Financial Conduct Authority

Market Study MS14/2

Cash savings market study: interim report

July 2014

Contents

We are asking for comments on this report by 8 August 2014.

You can send them to:

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Abbreviations used in this paper

BCOBS	Banking Conduct of Business Sourcebook
FCA	Financial Conduct Authority
FLS	Funding for Lending Scheme
ICB	Independent Commission on Banking
ISA	Individual Savings Account
NISA	New Individual Savings Account
OFT	Office of Fair Trading
PCA	Personal Current Account
PRA	Prudential Regulation Authority
PSD	Payment Services Directive (Directive 2007/64 on payment services in the internal market, OJ L 319/1, 5.12.2007)
PSRs	Payment Services Regulations

1.
Executive Summary

In October 2013, we launched a market study under our competition objective focused on the cash savings market. We wanted to assess whether competition in the market for cash savings products is working well for consumers. 82% of adults in the UK have a savings account[1] and approximately £699bn is held in savings accounts by the firms in our sample.

This report presents our interim findings. In it we set out our initial observations on the nature of competition in the cash savings market. Our analysis so far has been primarily focused on easy access accounts and no-term Cash ISA accounts which we estimate account for around two thirds of total cash savings balances held by firms in our sample. We will provide further analysis of the other products covered by the study in the final report.

The report highlights our emerging findings and the issues we have observed so far, but does not reach firm views on the nature of any competition concerns or on market interventions that should be made. We are publishing our interim findings to give interested parties the opportunity to comment before we reach final conclusions.

In a market where competition is working effectively and in the interests of consumers we would expect to see well informed and active consumers who shop around for savings products and switch when better interest rates or service is available. In such a market, savings providers would need to continue to offer competitive products and services to retain and attract consumers, leading to the 'virtuous circle'[2] of competition and to better outcomes for consumers.

The emerging evidence suggests that some aspects of the cash savings market work well for consumers. For example:

- A large number of firms compete with one another in the supply of cash savings products.
- Some consumers do shop around effectively, and will switch between providers to obtain the best deal for them. This is helping to drive competition between those providers that are seeking to attract new customers and grow their deposits.

However it also suggests that some aspects of the market may not be working well:

- Large numbers of consumers are not actively shopping around for savings accounts or providers. In response, providers, on average, pay lower interest rates on older accounts than on accounts opened more recently, such that consumers who remain with the same account for long periods of time will tend to receive lower rates on their savings. This means that, although more active consumers do drive competition which results in higher rates

1 GB TGI, Kantar Media UK Ltd Q1 2013 (October-September) - Taken from Mintel's Deposit and Savings Accounts – UK – April 2013.
2 See OFT (2010) "What does Behavioural Economics mean for Competition Policy?" http://webarchive.nationalarchives.gov.

on newer accounts, switching does not drive competition to the benefit of customers that remain with the same account for longer periods.

- Many consumers hold their savings with their Personal Current Account (PCA) provider, so the largest PCA providers appear to be able to generate in aggregate a significant share of the savings market (in particular in relation to easy-access products) despite, on average, offering interest rates that are materially below those offered by other providers.

- Low levels of switching by consumers and the high proportion of savings balances held by PCA providers mean that challenger banks face difficulties in developing substantial market shares in the cash savings market at a similar cost to the larger providers. Challenger banks must offer comparatively higher interest rates to attract and retain their customers and so customer deposits are a relatively more expensive source of funding for challengers than for the larger providers.

In the next phase of this study, we will investigate the issues identified in this report and conduct further analysis of the other products covered by the study to reach a final view on whether the market is characterised by competition issues that require our intervention.

Our approach

We have focused on interest-bearing cash savings accounts available to UK households which enable consumers to save their cash and generate an interest rate return, but which typically offer limited transaction functions compared to current accounts. At this stage of the study, we have collected views from providers and consumer organisations. We have gathered quantitative and qualitative information that we are using to consider:

- how consumers shop around and make decisions

- how firms compete with one another in the supply of the different products, and

- what barriers to entry and expansion are faced by new and challenger providers

Why we chose to launch a market study

In our Terms of Reference[3] we observed that there appeared to be a low level of switching when it comes to cash savings accounts compared to other products, including other financial products such as credit cards and insurance. We also observed that a number of savings accounts offered initial time-limited bonus interest rates, after which interest rates may fall.

In particular, we were concerned that some providers may be able to reduce the interest rates on existing savings accounts without needing to worry about consumers switching to other suppliers or other savings products. Many consumers who are not active in the market can receive very low levels of interest on their savings.

3 FCA (2013) Cash savings market study terms of reference: http://www.fca.org.uk/static/documents/market-studies/cash-savings-market-study-tor.pdf

Our interim findings

Around 82% of UK consumers hold a cash savings product[4], with savings per account across the providers in our sample averaging £6,400. Consumers save for a variety of purposes, and will focus on different product characteristics when selecting their account. Key characteristics include the interest rate, other product features such as internet, branch and phone access, the provider's brand and service proposition, and whether the consumer already holds other products, including a PCA, with the provider.

A small number of large providers are operating in the cash savings market, with six providers holding roughly two-thirds of all cash savings balances.[5] Firms' strategies in relation to savings are largely driven by their wider balance sheet management strategies. In determining the level of deposits they wish to attract, they will consider a number of factors including their lending strategy, prudential requirements, wholesale funding conditions and expectations about the Bank of England base rate. The Bank of England base rate has been at a historic low of 0.5% since March 2009, and the introduction of the Funding for Lending Scheme in 2012 made firms less reliant on retail deposits and led to a further fall in the average interest rates providers have offered to savers.

Our evidence suggests that the cash savings market is characterised by a range of consumers who vary greatly in their levels of engagement with savings products:

- At one extreme is a small group of so called 'rate chasers', a cohort of consumers who pay close attention to the products and rates being offered and who switch regularly to increase the interest they receive on their savings.

- At the other, there is a much larger group of consumers who pay little attention to the accounts on offer and who, for long periods, will not consider whether they could earn a higher return by moving to a different account.

- In the middle are those consumers who will review the accounts they hold and consider switching every few years.

Factors which influence consumer engagement and the likelihood of switching include: the balance a consumer holds and how much interest they can gain by switching; consumers' awareness of their own interest rates and those offered on other accounts; consumers' perception of the time and effort that switching involves; and the value a consumer places on existing relationships, including the convenience arising from keeping most of their financial products with one provider. Given the low interest rate environment, some consumers may have little to gain from switching and so may choose to switch less frequently. However our evidence suggests that switching rates are not particularly sensitive to changes in the level of interest rate offered by firms, so we would not expect a significant change in consumer behaviour should interest rates rise over the coming years.

Interest rates on older accounts are lower than interest rates paid on accounts opened more recently suggesting consumers who remain with the same account for long periods of time receive lower rates on their savings. For example, our analysis of the data submitted by firms in our sample suggests that at the end of 2013 the average interest rate on easy access accounts opened in the last two years was around 0.8%, but that the equivalent rate for accounts that were opened more than five years ago was less than 0.3%. While some consumers may switch

4 GB TGI, Kantar Media UK Ltd Q1 2013 (October-September) - Taken from Mintel's Deposit and Savings Accounts – UK – April 2013
5 © GfK NOP Ltd, Financial Research Survey (FRS), 6 months ending December 2013, 17,830 adults interviewed

away in response to the lowered rates, a significant proportion of consumers do not.

Providers use different strategies that can enable them to pay different rates to different types of consumer – they can offer higher interest rates to new customers that may be more active and lower rates to those customers that remain with the same account and demonstrate that they are more passive. Such strategies include:

- Product replacement strategies where on-sale products are superseded by newer products. Our data shows that at the end of 2013 the 21 providers in our sample together had around 400 easy access products that were open to new customers and just over 2000 that were closed to new customers. This product proliferation may also be confusing for consumers when comparing their savings accounts with those available in the market (which may be newer 'versions' of the same account offering higher rates).

- The use of bonus rate products which typically offer an added 'bonus' rate of interest for a temporary period. The use of bonus rates has declined recently with fewer than 5% of accounts available on the market in November 2013 offering them.[6] However our data shows that nearly half (48%) of total easy access balances are held in accounts which offer, or in the past have offered, bonus rates. The use of bonus rates is common in many markets, and can encourage switching. Customers who are engaged and active can get good value from bonus rates however more passive customers may revert to and remain on lower rates.

