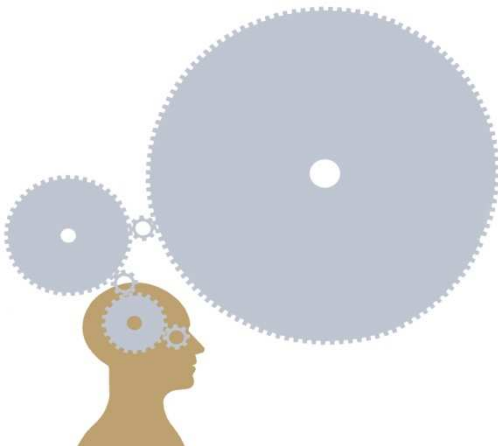


The role of competition in retail banking

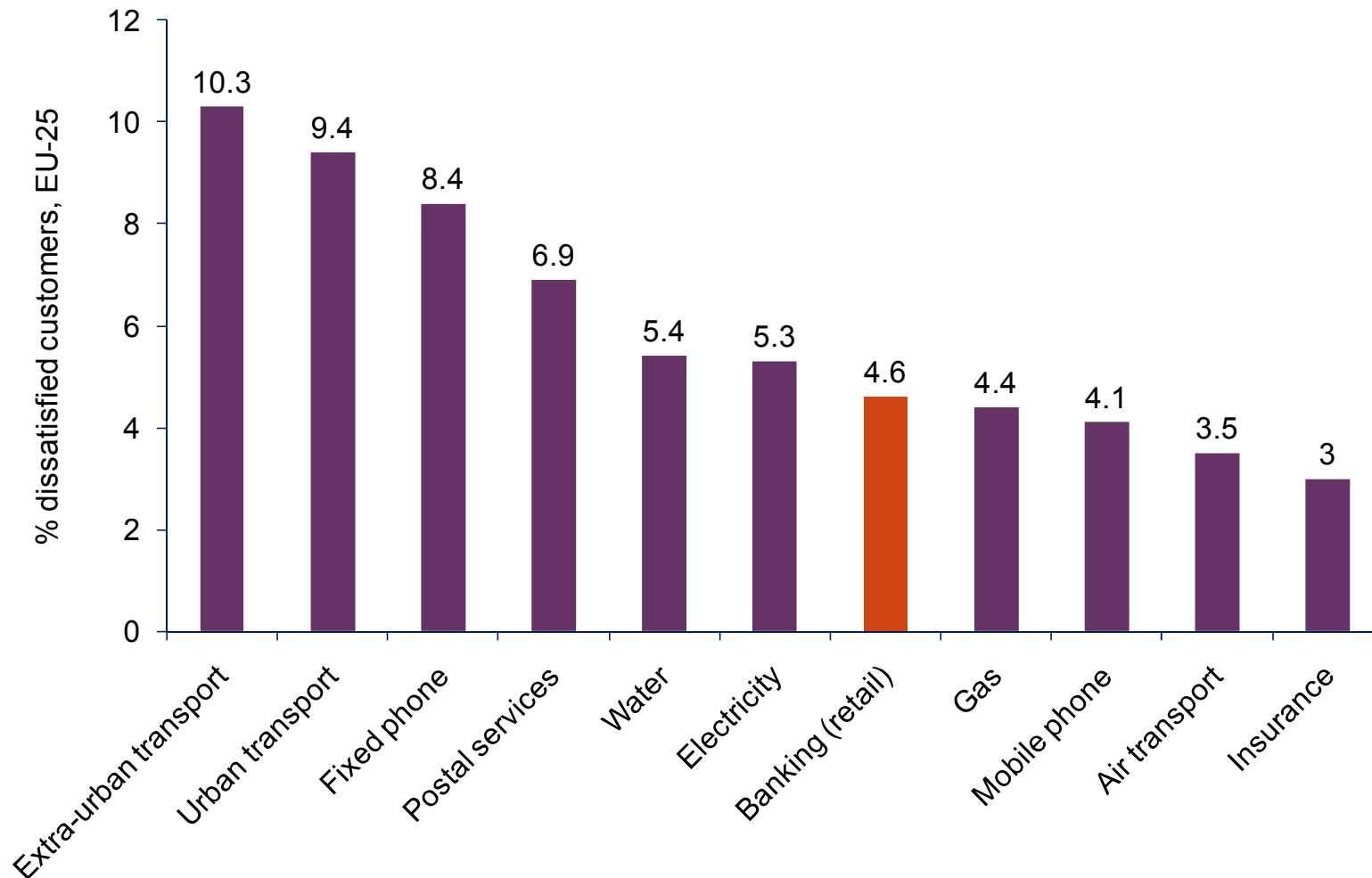
RPI conference
The role of competition in public policy

