA investigation into banking is in progress and the FCA has launched several competition investigations (for example, those into cash savings and credit cards).

5 Reducing barriers to entry and expansion

5.1 Low barriers to entry and expansion are key features of contestable markets, and are therefore an important determinant of competitive intensity. Regulation, while necessary, can act to create unnecessary barriers to entry. To address this risk, the government asked the PRA and FCA, in line with their competition objectives, to conduct a Review of Requirements for Firms Entering into or Expanding in the Banking Sector.

5.2 The Review, published in March 2013, focused on reducing barriers for new banks in two broad areas:

- for authorisation, the regulators introduced a new 'mobilisation' option, where authorisation is granted when a firm has met key essential elements but with a restriction on their activities due to some areas still requiring completion. This helps potential new banks who may previously have faced challenges in raising capital or investing in expensive new IT systems, without first having certainty that they would be authorised
- for capital and liquidity, requirements for new banks are now lower than before, and scale up less steeply as the bank is becoming established. These reforms are set against a requirement for a firm to demonstrate to the regulators that it has a clear recovery and resolution plan in place in the event of it getting into difficulty in the future. These changes represent a quantifiable reduction in the barriers to entry for new banks and mean that the minimum amount of initial capital required by a new entrant bank has been reduced from £5m to £1m

5.3 These efforts are bearing fruit. In the five years to May 2010, there was only one UK bank authorisation (Metro Bank). Since 2010 there have been eight brand new UK bank authorisations:

- One Savings Bank in 2011
- Cambridge & Counties, GE Capital Bank and Virgin Money in 2012
- Paragon and Hampden & Co. in 2014
- Charter Savings Bank and OakNorth in 2015

In addition, under this government four new UK banks have entered the market via a change in control:

- Shawbrook in 2011
- Hampshire Trust, Tungsten and Bank & Clients in 2014

Reflecting reduced barriers to entry in the sector, the pipeline of potential new banks is also strong: around 10 are currently going through the regulators' pre-application process.

Promoting competition and innovation in payments

6

6.1 As set out by the Cruickshank Review in 2000, access to payment systems has the potential to act as a very significant barrier to entry in banking. In order to provide basic banking services, banks need access to the payment systems that form the plumbing of the banking sector. These systems are, however, owned by a group of the big incumbent banks. As a result, there are two major risks of competition failure. First, challenger banks and non-bank payment providers may not be able to gain access to the payment systems on fair terms. Second, there may be lower incentives to innovate in payments, as improvements in the central systems benefit all banks' customers equally, so confer no competitive advantage on any one banks (although, of course, banks can seize competitive advantages by adopting the opportunities created by new innovations at the centre in different ways).

6.2 In order to tackle these issues, Cruickshank recommended that the government of the day should create an independent economic regulator of payment systems. Despite officially accepting Cruickshank's conclusions, the then-government ultimately failed to legislate for a new regulator, instead sponsoring an industry-led self-regulatory body, the Payments Council.

6.3 By contrast, this government has taken action; fully 15 years after Cruickshank made his recommendation, a new Payment Systems Regulator ("PSR"), created by this government, will open for business on 1 April 2015. The government set the legislative framework for the new regulator in the Financial Services (Banking Reform) Act 2013, giving it objectives to promote competition, innovation, and the interests of end-users. The regulator will have strong powers over the main inter-bank and international card schemes to promote these objectives.

6.4 As well as creating an entirely new system of regulation, however, the government has taken direct action to promote competition and innovation in payments. In particular, it has:

- legislated for cheque imaging, which will allow firms to offer customers innovative ways of paying in cheques (for instance, via their smartphones)
- launched a major programme of work on digital currencies, issuing a Call for Information in late 2014
- secured a landmark agreement in Brussels to cap anti-competitive credit card interchange fees, potentially saving UK businesses and consumers up to £480m per year

6.5 Building on this work, the government is taking further steps to drive innovation in payments.

6.6 The government is today announcing its intention to apply anti-money laundering regulation to digital currency exchanges in the UK, to support innovation and prevent criminal use. The government is also launching a new research initiative which will bring together the research councils, Alan Turing Institute and Digital Catapult with industry in order to address the research opportunities and challenges for digital currency technology, and will increase research funding in this area by £10 million to support this. Finally, the government will work with the British Standards Institution and the digital currency industry to develop voluntary standards for consumer protection.

Taken together, these measures place the UK at the forefront of the development of digital currencies, and will help make it the location of choice for digital currency and related tech firms, with significant potential benefits to UK consumers and the wider economy.