Our initial analysis suggests that many consumers hold savings accounts with their PCA provider, particularly easy access products. Evidence suggests some consumers find it easier to manage accounts through one branch or one internet banking system, reducing the likelihood of them switching providers. Our data from the sample of firms we surveyed shows that for the largest PCA providers, over 80% of their total balances in easy access accounts are held by consumers who also hold a PCA with the same provider.

The providers with the largest share of the PCA market are able to retain in aggregate a significant share of the easy access market despite, on average, paying interest rates that are materially lower than those offered by the smaller PCA providers. For example our analysis of data submitted by firms in our sample suggests that the average interest rate offered by the leading PCA providers on easy access saving accounts opened in the last two years is around 0.5%, but the equivalent rate offered by other providers is 1.2%. This suggests that the larger PCA providers may be protected from vigorous competition in the supply of easy access products.

Consumers need information in order to assess their options, choose the product or provider which best suits their needs and ultimately drive effective competition between firms. Providers' communications with their account holders provides one way of providing consumers with such information. We have though observed variation in the clarity and content of information shared in these communications.

Low levels of switching by consumers and the high proportion of savings balances held by PCA providers have been cited by new and growing firms as a key barrier to expansion in this market. Because many consumers are not inclined to switch account and/or provider, it is difficult for new firms to attract these consumers, and to attract and retain those consumers that do switch, these firms must offer relatively higher interest rates. This limits their ability to develop market share at a cost comparable to that incurred by the major incumbents.

6 Moneyfacts Treasury Reports, UK Savings Trends, November 2013

Next steps

In the next phase of the study, we will gather further information from providers and consumer organisations and consider both the results of our consumer survey and our research into how cash savings markets work in other countries.

We will continue to develop our thinking on whether to intervene in this market, and what interventions would be most effective in improving competition in the interests of consumers.

We will consider how intervening to improve the rates paid to consumers with older accounts would affect the interest rates paid on more recently opened accounts. Some parties have suggested that it would not be possible to intervene to improve the overall interest rates paid to consumers, and this is an issue that we would welcome views on. At this stage of the study, we consider that an intervention that improved consumer engagement could result in more effective competition and improved terms overall, and we are not convinced that improvements to the terms for some consumers would be cancelled out by worse terms at the time an account is opened. In particular:

- If more consumers are active and willing to switch between providers, it will be easier for new and expanding firms to grow their market share and this should improve competition.
- If consumers were better able to compare products at the point of sale, and identify those providers more likely to pay higher rates on older accounts, it could strengthen competition and allow these providers to gain market share.

In considering possible interventions we will consider the extent to which we might be able to promote greater consumer engagement, for example:

- what could be done to ensure that more consumers are aware of the rates they receive, the rates on offer on other accounts, and the ways that they can switch accounts
- whether it is possible to give consumers greater insight into how their interest rate is likely to evolve over time, so that they can make an informed long-term choice between providers when opening an account
- whether changes could be made by providers to make it easier for consumers to manage accounts that are held with multiple providers and
- what could be done to make it easier to move savings to a new account or provider.

However, if we consider that such measures would be likely only to prompt a marginal number of consumers to become more engaged and/or active, we will consider whether other interventions are necessary to improve outcomes for consumers overall.

If we conclude that we need to take action, we will consider what intervention or a package of interventions would be most effective in promoting effective competition. Before we adopt any such measure, we will consult with interested parties on the relevant costs and benefits. The possible measures are:

- policy or regulatory changes
- rule-making, including changes to or potential withdrawal of existing rules[7]
- publishing guidance or
- proposals for enhanced industry self-regulation

We will publish our final report in late 2014.

We would like to hear your views on this report, including on the need for intervention and, if so, your views on what form it should take. Please send us written comments by 8 August 2014.

7 Before making any rules, we must consult the Prudential Regulatory Authority (PRA) and publish draft rules, with a cost benefit analysis and an explanation of the purpose of the rules, and consider any representations about proposed changes.

2.
Our approach

In this chapter we outline:

- why we chose to launch a market study into cash savings
- the scope of the study
- why we are publishing an interim report and
- the evidence gathered to support our analysis

Why did we decide to look into the cash savings market?

We are carrying out this study to assess whether competition in the cash savings market is working effectively in the interests of consumers and, if not, to understand why. The study was launched in October 2013.[8]

The market for cash savings products is large, creating scope for potentially sizable consumer detriment arising from ineffective competition and the potential for significant benefits to consumers from a competitive and well-functioning market. 82% of adults in the UK have a savings account[9] and approximately £699bn is held in savings accounts by the firms in our sample.

In a market where competition is working effectively and in the interests of consumers we would expect to see well informed and active consumers who shop around for savings products and switch when better interest rates or service is available. In such a market, savings providers would need to continue to offer competitive products and services to retain and attract consumers, leading to the 'virtuous circle'[10] of competition and to better outcomes for consumers. When we set out to do this work, we were concerned that:

- there appeared to be low levels of switching between cash savings accounts
- a number of savings accounts offered initial time-limited bonus interest rates, after which interest rates may fall; and
- providers may be able to reduce interest rates on existing savings accounts without needing to worry about consumers switching to other providers or products

8 FCA (2013) Cash savings market study terms of reference: www.fca.org.uk/static/documents/market-studies/cash-savings-market-study-tor.pdf
9 GB TGI, Kantar Media UK Ltd Q1 2013 (October-September) - Taken from Mintel's Deposit and Savings Accounts – UK – April 2013.
10 See OFT (2010) "What does Behavioural Economics mean for Competition Policy?" http://webarchive.nationalarchives.gov.uk/20140402142426 http://www.oft.gov.uk/shared_oft/economic_research/oft1224.pdf

We were concerned that as a result many consumers, who are not actively shopping around and switching between providers, may receive very low levels of interest on their savings.

We also wanted to explore whether many consumers hold savings accounts with their PCA provider because they do not shop around effectively, and whether competition between providers is hindered by structural features in the market. In cash savings, these may be caused by economies of scale or scope, or barriers to consumer switching.

Scope of the study

This study focuses on interest-bearing cash savings accounts. These accounts enable consumers to store their cash and generate an interest rate return, but they typically offer limited transaction functions compared to PCAs.

Savings accounts can vary according to the terms on which cash can be accessed (instant, notice, fixed term) and tax privileges (cash ISAs). The interest rate can be fixed or variable and can include initial time-limited bonus rates.

Savings accounts for business customers are not being considered as part of this market study.

Why are we publishing an interim report?

We are publishing this interim report to give all interested parties an opportunity to comment on and challenge our emerging thinking and analysis. We hope this will help promote constructive engagement between the FCA, the firms, trade associations and consumer bodies at an early stage.

Since launching the study we have collected a significant amount of evidence from cash savings product providers and have met a number of market participants, trade bodies and consumer groups.

In the report we set out our initial observations on how competition functions in relation to easy access accounts and no-term Cash ISA accounts, which account for around two thirds of total cash savings balances held by firms in our sample. The report highlights what we see as the key evidence and issues that we have observed so far, but does not reach firm views on the nature of any competition concerns or on market interventions that should be made.

In the next phase of the study we intend to investigate further the issues identified in this report as well as conduct further analysis of the other products covered by the study in order to provide more detailed analysis in the final report, which we expect to publish in late 2014.

The evidence gathered to support our analysis

To better understand the market in our study we requested data and information from a sample of firms in the market. We also invited views from stakeholders in a call for evidence and have met with a number of firms, trade associations and consumer groups. A summary of the views provided by stakeholders is set out in Annex A.

In the next phase of the study we intend to investigate further the issues identified in this report and will therefore request further data from firms prior to publication of the final report. We have also commissioned two pieces of external research: an international comparison of how competition works in cash savings markets in other countries, and a consumer survey.