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Why intervene in the retail banking sector?



Source: European Commission Directorate General for Health and Consumers (2007), Consumer Satisfaction Survey, May. http://ec.europa.eu/consumers/cons_int/serv_gen/cons_satisf/consumer_service_finrep_en.pdf

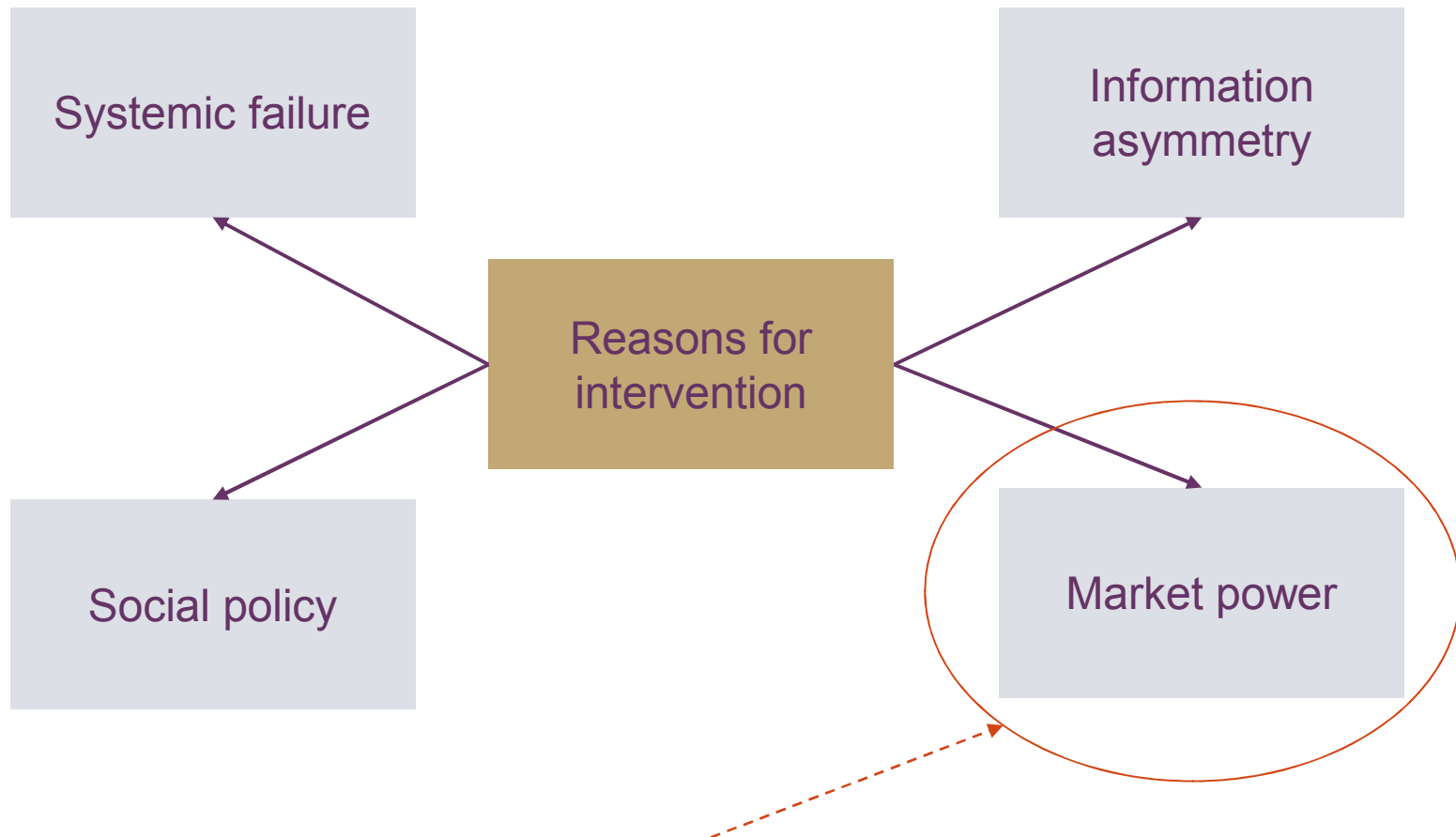
Competition aims: happy customers

- high customer satisfaction ratings for Internet and telephone banks (*Which?*)
- 72% of those who switched found it easy (*Which?*)
- 80% of non-switchers give 'Been with current provider a long time' as reason (CC)
- 'customers are generally not particularly interested in personal current accounts' (CC)
- 17% find thinking about financial services 'interesting' (4% find it 'enjoyable') (Eurobarometer)

Happy, or indifferent?

Source: *Which?* (2008), Eurobarometer (2005), Competition Commission (2006), 'Northern Ireland Personal Banking', Provisional Findings, October.

Why intervene in the retail banking sector?



Main focus of competition policy, but what (if any) is the proper role of competition policy in dealing with the other issues?

Why intervene in the retail banking sector?

problem:

Systemic failure

response:
prudential
regulation

Information
asymmetry

consumer
protection

economic motivation:

**coordination
failure and
moral hazard**

**bounded
rationality**

Social policy

social
inclusion/
lending
targets

Market power

competition
policy

**distributional
concerns**

**social cost of
monopoly**

How to respond to these problems

- a rational evaluation of trade-offs, including competition policy concerns
 - eg, the balancing test used in the state aid framework
 - is the measure aimed at a well-defined object of common interest?
 - is the measure well-designed: could the same effect be obtained with a lighter-touch approach?
 - is the distortion to competition minimised such that the overall balance is positive?
- be clear about the alleged harms and recognise competition alone may not be the solution

Unarranged overdraft charges: UTCCR