6.7 The Payment Systems Regulator (PSR) will open for business on 1 April, with powers to promote innovation, competition and the interests of end users in the UK payments sector. The PSR will have a remit over the major inter-bank and international card schemes, and will help ensure that challenger banks and small non-bank players can access the payment systems on fair and transparent terms.

6.8 The government wants all customers to be able to deposit as well as withdraw cash from intelligent cash machines, and is working with LINK and its Members to explore how required changes can be made to LINK Scheme Rules. This will give customers greater options for accessing banking services, providing an alternative to visiting a branch.

6.9 The measures the government has taken, and continues to take, are delivering positive change in the market for payment services.

6.10 The PSR has set out its planned regulatory framework for consultation. In this document, the PSR proposed to:

- take control of the strategy development and setting process to enable the UK to have world class payment systems
- launch market reviews into the ownership and competitiveness of payment system infrastructure, and indirect access to payment systems
- open up governance and control of payment systems by involving additional players in more transparent decision-making (and consider further action should this prove insufficient)
- ensure that access to payment systems is open, transparent and fair

6.11 The PSR will shortly come forward with its final regulatory framework, in advance of the 1 April launch.

6.12 In addition to this, we can already see a number of positive signs in the payments market. In particular, we have seen increased innovation from established players, with mobile apps such as Paym and Barclays' Pingit app. We have also seen increasingly influential new players in the UK market, such as Transferwise and Azimo. Finally, the UK has become a welcoming location for digital currency firms, with international companies such as Coinjar choosing to have their headquarters here. With the new regulatory system coming on line, we can expect to see a continued expansion in payment options for UK consumers and businesses, and a fairer playing field for new/small banks and non-bank players.

7 Supporting competition in personal banking

7.1 The government has also taken steps to increase the ability of customers in the personal banking market to effectively engage with the market, by comparing products effectively, moving between products quickly and safely, and take advantages of innovation to access new services, or established services delivered in new ways. Not only is this of great benefit to individual customers, who become more able to take advantage of the best deals, it is of benefit to competition in the market as a whole, as bank and non-bank competitors strive to offer the best deals to retain customers who are better able to seek out the best products and vote with their feet.

7.2 A key element of the government's strategy in this area has been the 7-day Current Account Switch Service (CASS). The Independent Commission on Banking's Final Report recommended that, in order to tackle low levels of switching in the personal current account market, a faster and more reliable account switching service should be introduced. The government accepted this recommendation, and demanded the banking industry make this happen within two years of the ICB's report.

7.3 CASS was delivered on schedule, launching in September 2013. As a result, for the first time, customers have been able to safely and reliably switch their accounts between banks in 7 days, with a guarantee that they will be fully protected against any financial loss in the event a problem occurs during the switch. At launch, the new service covered 33 current account brands across 17 participating institutions, which together covered almost 100% of the UK's current account market. It also included a 13 month redirection service, so any debits or credits mistakenly made on a customer's old account during that period would be automatically forwarded on.

7.4 Since the launch of CASS, the number of participating institutions has grown to 36, meaning that all but a fraction of 1% of UK current accounts are eligible for CASS. In addition, CASS has been extended to cover 99% of SMEs, and the payments redirection service has been extended from 13 to 36 months. The FCA has also conducted a review of CASS, which found that more can be done to improve customer awareness of and confidence in the service, such as through targeted marketing campaigns or greater prominence of the service in bank branches, as well as to address some operational issues. The government agrees with the FCA's conclusions and expects the banks to deliver the recommendations without delay. If the banking industry fails to deliver the recommendations, the government expects the regulators to use their powers to force appropriate action. The FCA also found that account number portability could make switching accounts even easier; the government expects the new PSR to consider these findings as part of its wider work programme.

7.5 While being able to quickly and easily switch products is a key element of creating a more competitive market, it is also extremely important that customers are able to work out what is the best deal for them. This is a particular challenge in banking, where product features and pricing can be complex, and the best deal for particular customers will depend on individual financial circumstances and choices. In order to address these difficulties, the government has taken a number of steps to improve transparency and comparability of banking products.

7.6 Under the government's midata programme, the leading current account providers have agreed to allow customers to download a year's worth of their current account transactional

data in a single file that can be read by online tools. Customers can then input this data into online comparison tools, to help them work out what current account product would best suit their individual needs.

7.7 Going beyond midata, the government has recently conducted a Call for Information on an even more powerful and flexible way for customers to use their own banking information: Application Programming Interfaces (APIs). APIs are a coding mechanism that allow two pieces of software to “talk to” each other and directly exchange information in a secure manner. While financial services firms already make use of APIs to differing extents, their full potential has not been explored to date. In particular, the lack of a standardised approach to APIs in the UK banking sector means that it has not been possible to develop single software applications (apps) that are compatible with all UK banks; there has therefore been less incentive for developers to develop apps that could potentially be of great benefit to UK consumers.