Request for firm data and information

We requested data and information from a sample of 21 providers of cash savings products[11], including 20 firms regulated by the FCA[12] and National Savings and Investments (NS&I).[13] We estimate that these firms have balances which make up around 77% of the total market. The 20 firms regulated by the FCA include:

- Six 'large providers.' These are the large high street banks and building societies which have been in existence for a long time, operate across the UK and have an established branch and online presence.
- Seven 'small and medium building societies.' These are building societies which may have been in existence for a long time but which may only operate in a particular region.
- Seven 'small and medium banks.' Some of these are banks which may only have entered the market more recently.

In particular we asked providers for:

- **Data** including detailed account and balance information, interest rates, account features, distribution channels, sales and data on cross-holding, for all open and closed accounts.
- **Strategy documents** including information on each firm's current strategy in relation to savings products, how this strategy fits with the wider strategy of the firm, its pricing practices and how the firm's strategy is impacted by external factors such as the competitors, technology and macro-economic conditions.
- **Consumer research** including any research or analysis on consumer segmentation, switching patterns, consumer decision making, consumer practices and the methodology used to measure switching.
- **Transparency and disclosure documents** including financial promotions and other customer communications such as letters to customers informing them their bonus rate was coming to an end or their interest rate would be cut.

11 Our study focuses on banks, building societies and NS&I. There are two other types of providers, namely credit unions and peer-to-peer lenders that offer products that potentially compete with the products investigated by the study. However, at this stage we have decided not to focus on these providers because the sectors are relatively small in scale. Also, the specific differences in product features may not make them substitutable from a consumer's perspective (see also footnote 16).

12 The 20 firms regulated by the FCA cover 26 large savings brands. Firms did not have to provide the requested information for the brands that were relatively small.

13 NS&I is an Executive Agency of the Chancellor of the Exchequer, and is accountable to HM Treasury. NS&I is not authorised and regulated by the FCA. When customers invest in NS&I products, they are lending to the Government

3.
Market overview

There are a number of different products within the cash savings market ranging from basic easy access accounts to fixed-term products. Easy access accounts are the most widely held with total balances of approximately £353bn across the providers we surveyed.

Around 82% of UK consumers hold a cash savings product[14], with savings per account across the providers in our sample averaging £6,400. Consumers save for a variety of purposes, and will focus on different product characteristics when selecting their account. Key characteristics include the interest rate, other product features such as internet, branch and phone access, the provider's brand and service proposition, and whether the consumer already holds other products, including a PCA with the provider.

A small number of large providers are operating in the cash savings market, with six providers holding roughly two-thirds of all cash savings balances.[15] Firms' strategies in relation to savings are largely driven by their wider balance sheet management strategies. In determining the level of deposits they wish to attract, they will consider a number of factors including their lending strategy, prudential requirements, wholesale funding conditions and expectations about the Bank of England base rate.

The provision of cash savings products falls within our regulatory remit as we regulate the conduct of firms who accept retail deposits.

This chapter sets out a short overview of the cash savings market, including the products within the scope of our study and the main providers and consumers of these products.

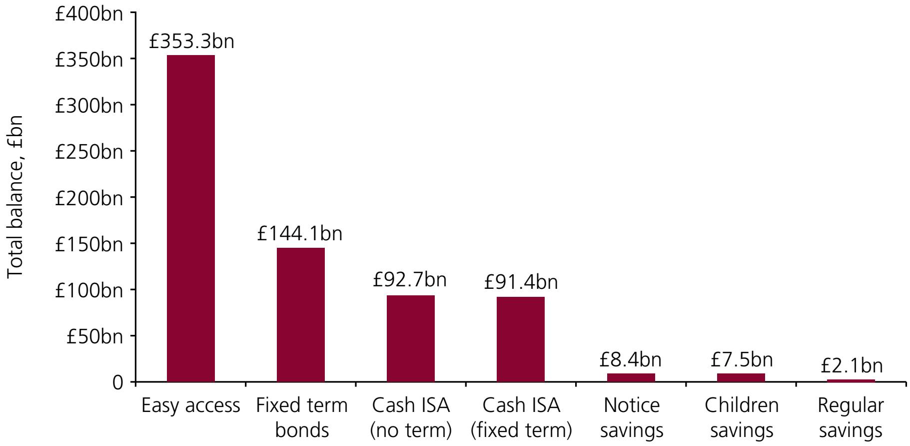
Main products in our study

Our study covers seven main types of cash saving products described in this section.[16] Based

14 GB TGI, Kantar Media UK Ltd Q1 2013 (October-September) - Taken from Mintel's Deposit and Savings Accounts – UK – April 2013
15 .© GfK NOP Ltd, Financial Research Survey (FRS), 6 months ending December 2013, 17,830 adults interviewed
16 Some consumers may choose to deposit their money in other products, for example interest-bearing PCAs, offset mortgage accounts, premium bonds and savings accounts offering returns tied to some form of investment such as stocks and shares ISAs. Some consumers may also consider savings accounts offered by credit unions or investing their money with a peer-to-peer lender. We will not focus on these products within our study as the specific differences in product features may not make them substitutable from a consumer's perspective. For example most credit unions offer a dividend rather than an advertised interest rate on their savings which can vary depending on how much profit the credit union has made in the year. Some credit unions, usually the larger ones, offer savings accounts with advertised rates like other deposit takers' savings accounts, though the admission to membership is restricted to persons who fall within the common bond of the particular credit union (e.g. following a particular occupation, residing or being employed in a particular locality).

on the data provided by firms in our sample, there are about £699bn savings held in these accounts, with easy access accounts having the highest total balances (Figure 1).

Figure 1: Total balances in different types of accounts, £bn



Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

Easy access savings accounts

- Easy access savings accounts include instant access accounts and no-notice accounts. These are the most basic savings accounts with few or no restrictions on making additional deposits or withdrawals.

- Easy access accounts usually offer a variable rate of interest and an unlimited term and may include a time limited introductory bonus or preferential rate to certain groups of customers.

- The firms we surveyed have approximately 69m easy access accounts held by retail consumers in the UK. Approximately £353bn is held in these accounts.

Fixed-term savings accounts/bonds

- Fixed-term accounts offer fixed rates of interest over a specified term, during which consumers are often unable to access their money and may incur penalties if they do. The term of fixed rate products tends to range from one to five years.

- The firms in our sample have approximately 4m fixed-term bond accounts held by consumers in the UK. Approximately £144bn is held in total in these accounts.

Cash ISAs

- Cash ISAs pay interest tax-free and there are limits set by the Government on the amount of money that can be deposited in an ISA in a given year. There are two main types of Cash ISA products: easy access ISAs and fixed rate ISAs.

- Easy access ISAs usually have a variable rate of interest and an unlimited term. Consumers can withdraw money from them with few or no restrictions (although doing so may impact the tax free interest earned).

- Fixed rate ISAs have an interest rate which is fixed for a specified term during which consumers may incur a charge for making withdrawals. The term of fixed rate ISAs tends to range from one to five years.

- The firms in our sample have approximately 17m Cash ISAs with unlimited term and 9m fixed-term Cash ISAs held by retail consumers in the UK.[17]

- Approximately £93bn is held in these Cash ISAs with unlimited term and £91bn in these Cash ISAs with a fixed term.

Notice savings accounts

- Notice savings accounts require a customer to provide a set amount of notice if they wish to make a withdrawal. The notice period can typically range from 30 to 180 days. Withdrawals before the end of the notice period usually incur a penalty.

- These accounts usually pay a variable rate of interest and have no set term.

- The firms we surveyed have approximately 640,000 notice accounts held by consumers in the UK. Approximately £8bn is held in total in these accounts.

Children's savings accounts

- There is a range of children's savings accounts including easy access accounts, regular savings accounts and fixed-term accounts which tend to operate in the same way as adult accounts. An alternative is a Junior ISA which is a long-term tax-free savings account for children, usually with a variable rate of interest. Money can be deposited into these accounts up to an annual limit and can only be withdrawn by the child when they turn 18.

- The firms in our sample have approximately 7m children's savings accounts in operation in the UK. Total balances held in these accounts add-up to approximately £7bn.

Regular savings accounts

- Regular savings accounts offer a fixed interest rate over a specified term providing consumers make regular deposits into their account. Customers are often unable to make withdrawals and may incur penalties if they do.