- Supreme Court Judgement: balancing the need for consumer protection against residual freedom of contract

OFT case and market study	Supreme Court judgement
charges too complex	charges were clearly set out
charges not transparent	significant proportion (77%) of customers knew them
switching difficult	part of the main service of providing current account
therefore charges unfair	therefore fairness of the charges could not be assessed under UTCCR

What is fairness?

- fairness (as judged by the excessive nature of the charges) cannot be assessed by comparing the price of the product with the service offered, where that contract has been knowingly entered into
- could be argued to be unfair under other criteria
- is fairness about cost reflectivity?
- is fairness about the underlying nature of the customers that bear those costs?
 - are these customers 'spendthrift and improvident' or 'disadvantaged and finding it hard to make ends meet'?

Some tensions

- **banning price discrimination**
(eg, intervening against overdraft charges)
 - may serve aim of consumer protection
 - but price discrimination can be output-expanding
 - firm versus industry elasticities
 - (Midland Bank gained 450,000 extra customers in the year following its introduction of 'free if in credit' banking)
- **consumer information remedies**
(eg, form of credit card statements)
 - may assume that consumers have a basic level of competence in numeracy and literacy, whereas 21% of UK consumers fail basic literacy and numeracy tests¹

¹ Source: DfES Research Brief RB490 and OECD. <http://www.dcsf.gov.uk/research/data/uploadfiles/RB490.pdf>;
http://www.oecd.org/document/42/0,3343,en_2649_35845581_40026026_1_1_1_37455,00.html

Range of different charging models

Predicated on consumer choice being desirable

'free-banking'
model

per-transaction
charges

flat (monthly)
fee per account
(eg, packaged
accounts)

mobile phone
pricing model

hybrids

Are these cost reflective?

'Nudging' consumers may be better than choosing for them

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