7.8 Once a common API standard is in place, there is huge potential for the development of useful apps. The most relevant area for banking competition is in product comparability. Using APIs, comparisons could improve on the midata approach, by being more user-friendly, taking into account a wider range of data, and being much more customisable. Going beyond comparisons, the potential range of applications is limited only by app developers’ imaginations, ranging from apps that can work out where you like to eat out and email you special offers, to apps that can turn saving into a game with achievements unlocked as personal milestones are reached, and beyond.

7.9 Looking beyond personal current accounts, the mortgage market in the UK is already keenly competitive. Given the sheer range of mortgage products available, however, consumers can find it hard to make accurate comparisons and work out the best product for them. In order to tackle this, at Autumn Statement 2014, the government asked the Council of Mortgage Lenders (CML) to work with Which? to improve the transparency of mortgage fees and make it easier for borrowers to choose the best mortgage deals.

7.10 Building on these steps already taken, the government is today announcing further measures to increase competition in personal banking.

7.11 The government announced at Autumn Statement that the midata initiative would launch by the end of March 2015. The government is today announcing that Gocompare will launch their personal current account comparison tool on 26 March 2015. As a result, individual consumers will be able to obtain tailored comparisons setting out the best current account options for their individual needs, based on their actual transaction history.

7.12 The government is today announcing its intention to deliver an open API standard in UK banking. HM Treasury will work closely with banks and financial technology firms to take the design work forward and will set out a detailed framework for an open API standard by the end of 2015. This will allow the development of third-party apps that are compatible with the systems of all UK banks, and that can securely use customer banking data (with their permission), to provide even more in-depth comparisons and other value-added services.

7.13 As set out at Autumn Statement 2014, the Council of Mortgage Lenders and Which? have today published their interim report on mortgage lenders’ plans to standardise and improve the transparency of their fees and charges. This will increase comparability, empower consumers and make it easier for borrowers to choose the best mortgage deals. The CML and Which? will publish firm conclusions in July and the government expects the majority of the industry to have made the necessary changes by the end of the year.

7.14 The government’s measures will inevitably take some time to feed through into changes in the market. However, in the case of CASS, which has had some time to bed in, we are

beginning to see real results. Switching figures during CASS's first full year of operation were up 22% on the previous year. Current account suppliers also appear to be reacting to a more competitive personal current account market; new players such as Tesco and Virgin Money have entered the market in recent years, and the institutions that are the biggest net gainers from CASS are notable for the degree of innovation in their current account offering (Santander's 1-2-3 account, Halifax's Extra offer and Nationwide's Flex Range).

7.15 While the government's actions around increasing competition in banking are delivering tangible results, as noted above the CMA is currently carrying out its investigation into the personal current account market. The government welcomes this important investigation, will respect the independence of this process, and stands ready to take appropriate action once the CMA comes forward with its findings.

8 Supporting competition in business banking

8.1 With the reduction in the availability of business lending that followed the financial crisis, the need to increase competition in business banking, particularly in terms of the availability of products and services to SMEs, became particularly acute. In order to address this, the government has adopted numerous measures to increase the range of players in the SME banking market, improve the ability of SMEs to work out where they can get the best deal for them and move their business accordingly.

8.2 The government has taken significant steps to improve the performance of the incumbent banks in the business lending market. The SME lending appeals process, which was one of the recommendations of the government's Business Taskforce, was launched in 2011. The appeals process is independently overseen by Professor Russel Griggs, and has driven banks to improve their business lending assessments, to ensure they make the right decision first time. The Business Banking Insight Survey, which this government commissioned, allows SMEs to more accurately work out where they can get the best deal for them. And the extension of CASS to 99% of SMEs, and the action of the CMA to prevent banks from requiring SME customers to open a business account with them as a condition of obtaining a loan ("bundling") has made it easier for SMEs to move to new products.

8.3 Looking beyond the traditional banking sector, the government has also sought to widen the pool of potential providers of SME financing by supporting the growth of the peer-to-peer ("P2P") and crowdfunding sectors in the UK taking steps including:

- creating a bespoke regulatory regime for P2P and crowdfunding platforms, providing both the Industry and its customers with the confidence that comes with regulatory certainty
- acting to level the playing field between bank and non-bank lenders by creating a new bad-debt relief for P2P investments
- extending ISA eligibility to P2P investments from April 2015 (and committing to consult on doing the same for crowdfunded, debt-based securities)
- providing £85m of British Business Bank investment via peer-to-peer and crowdfunding platforms, supporting more than £460m of new lending to more than 5700 smaller businesses

8.4 In addition, the government offers tax incentives to investors taking on the risk of investing in smaller companies through the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and other tax incentives, which, in combination with equity crowdfunding, are helping firms access the finance that they need to grow.