- The firms we surveyed have approximately 1m regular savings accounts held by consumers in the UK. Approximately £2bn is held in total in these accounts.

Consumers of cash savings products

Around 82% of consumers in the UK hold one or more cash savings product.[18] We estimate the average balance per account is £6,400.

Based on consumer research, the key factors that consumers consider when choosing a cash savings product fall into the following five categories:

- **Interest rate,** including whether it is a variable or a fixed rate, and whether the account offers a time limited bonus rate.

- **Other product features,** such as terms around accessing funds, term of the account, and channels available for managing the account including branch, online, post, phone.

17 From our own analysis of data submitted by a sample of 21 firms
18 GB TGI, Kantar Media UK Ltd Q1 2013 (October-September) – Taken from Mintel's Deposit and Savings Accounts – UK – April 2013

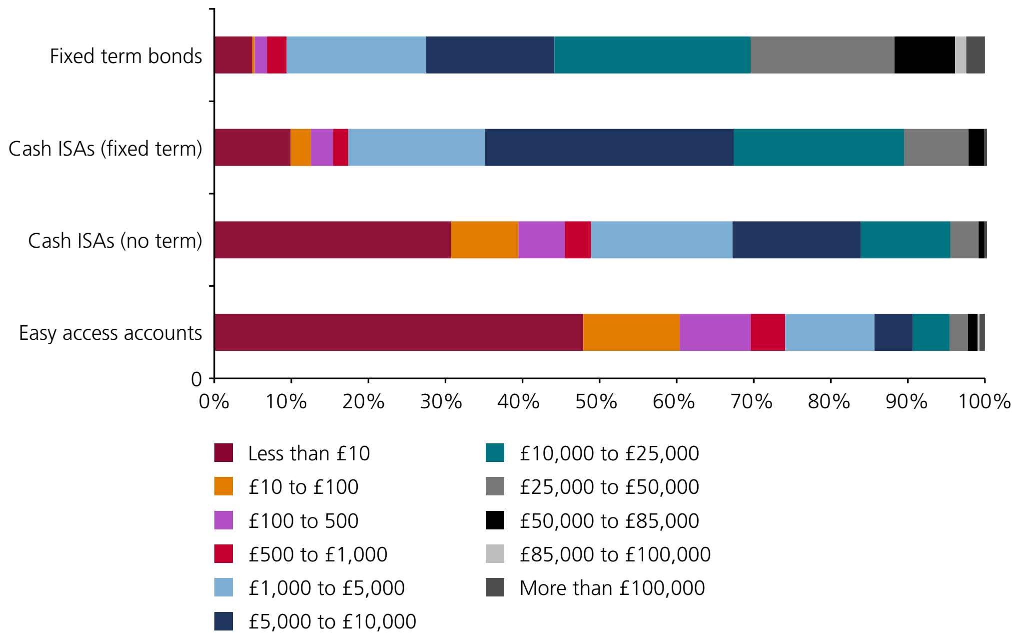
- **Provider's service proposition as a whole,** in particular the availability and quality of online banking tools, customer service and the branch network.

- **Existing and past relationships with the firm,** in particular whether the customer already holds a PCA with the firm, including the convenience arising from keeping most of their financial products with one provider.

- **Perceptions of the provider,** including the appeal of the brand and the perceived financial stability and reputation of the firm.

The higher a consumer's balance, the more they have to gain from receiving a higher rate of interest on their savings.[19] The data received from our sample of firms (as set out in Figure 2 below) shows that higher balances are more likely to be held in fixed term accounts than easy access accounts, and most easy access accounts have relatively low balances.[20] Consequently interest rate may be of greater importance to fixed term account holders than to easy access account holders as they are more likely to hold higher balances and so have more to gain from receiving a higher rate of interest on their savings.

Figure 2: Percentage of accounts with balances falling into the different balance bands



Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

Our data from firms in our sample shows that most new cash savings products are opened in branch (69%). However, the internet is being used increasingly with 25% of accounts opened online in 2013.[21]

19 For example, switching to an account that pays 1% more in gross annual interest will translate into only £1 more in gross interest for someone with £100 in the account and £100 for someone with £10,000.

20 Though some of the easy access accounts may no longer be used, as people may have switched or withdrawn the funds without closing the account.

21 Data on account openings by channel is taken from analysis of a subset of the data submitted by a sample of 21 firms. The subset covers just under 80% of all account openings by firms in our sample.

Consumer research shows that online management of accounts is also growing and in December 2013 42% of accounts were managed online compared to 41% that were managed in branch.[22]

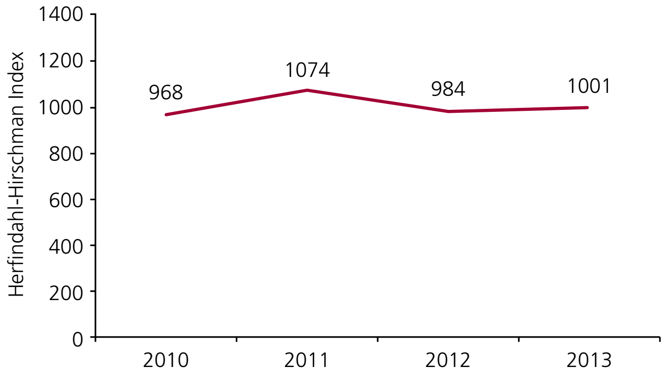
Providers of cash savings products

Cash savings products are provided by deposit-takers such as banks, building societies, credit unions and National Savings & Investments (NS&I).

As at November 2013, 135 firms were offering cash savings products in the UK.[23] There are a small number of large providers with six providers holding approximately 66% of all cash savings balances.[24] Our own analysis of market shares from the data submitted by firms in our sample is consistent with this estimate.

Estimates of market concentration[25] (as set out in Figure 3 below) show that the savings market is not particularly concentrated. However, the level of concentration has stayed relatively stable for a number of years. The biggest impact on market shares in previous years appears to have come from merger or divestment activity.

Figure 3: Market concentration in cash savings (balances) over time



Source: Based on data provided by © GfK NOP Ltd, Financial Research Survey (FRS), 6 months ending December 2013, 17,830 adults interviewed

A number of new providers have appeared in recent years and begun to grow. Although some of these entrants appear to be gaining a foothold and are developing increasingly strong brand identities (or building on existing brands), no new entrant banks have yet been able to achieve a market share that is comparable to those of the larger providers without significant acquisition. The level of market concentration has therefore remained relatively stable.

22 © GfK NOP Ltd, Financial Research Survey (FRS), 6 months ending December 2013, 17,830 adults interviewed
23 Moneyfacts Treasury Reports, UK Savings Tends, November 2013
24 © GfK NOP Ltd, Financial Research Survey (FRS), 6 months ending December 2013, 17,830 adults interviewed;
25 The estimates of market concentration use the Herfindahl-Hirschman Index (HHI) measure of market concentration. This is calculated by adding together the squared values of the percentage market shares of all firms in the market. It therefore takes account of the different sizes of market participants as well as their number. The Office of Fair Trading's Merger Assessment Guidelines (September 2010, OFT1254) indicate that a market with an HHI exceeding 1,000 may be regarded as concentrated. The HHI scores for the cash savings market indicate that it is around, but not markedly above, that threshold.

Provider strategies

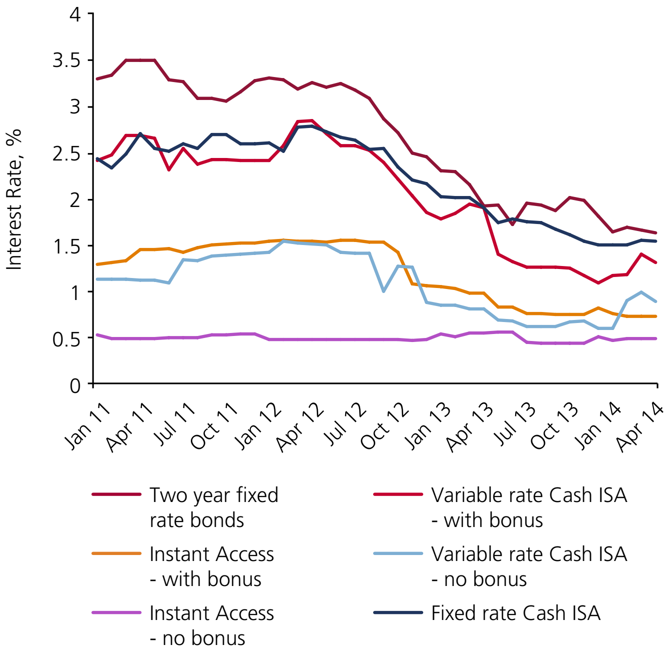
Firms' strategies in relation to savings are largely driven by their wider balance sheet management aims. That is, they do not focus on simply attracting the largest possible in-flow of retail deposits but rather will assess their need for deposits (and at what price) in the context of their lending strategy. In doing so, a provider will consider various factors including the margins it can achieve, capital and liquidity requirements, and the availability of alternative funding sources.

