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# Competition Law Update

Authors **Becket McGrath** and **Trupti Reddy** of Cooley (UK) LLP

## Regulatory scrutiny of the retail banking market

This article considers recent developments in the UK in relation to the ongoing market investigation into banking services for small and medium enterprises.

On 6 November 2014, the UK Competition and Markets Authority (CMA) announced that it had decided to initiate a full market investigation of the supply of retail banking services to personal current account holders and to small and medium enterprises (SMEs). The CMA is now conducting its investigation, which is due to conclude by 5 May 2016.

### BACKGROUND

Under the Enterprise Act 2002, the CMA may subject a UK market to a detailed investigation where it has reasonable grounds for suspecting that any of its features prevent, restrict or distort competition.<sup>1</sup> If the CMA's investigation indicates that its initial suspicions were well-founded (ie it finds that there is an "adverse effect on competition" (AEC) in any market investigated), the CMA has extensive statutory powers to impose remedies to address its concerns. These extend to the power to regulate prices and to impose structural remedies on market participants, up to and including divestments of assets or entire businesses.

Although the initiation of the retail banking market investigation marks a new, and very intensive, phase of regulatory scrutiny of the sector, it is itself the product of extensive preparatory work. Back in June 2013, the CMA's predecessor authority, the Office of Fair Trading (OFT), announced that it would be conducting a market study of SME banking. (Such a study is a preliminary step before a full market investigation can be launched.) Although at the outset the OFT noted simply that it would "work closely" with the Financial Conduct Authority (FCA),<sup>2</sup> the study subsequently became a joint CMA and FCA product. In March 2014, shortly before it took over the OFT's competition functions, the CMA announced that it would also undertake a "short update" of previous work by the OFT on personal current accounts (PCA) services, thus effectively combining the SME and PCA workstreams into one project.<sup>3</sup>

The CMA ultimately announced in July 2014 that it was "minded to refer" the markets for personal current accounts and SME banking

for a full market investigation, on the grounds that they were "not working well for customers". As required by statute, the CMA's preliminary decision was put to public consultation. Although some respondents (including the four largest banks) raised objections, the CMA unsurprisingly confirmed the market investigation reference. It also confirmed that it would simultaneously review the undertakings entered into by nine banks in 2002, following the last market investigation of SME banking, given the significant overlap with the subject matter of the new investigation.

### SCOPE OF THE MARKET INVESTIGATION

For the purposes of the market investigation, the provision of banking services to SMEs<sup>4</sup> includes, but is not limited to, the provision of business current accounts, overdrafts, general purpose business loans and deposit accounts. It specifically excludes the provision of other non-lending products such as insurance, merchant acquiring, hedging and foreign exchange. PCA services comprise the provision of a sterling bank account marketed to individuals offering facilities to hold deposits, to receive and make payments by cheque and/or debit card, to use ATMs and to make regular payments by direct debit and/or standing order, as well as (where used) the provision of overdraft facilities.

The CMA is now considering in more detail a number of preliminary competition concerns that it identified during its market studies. According to the CMA's Issues Statement, which maps out the scope of the investigation, the CMA is focusing on three possible features of the market (or "theories of harm") which could be preventing, restricting or distorting competition: (i) that there are impediments to customers' ability to effectively shop around, choose and switch products or suppliers, which result in weak incentives for banks to compete for customers on the basis of price, quality and/or innovation; (ii) that concentration gives rise to market power of some banks leading to worse outcomes for customers; and (iii) that barriers to entry and expansion lead to worse outcomes for customers. As the CMA has acknowledged, there are strong interrelationships between these three hypotheses and it has noted that it may find an AEC based on features identified under separate theories or harm or indeed on another basis altogether.

### NEXT STEPS

The CMA inquiry team is now in full information-gathering mode, with the CMA's website indicating that it is undertaking consumer surveys and site visits. Hearings will be held over the summer, after which the next major milestone in the investigation will be publication of the CMA's Provisional Findings, which is due by September. Once

**Big box**

Becket McGrath is a partner in the Competition and Antitrust practice and a member of the Business Department of Cooley (UK) LLP in London. Email: [bmcgrath@cooley.com](mailto:bmcgrath@cooley.com). Trupti Reddy is an associate in the Competition and Antitrust practice of Cooley (UK) LLP. Email: [treddy@cooley.com](mailto:treddy@cooley.com)

that has been published, attention will switch to discussion of potential remedies (assuming that one or more competition concerns have been identified), with the CMA indicating that it will publish its final report in April 2016, ahead of the 5 May 2016 statutory deadline.