8.5 The government has set up the £60m Community Development Finance Association Wholesale Fund to lend to businesses from deprived areas and disadvantaged groups. In 2014, CDFIs lent £72m to SMEs and microenterprises, including 11,500 new businesses. The British Business Bank is also currently commissioning new independent research for a report into the sustainability of the CDFI sector. The report's findings will suggest how the CDFI sector could attract more commercial investment, providing a longer-term funding option for the sector and

in turn enabling the sector to continue to provide small businesses with a competitive alternative to bank lending.

8.6 The government has also take action to remove barriers in the market that prevent challenger banks and non-bank lenders from competing effectively with the incumbent banks. It has:

- legislated via the Small Business, Enterprise and Employment Bill to require banks to share SME credit data with other lenders via designated credit reference agencies, and to pass on the details of SMEs they turn down for finance to designated rejected loan platforms, which will help address the information gap faces by non-traditional lenders and new-entrants in the SME market
- required the banks to release their SME lending data on a postcode-basis, which will allow alternative providers to identify under-served areas
- tackled bans on assignment and deeds of priority, both of which had prevented businesses from seeking finance outside their established banking relationship
- levelled the playing field for private placements, by exempting them from withholding tax

8.7 Building on these measures, **the British Business Bank will shortly invite expressions of interest from Credit Reference Agencies and finance platforms that wish to be designated by HM Treasury to receive data from banks under powers contained in the Small Business, Enterprise and Employment Bill.** This is the next step in delivering the government's measures to tackle information asymmetries that prevent challenger banks and alternative finance providers from competing on level terms with established incumbents in the SME lending market.

8.8 Additionally, **the government welcomes a Bank of England study which will quantify the economic benefit of improving access to credit data for trade creditors.** Improved access will level the playing field by allowing trade creditors access to the information they need to compete more effectively. The results of the study are expected in the Autumn and if, as expected, this demonstrates significant potential benefits, the government expects that industry will quickly make the necessary changes to allow these benefits to flow to businesses.

8.9 Again, while the reforms the government has made will naturally take some time to fully feed through to improvements in the market, we are beginning to see some positive outcomes:

- the incumbent banks are making better lending decisions, with decisions overturned on appeal down from 32.6% to 20.4%
- new banks are expanding fast with total business lending increasing from new players such as Aldermore (£1.69bn), Shawbrook (£1.4bn) and Metro (£0.7bn)
- we have seen strong growth in P2P and crowdfunding with average annual growth rates from 2012-2014 of 250% for P2P business lending, 410% for crowdfunded equity and 117% for crowdfunded debt. In addition, 17 new P2P platforms launched in 2014, with a further 8 expecting to launch imminently
- two new platforms are ready to enter the market to match SMEs that have been turned down for lending by the big banks with alternative finance providers
- 2013 saw £13bn gross flows of asset finance to SMEs, up 6% year-on-year
- as a direct result of the withholding tax change, six major investors last year committed £9bn in private placements and other direct lending

8.10 As with personal current accounts, the government welcomes the independent CMA's review of the SME banking market. Should the CMA review highlight areas for further action, the government stands ready to act as appropriate.

9 Conclusion

9.1 The story of banking competition in the UK since the 1960s has been one of extremely significant consolidation, punctuated by innovations and actions that increased competitive intensity. The Financial Crisis, however, accelerated this consolidation and laid bare the extent to which the too-big-to-fail banks had gained an unfair competitive advantage through the implicit government guarantee. In dealing with the fall-out from the financial crisis, this government has been committed to reversing this anti-competitive trend.

9.2 The steps the government has taken in this area have already led to real-world improvements, but we can expect this to become more evident as these reforms have time to work through.

9.3 The government created the Competition and Markets Authority to provide a more robust challenge in uncompetitive markets. It is absolutely right that they are taking a closer look at banking. The government will respect the independence of this process, and stands ready to take appropriate action once the CMA has reached its final conclusions.

9.4 Looking to the future, the government remains committed to building on this good work, maintain the pipeline of new challengers coming through, and ensuring that the new challengers have an appropriate environment to grow and offer more robust competition to the established players. The government will not rest until the UK has a highly competitive banking sector, working in the interests of all consumers and businesses right across the country.

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