A number of external factors will influence the volume of savings a firm wishes to generate and the interest rate it has to offer. Such factors include the competitive landscape, macroeconomic factors, cost and availability of alternative funding sources and regulatory and government initiatives. Factors of particular relevance during the period of this study include:

- The Bank of England base rate, which has been at a historic low of 0.5% since March 2009.
- The Funding for Lending Scheme (FLS), which was introduced by the Bank of England and HM Treasury to incentivise providers to boost their lending to the UK real economy by providing them with funding at price and quantities linked to their lending performance. The launch of this scheme made firms less reliant on funding from retail deposits.

These external factors have led to a fall since mid-2012 in the average interest rates that providers have offered to savers (see Figure 4)[26] as well as a reduction in the spread of different interest rates available on similar types of accounts.

Figure 4: Changes in average interest rates on various types of cash savings products over time



Source: Bank of England, 2014

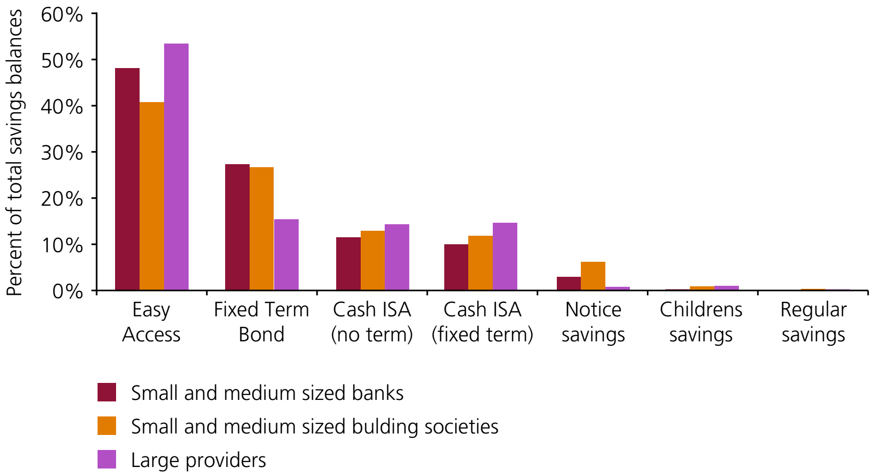
26 Data taken from that available on the Bank of England website. The average interest rates represent the average interest rates offered by firms in the Bank of England sample.

Firms have a number of tools they can use in order to manage the volume of savings balances they hold on their balance sheet. For example, in the short term, changing the interest rate on the savings accounts offered in the market (and so changing the position in 'best-buy' tables or on comparison websites) can have a significant effect on the in-flow of retail deposits firms are able to generate (as those engaged and active consumers 'chase' the best available rates). Firms can also make other more extensive changes, for example to their distribution channels, their product range (including the number of open and closed accounts), and developing the functionality of online account management systems.

Within the cash savings market, there is variation in the wider strategies providers have adopted:

- **The product types marketed or focused upon.** Data from our sample of firms shows that large providers have the highest proportion of their total balances in easy access accounts, whereas small and medium sized banks and building societies hold a greater proportion of their balances in fixed terms bonds relative to the large providers (Figure 5 below).

Figure 5: Percentage of total savings balances held in different types of accounts by type and size of firm



Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

- **The range of products offered, and the frequency with which new products are introduced into and then withdrawn from the market.** As at 31 December 2013, the 21 providers in our sample had around 400 easy access products that were open and just over 2000 that were closed to new customers. Our data shows that firms in our sample launched 300 new easy access products in 2013.

  A small number of the firms in our sample are extensively simplifying the number of products they offer. For many this includes moving all customers with balances in old accounts which are closed to a reduced range of new cash savings products. One firm which completed a simplification process reduced the number of cash savings products it offered from 90 to eight. Such simplification processes can generate operational benefits to firms in terms of account administration and management, whilst also having the potential to be of benefit to consumers.

- **The use of promotional offers, conditional or loyalty rates.** The use of bonus (or so-called 'teaser') rates, i.e. accounts offering a 'bonus rate' of interest for a limited period of time (usually 6-12 months), has fallen. Fewer than 5% of accounts available on the market in November 2013 offered introductory bonus rates compared to 9% in October 2011.[27] However our data shows that nearly half (48%) of total easy access balances are held in accounts which offer, or in the past have offered bonus rates. In addition, a number of firms use conditional rates where the interest rate paid depends on some action by the customer (for example making a certain number/amount of deposits or making no/a certain number of withdrawals). If the customer does not undertake the specified action their rate usually drops substantially. Lastly, some firms use 'loyalty rates' and offer higher rates of interest to customers holding other products with the firm (such as a current account) or who have banked with the firm for a number of years.

- **The service levels provided.** Firms' offerings in terms of ways in which customers can manage their accounts also vary. The large providers in the main offer branch, telephone, post and online access. A number of the small and medium sized banks do not have a branch presence or their branch presence is not on the same scale as that of the large providers but instead offer a comprehensive internet banking proposition. In contrast, some of the small and medium sized building societies' accounts could only be managed in branch or via post therefore restricting product access to local residents or those prepared to make a journey in order to service their account.

- **Pricing.** The interest rate a firm offers on its savings accounts (and so their position in 'best-buy' tables) can have a significant effect on the in-flow of retail deposits they are able to generate (as those engaged and active consumers 'chase' the best available rates). A number of firms expressed concern about placing themselves too near the top of best-buy tables as the inflow of deposits they would expect to follow would stretch them operationally. In addition, the higher the interest rate, the more likely the firm is to attract a higher proportion of 'rate chasers' whose deposits were likely to be a less stable form of funding, as these consumers are more likely to switch to a higher rate product in the short and medium term.

- **Marketing and consumer segmentation.** Firms seek to attract different sorts of customers in marketing their products. Many of the large providers offering current accounts often focus on sales to their existing current account customers in order to increase their 'share of the wallet.' A number of the small and medium sized banks seek to attract rate chasers in the hope of keeping them by continuing to offer them market leading rates over longer periods of time.

How cash savings products are regulated

The provision of cash savings products falls within our regulatory remit because we have responsibility for regulating the conduct of firms who accept retail deposits.[28]

All firms wishing to accept retail deposits (such as savings) must be authorised by the Prudential Regulation Authority (PRA) or benefit from an European Economic Area (EEA) passport, and are regulated by the FCA in relation to conduct.[29]

In their provision of cash savings products, regulated firms must have regard to the FCA's eleven Principles for Businesses, the conduct of business requirements of the Payment Services

27 Moneyfacts Treasury Reports, UK Savings Trends, November 2013
28 Excluding NS&I – see footnote 13.
29 Some limitations apply in relation to incoming EEA firms.

Regulations (PSRs) and the FCA's accompanying approach document, and the Banking Conduct of Business Rules (BCOBS) alongside other more general consumer protection legislation.

The Principles for Businesses are a general statement of the fundamental obligations of firms under the regulatory system. In particular they state that:

- a firm must pay due regard to the interests of its customers and treat them fairly (Principle 6) and
- a firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading (Principle 7)

Some savings accounts may be considered 'payment accounts' within the scope of the PSRs, for instance if they have some payment functionality. The BCOBS rules are complementary to the PSRs and apply to retail deposit taking, except where this is contrary to the provisions of the Payment Services Directive:

- when the account is a payment account, BCOBS only applies when there is no corresponding provision in the PSRs
- BCOBS rules and guidance apply to all non-payment accounts

BCOBS contains rules and guidance on a number of matters including on communications with customers, financial promotions and post-sale conduct. The PSRs contain some similar conduct of business provisions primarily around the provision of information to the consumer.