**INTERACTION WITH OTHER REGULATORS AND POLICIES**

The banking sector is complex and highly regulated. In deciding what remedial action, if any, to take, the CMA will need to be mindful of pending changes in the wider regulatory framework. These include, for example, the implementation of the EU Payment Accounts Directive, aimed at increasing the information available on products and charges, as well as new legislation to increase the availability of SME creditworthiness information.

Concerns have already been raised by some stakeholders about the type and cost of remedies which could be implemented, particularly if they are structural in nature. While the CMA has stated that it recognises the significant costs associated with structural remedies, it continues to consider that it is important for all remedy options to remain open, and that it is premature to rule any out. A specific point was raised regarding the undesirability of possible structural remedies in the light of the structural reforms currently under consultation relating to ring-fencing. The Prudential Regulation Authority (PRA) is required<sup>5</sup> to make policy to implement the ring-fencing of core UK financial services and activities. The CMA has noted that it will remain in contact with the PRA regarding the timetables for the ring-fencing reforms. However, it currently sees no grounds to believe that ring-fencing would or should preclude any structural remedies, or that a market investigation would or should preclude implementation of ring-fencing.<sup>6</sup>

The UK banking sector has been subject to almost continuous regulatory and competition scrutiny for more than 15 years.<sup>7</sup> This intensified, however, after the financial crisis of 2008 (and the ensuing bailouts) significantly raised the political temperature, leading to a plethora of reviews and investigations, by an increasing number of authorities. As a result, in addition to working with the PRA to ensure its market investigation, and any potential remedies, take into account the ring-fencing reforms, the CMA will also have to liaise with the FCA and the new Payment Systems Regulator (PSR) to avoid conflict with their concurrent works and to take into account the views and experience of the FCA and PSR.

The FCA has already carried out extensive work into the manner in which competition in various markets in the financial services sector is working, and published a number of market studies. The FCA has just launched a market study in the credit card market. It has also recently published its final market study report into cash savings products, which found that there is little transparency in the market regarding alternative products, customers find it difficult to switch accounts, and large PCA providers have considerable advantages because they can attract most easy access balances despite offering lower interest rates. The FCA is currently consulting on remedies to give consumers sufficiently clear and targeted information on alternative products, simplify the switching process, and remove the advantages that large PCA providers enjoy.

Other work already undertaken by the FCA includes steps to reduce

regulatory barriers faced by new bank applicants who may provide more competition in the future; a programme of work to promote competition and innovation by making it easier for start-ups and established businesses to bring innovative ideas into financial services markets; and a review of the Current Account Switching Service.

The PSR, which will become fully operational in April, will focus on ensuring effective competition and innovation in the systems and infrastructure that underpin retail banking, with aims including opening up access to payment systems and establishing a process to drive industry strategy development. The PSR will also have concurrent powers to apply general competition law. The PSR is currently examining access to payment systems and developing policy proposals to address concerns similar to those considered by the CMA in the market studies. HM Treasury is currently consulting on the payment systems that it proposes to designate as payment systems which the PSR will oversee.

The CMA has stated that it will maintain a collaborative approach to working with the FCA and PSR, that it has taken into account work already undertaken by the FCA, and that it agrees with the views of the FCA and PSR that any market investigation should avoid duplicating the work of other regulators and that work should be co-ordinated as far as appropriate. It is understood that the staff supporting the CMA's market investigation include at least one secondee from the FCA, presumably to assist with policy co-ordination and knowledge transfer.

The combination of the CMA's market investigation and the increasing number of market studies and consultations being undertaken by the FCA and PSR will ensure a busy few years for banks and their advisers. The potentially wide-reaching remedies which may be implemented at the end of these processes, as well as the proposed ring-fencing reforms, could have a significant impact on the whole sector, both from the perspective of the banks and consumers. Whether any such measures succeed in resolving the central conundrum of retail banking, namely that customers tend to stay with their existing lenders even while appearing to be dissatisfied with the service that they receive from them, remains to be seen. ■

- 1 Section 131, Enterprise Act 2002.
- 2 The FCA has an operational objective to promote competition in the interests of consumers. From April 2015, it will also have full powers to enforce general competition law in the financial sector, which will be exercised concurrently with the CMA. These will include the power to make its own market investigation references under the Enterprise Act 2002, which it cannot currently do.
- 3 The conclusions of which were published in January 2013.
- 4 An SME is defined by the CMA for the purposes of this investigation to mean a business that, in respect of a given financial year applying to it, has annual sales revenues (exclusive of VAT and other turnover-related taxes) not exceeding £25m.
- 5 Under FSMA, amended by Financial Services (Banking Reform) Act 2013.
- 6 See the CMA's decision on market reference.
- 7 The CMA Issues Statement notes four major reviews since the Cruickshank Report in 2000.