In a similar way to BCOBS, there may be circumstances in which the treating customers fairly principle is limited by the harmonised conduct of business rules in the PSRs or made under the Electronic Money Directive.

Firm compliance with BCOBS rules is not a focus of this market study, but we will deal with any rule breaches encountered during the study by following our usual procedures. While we will not focus on firm compliance with existing rules, we may consider whether making changes to the existing rules could help promote effective competition in the interests of consumers.

Deposit-takers must also comply with a range of prudential requirements of the PRA. We discuss some aspects of the prudential regime in Chapter 6.

Recent regulatory developments

OFT Cash ISA market study

In 2010, Consumer Focus made a super-complaint to the Office of Fair Trading (OFT) raising concerns that transferring Cash ISAs took too long and there were arbitrary rules preventing transfers in to some of the most attractive accounts, interest rates were not sufficiently transparent and consumers were being attracted by temporary bonus rates which subsequently fell substantially.

The OFT considered these concerns and made a number of recommendations. These interventions were aimed at increasing consumers' awareness of their interest rate and making them more confident in the transfer process. The main initiatives were that:

- the maximum transfer time should be reduced from 23 to 15 working days
- industry should consider an electronic transfer system
- interest should be received during the entire transfer process
- customers should get their new interest rate no later than 15 working days after requesting a transfer
- interest rates should be published on Cash ISA statements
- consumers should receive notification of bonus rate expiry on all types of cash ISA

In 2014 the OFT evaluated the impact of their recommendations on switching, transparency and interest rates.[30] It found these recommendations have had a substantial and positive impact on the transfer process as transfer times have more than halved since the intervention and interest is now paid for the entire transfer process. In addition, a large number of providers have adopted an electronic transfer system. However the impact on consumers' awareness of their interest rate or actual switching was unclear.

Changes to the ISA rules

Changes to ISAs were announced in the March 2014 Budget with the introduction of New ISAs (NISAs).[31] Consumers could previously save £5,760 per year in a Cash ISA and £11,520 per year in a stocks and shares ISA. However, as of 1 July 2014 consumers are able to save a new higher allowance of £15,000 either in cash, stocks and shares or any combination of both.

CMA work on retail banking

The Competition and Markets Authority (CMA) have a programme of work underway on retail banking, including a market study into banking for small and medium sized enterprises (SMEs) and an update to the OFT's 2013 review of personal current accounts.[32]

There are some similarities between the conditions for competition in these markets with the market for cash savings products, including a large degree of overlap in providers active in these markets. However there are also many differences and so the work on these markets is being taken forward separately.

The FCA will continue to work closely with the CMA across all retail banking work.

30 OFT (2014) Evaluating the impact of the OFT's 2010 Cash ISAs: Response to super-complaint by Consumer Focus http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/reports/Evaluating-OFTs-work/OFT1523eval.pdf

31 See HM Treasury (2014) Fact sheet on the New ISA (NISA):
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293746/Fact_sheet_ISA_8.pdf

32 See Competition and Markets Authority (2014) Competition and Markets Authority announces programme of work on banking:
https://www.gov.uk/government/news/cma-announces-programme-of-work-on-banking

4. Consumer behaviour

Engaged and active consumers are key to driving effective competition in the cash savings market. Consumers drive effective competition by:

- shopping around effectively, by comparing both the interest rates and quality of the service propositions offered by firms and
- monitoring the competitiveness of the products they already hold and switching to get the deal that best satisfies their needs

We have found that consumer engagement with savings products varies greatly:

- at one extreme are the so called 'rate chasers', a cohort of consumers who pay close attention to the products and rates being offered and who switch regularly to increase the interest they receive on their savings
- at the other, there is a group of consumers that pay little attention to the accounts on offer and who, for long periods, will not consider whether they could earn a higher return by moving to a different account
- in the middle are those consumers who will review the accounts they hold and consider switching every few years

The likelihood of a consumer being engaged and active in the cash savings market depends on a number of factors including:

- the balance a consumer holds, and how much interest they can gain by switching
- a consumer's awareness of the interest rate they receive on their account and that offered on other accounts in the market
- a consumer's perception of the time and effort switching involves, and their preference to devote that time to other things and
- the consumer's preference for managing all or most of their financial products, including savings accounts and PCAs, through one branch or one internet banking system

We find that while some consumers in the market switch regularly (one survey estimates 24% of consumers had switched a savings account from one provider to another in the past three years[33]), most have not switched their provider for many years.

33 FI (2013) UK Savings Council, Annual Research Survey of around 2000 consumers, provided by Aldermore in response to an information request

This chapter outlines our interim findings on how effective consumers are at driving competition in the cash savings market. These emerging findings are based on conversations with consumer groups, firms, trade bodies, and our review of the data and consumer research submitted by firms. We have commissioned our own consumer research which will provide further evidence on a number of the points discussed in this Chapter and which will inform our final findings.

In this chapter, we discuss:

- how consumers can drive effective competition in the market and
- shopping around and switching in the market, including estimated switching rates and the drivers to switch or stay with an existing provider

How can consumers drive competition in the cash savings market?

To drive effective competition in the cash savings market consumers have to be both engaged and active. Consumers drive effective competition by:

- shopping around effectively, by comparing both the interest rates and quality of the service propositions offered by firms, and
- monitoring the competitiveness of the products they already hold and switch to get the deal which best satisfies their needs

Engaged and active consumers will incentivise firms to compete, allowing those providers that offer good deals to grow their market shares. Savings account providers will only face a material competitive constraint from providers that offer similar products with higher interest rates and/or better quality service propositions if consumers are aware of these offers and consider them when shopping around for a new account.

In many markets, the active consumers help to protect the interests of the more passive consumers and drive competition in the market as a whole. However, shopping around and switching by active consumers will be less effective at driving competition if providers are able to segment customers and price discriminate by offering high prices to active consumers and lower prices to passive consumers.

Based on the available evidence, we have found that some savers do shop around and switch regularly. However, we have also identified several ways in which consumers may not be driving effective competition. These are discussed in more detail below and cover the following:

- the extent to which savings account choices are driven by consumers' existing relationships with savings account providers
- the extent to which consumers assess the competitiveness of their existing savings accounts, and
- consumer switching behaviour, including reasons for switching and not switching

Analysing switching in the market

Switching in the market for cash savings products can take many different forms, for example:

- consumers can switch to an account offered by a different provider or to a different account offered by their existing provider
- consumers may move money from one account to another, but may not close the account that no longer holds a significant amount of money
- some consumers may transfer money from one account to another, but retain some funds in the old account if they intend to use it in the future, and
- consumers may add a new account and transfer some money from another account instead of 'switching' to a different account, potentially blurring the boundaries between what constitutes the purchase of an additional complementary product and the practice of switching funds between substitute products

Firms have told us that because of this complexity, there is no established industry level measure of switching. Instead, firms monitor a range of measures, including internal and external flow of funds between different accounts, internal account opening and closure data and balance attrition after key events such as bonus rate expiry, the maturity of a term account, and the introduction of a competitor's product.

Given these difficulties, during the course of this study, we will take account of a number of different switching measures. We will also collect further evidence from firms on measures of switching in relation to specific products (e.g. balance attrition after bonus rate expiry) in the second phase of the study.

Estimated switching rates in the market

The market research we have seen suggests that a relatively significant proportion of customers switch fairly regularly. However, the research also identifies other cohorts of consumers, including a significant proportion that has not switched their accounts for a long period of time:

- Estimating switching is difficult and therefore the available estimates vary. According to one survey of around 2,000 consumers in 2013, 24% of consumers had switched a savings account from one provider to another in the last three years, whilst 76% of consumers had not.[34]
- Our analysis of firm data shows that significant total balances are still held in savings accounts that were opened many years ago and now receive relatively low interest rates (see Figures 6 and 7).
- A significant proportion of customers with relatively large balances opened their savings accounts several years ago. GfK estimates that of easy access accounts holding balances of more than £50,000, 62% were opened more than two years ago, and 39% were opened more than five years ago (Figure 8).[35]

34 RFI (2013) UK Savings Council, Annual Research Survey, provided by Aldermore in response to an information request

35 © GfK NOP Ltd, Financial Research Survey (FRS), 12 months ending December 2013, 35,737 adults interviewed

Figure 6: Distribution of number of easy access accounts and total balances in easy access accounts by age of individual accounts

	Up to 2 years ago	2 to 5 years ago	More than 5 years ago
% of total number of accounts	19%	21%	60%
Total balances	£157bn	£78bn	£106bn

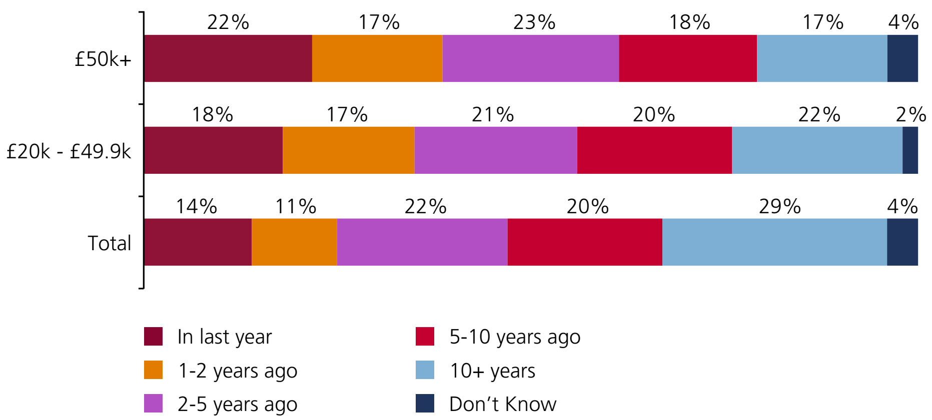
Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

Figure 7: Percentage of total number of accounts and total balances by age of account for no-term Cash ISA accounts

	Up to 2 years ago	2 to 5 years ago	More than 5 years ago
% of total number of accounts	33%	29%	38%
Total balances	£37bn	£23bn	£16bn

Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

Figure 8: Length of time since easy access accounts were opened by account balances



'Total' relates to balances in all balance bands, however we have also included length of time since easy access accounts were opened for the high balance bands to show that a significant proportion of large balances are held in accounts that were opened many years ago.

Source: © GfK NOP Ltd, Financial Research Survey (FRS), 12 months ending December 2013, 35,737 adults interviewed

This means that a significant proportion of customers do not switch and remain with the same account for long periods of time. Although the proportion of consumers with older easy access accounts decreases to some extent as balances increase, a large proportion of consumers with high balances do nevertheless appear to retain accounts for over 5 years.

As set out earlier, switching can take many forms including switching to a different account offered by an existing provider. Consumers do not always have to switch to a different provider to benefit from a better rate, as their existing provider may already offer the same type of account with better terms. Consumer surveys we have reviewed suggest that it is just as common for consumers to switch between accounts with the same provider as it is to switch to a different provider.[36] However, our analysis of firm data suggests that significant balances are still held in older accounts even where providers offer different accounts with better interest rates (Figures 6 and 7).

Why some consumers switch?

As outlined in the beginning of the chapter, we have found that there are different types of consumers in the cash savings market and that their behaviour varies greatly:

- At one extreme are the so called 'rate chasers', a cohort of consumers who pay close attention to the products and rates being offered and who switch regularly to increase the interest they receive on their savings.
- At the other, there is a group of consumers that pay little attention to the accounts on offer and who, for long periods, will not consider whether they could earn a higher return by moving to a different account.
- In the middle are those consumers who will review the accounts they hold and consider switching every few years.

We found that most consumers who switch do so to get a higher interest rate. One survey found that 59% of those who switched their 'primary savings accounts' in the last three years did so because of the interest rate or expiry of a bonus rate. 8% switched because of customer service and 6% because they switched their PCA provider.[37]

This survey also estimates that about half of those who switched in the last three years can be described as 'rate chasers' as they placed high importance on getting the best interest rate in the market.[38] The 2012 issue of the same survey shows that rate chasers tend to make higher average monthly deposits, earn higher interest rates and have a greater awareness of interest rates on their accounts.[39]

Why some consumers do not switch?

We have found that a significant proportion of consumers have not switched their savings accounts for long periods of time. There appear to be four main factors that reduce consumer willingness to switch:

- consumers perceive that switching costs are significant

36 © GfK NOP Ltd, Financial Research Survey (FRS), 6 months ending December 2013, 17,830 adults interviewed: GfK estimates that in 2013 3.1% of savings accounts were switched to a different provider, whereas 2.8% switched to different savings products offered by the same brand.

37 RFI 2013 UK Savings Council Report, provided by Aldermore in response to an information request.

38 RFI 2013 UK Savings Council Report, provided by Aldermore in response to an information request. According to the survey, rate chasers are defined as customers who have stated that they place high importance on getting the best interest rate in the market and have switched at least once in the last three years.

39 RFI 2012 UK Savings Council Report, provided by HSBC in response to an information request: A significantly higher proportion of rate chasers knew exactly what their rate was compared to other groups of consumers.

- consumers are not aware of the interest rates on their accounts and in the market
- the gains from switching are low, given the low interest rate environment and/or balances in the accounts, and
- consumers value the existing relationship with their provider, including the convenience arising from keeping most of their financial products in one place, over the interest rate

We discuss these in turn below.

Switching costs

Switching costs refer to the real or perceived costs that are incurred when changing accounts but which are not incurred by retaining the existing account. Switching costs may take many forms including:

- the time and effort involved in searching for a new product and/or provider
- the time and effort involved in switching to a new product and/or provider (for example, having to provide documentation)
- the cost of learning how to navigate a new provider and its branches/internet banking service
- any charges incurred from exiting the current product

Switching cash savings products is relatively easy compared to other products such as mortgages, but the overall process can still be time-consuming. Consumers can switch either to a new savings account provider or to a new product offered by their existing provider (if their existing provider offers a similar product with better terms).

To switch to a new provider, a customer needs to consider which type of account best suits their needs, which provider offers the best deal for them, and open a new savings account through their preferred channel (though some channels may not be available for all products or offered by all providers).[40] When opening a new account, consumers may be asked to provide additional documentation such as proof of their address or identity.[41]

The customer then transfers the funds from the old provider using one of a variety of channels such as in branch, online or mobile banking or over the phone. In many cases, switching to a new product offered by an existing provider is easier and less time consuming than switching to a new provider, as the existing provider already holds information about the customer. We will collect further information on the complexity of the account opening process in the second stage of the study.

For ISAs, the switching process is more time consuming, as the customer would generally need to complete a form to transfer the previous years' balances to the new ISA. Following the OFT 2010 recommendations on improving the Cash ISA switching process, transfer times have been reduced and an electronic transfer system adopted by many providers.

40 For example, some accounts can only be opened and managed in a branch.

41 Verifying a customer's identity is a requirement under the Money Laundering Regulations 2007. Firms have some flexibility in deciding how they do this, including by reference to certain documents like passports or driving licenses, or electronically. Most follow guidance published by a group of financial sector trade associations, the Joint Money Laundering Steering Group (JMLSG). The JMLSG Guidance is at www.jmlsg.org.uk

However, in its review of February 2014, the OFT did not find that these improvements had had a clear impact on switching rates, as there still appears to be a core of cash ISA consumers who have never switched or considered switching.[42]

While switching costs in the cash savings market appear relatively low, consumer research suggests that many consumers still cite the perceived difficulty and inconvenience as the primary reason for not switching. Research submitted by one major provider highlighted perceived 'hassle' as the leading factor in its Cash ISA customers' decisions not to switch to an account that provided a better rate.[43]However, this research was completed less than six months after the first tax-year-end season where the electronic cash ISA transfer system had been in operation.[44] Over time, the introduction of electronic transfers may change customers' perception of ISA transfers and increase confidence in the process.

If consumers perceive that switching is more difficult than is actually the case, it will have a negative impact on switching rates. Furthermore, behavioural biases (for example, procrastination arising from a present bias)[45] will lead to consumer inertia even where switching costs may be relatively low. This is particularly important for products paying initial time limited bonus rates, as consumers may be overconfident about the likelihood of them switching at the time of purchasing the product. We will investigate these issues further prior to our final report.

Consumer awareness of interest rates

Consumers who are not aware of their interest rate and interest rates offered in the market are less likely to shop around and switch. Consumer awareness and attention is particularly important where the interest rate on their account has been cut or a bonus rate has expired, and the consumer has been notified by the firm.

Consumer research suggests that a large proportion of consumers do not know the interest rate paid on their accounts. A survey of around 2,000 consumers[46] found that:

- only 22% of savers knew exactly what their rate was on their main savings account, compared to 41% of consumers who were not sure
- 29% of consumers were not aware of whether a variable or a fixed rate applied to their main savings account, and
- 34% of consumers said that they do not check competing interest rates

42 OFT (2014) Evaluating the impact of the OFT's 2010 Cash ISAs: Response to super-complaint by Consumer Focus http://webarchive.nationalarchives.gov.uk/20140402142426 http://www.oft.gov.uk/shared_oft/reports/Evaluating-OFTs-work/OFT1523eval.pdf

43 The research was completed in October 2013. 41% of variable rate ISA customers and 36% of fixed rate ISA customers believed that they could get a better deal elsewhere for their type of ISA, but from these 63% of variable rate ISA customers and 52% of fixed rate ISA customers had not switched either because it was more convenient not to or because it would involve too much effort and hassle. In comparison, only 6% said that switching is not worth it with interest rates at such low levels, and 5% indicated that switching would be 'too costly'. This information was provided by a large provider in response to an information request. The information was prepared by a market research agency.

44 The BACS electronic cash ISA transfer system was launched on 22 October 2012. According to the OFT review, as of 27 January 2014 this system was used by 47 savings brands, which covered over 80 per cent (by value) of the market. (Source: OFT (2014) Evaluating the impact of the OFT's 2010 Cash ISAs – see footnote 46)

45 The academic literature identifies 'behavioural biases' as specific ways in which normal human thought systematically departs from being fully rational. Biases can cause people to misjudge important facts or to be inconsistent. For example, present bias is characterised by people having disproportionate preferences for immediate gratification, overvaluing the present over the future. Procrastination arising from behavioural biases can lead to consumers postponing indefinitely all tasks that require even little effort, such as switching a savings account. See FCA (2013) "Applying behavioural economics at the Financial Conduct Authority."

46 RFI 2013 UK, Savings Council Report, provided by Aldermore in response to an information request.

Some of this lack of awareness could be explained by consumers not having significant balances in their account and thus not earning significant interest regardless of the interest rate paid on their accounts. However, it could also be driven by behavioural biases, particularly where information about interest rates is not easily accessible or the notifications are not effective enough at attracting consumers' attention and encouraging consumers to consider switching. We are currently carrying out consumer research to investigate further the drivers of consumer engagement.

In the final report, we will also explore further whether this lack of awareness of interest rates is partly due to the current low interest rate environment.

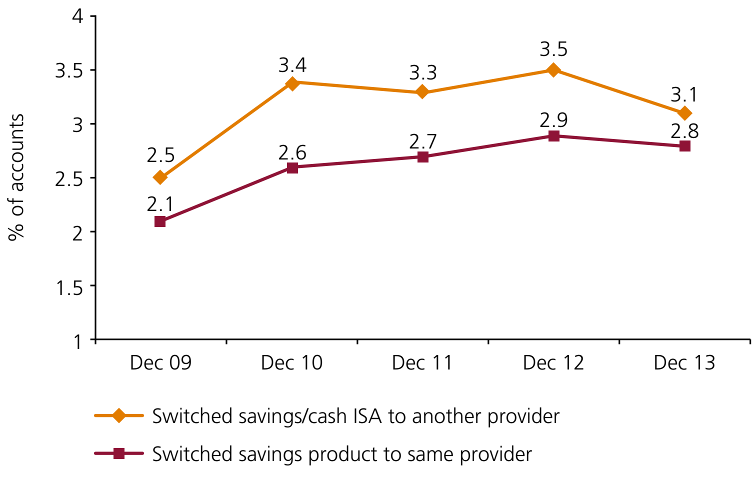
Gains from switching

Many providers have argued that the lack of switching by some consumers can be explained by the low expected benefits from switching, given that many consumers have relatively low balances and the current interest rates are very low.

Consumer research finds that the current low interest rate environment is at times mentioned as a reason for not switching. For example, a survey from 2010 found that 23% of consumers with balances exceeding £5,000 were inactive, and that 35% of these inactive customers were not adding to or switching their savings because they were 'put off by low interest rates'.[47] The reviewed consumer research does not provide clear evidence on what minimum monetary benefits are necessary to motivate consumers to switch, but we will analyse this further in the final report.

GfK data on switching rates since 2009 (Figure 9 below) shows that switching activity did not decrease significantly in the last few years following the reduction in average interest rates offered in the market (see Figure 4 in Chapter 3). While switching activity is likely to increase as interest rates rise, we expect that a significant proportion of customers will remain inert due to the reasons outlined in this report. We will investigate this issue further in the final report.

Figure 9: Percentage of savings accounts switched in the preceding 12 months for the period Dec 2009 – Dec 2013.



Source: © GfK NOP Ltd, Financial Research Survey (FRS), 6 months ending December 2013, 17,830 adults interviewed

47 This information was provided by a large provider in response to an information request. The information was prepared by a customer research agency.

The importance of existing relationships in driving savings account choices

Consumer research shows that consumers' existing relationships (especially with their PCA provider) have a significant influence on where they choose to open new savings accounts and on their switching behaviour.

We found evidence that a significant proportion of consumers are not necessarily considering a broad range of providers when opening a new account or considering switching. For example, a GfK survey of 60,000 savers found that:

- 82% of savings accounts opened in 2013 were opened with a provider with whom the customer had an existing relationship
- 57% of accounts were opened with the customer's PCA provider and 30% with a provider with whom the customer already held a savings account[48]

One of the most important drivers behind these choices is likely to be convenience, as it is easier to manage several retail banking products through a single branch or online banking facility than across different providers. The ease with which funds can be transferred between accounts within the same provider compared to the speed of transfers between providers is likely to be one aspect of this convenience. Sending funds to a different provider necessarily involves the consumer having to input more information about the payment, and it may take longer. However, the advent of payment systems, such as Faster Payments, under which funds will generally be available in the receiving account within minutes will help address some of the inconvenience.[49]

While PCA providers do appear to be effective in attracting their existing PCA customers who are seeking to open savings accounts, they told us that they do not hold all of their PCA customers' savings. Many consumers do shop around and often save with providers other than their PCA provider. We will analyse this further in the final report once we have seen the results of our consumer survey.

Furthermore, consumers are more likely to shop around for products which would typically hold higher average balances, such as fixed term bonds and cash ISAs. Consumers with higher balances may choose to spread their savings across a number of providers to ensure they do not exceed the £85,000 Financial Services Compensation Scheme (FSCS) deposit protection limit which applies per firm authorised to carry out a regulated activity by the FCA or PRA.

48 © GfK NOP Ltd, Financial Research Survey (FRS), 6 months ending December 2013, 6,826 adults interviewed

49 Although not for customers wishing to transfer large balances as the maximum value threshold for payments that can be processed through Faster Payments is £100,000, and individual banks may impose lower limits. See: http://www.fasterpayments.org.uk/about-us/benefits-faster-payments

5. Firm conduct

The evidence we have observed to date suggests that, overall, providers offer lower rates to customers who stay with them for longer. For example, our analysis suggests that at the end of 2013 the average interest rate on easy access accounts opened in the last two years was around 0.8%, but that the equivalent rate for accounts that were opened more than five years ago was less than 0.3%.[50] While some consumers may switch away in response to the lowered rates, a large proportion of consumers do not.

Providers use different pricing structures that can enable them to offer these higher rates to new customers and lower rates to those that remain with the same account for longer periods of time. In particular, providers can:

- offer time limited bonus rates on the actively marketed accounts, or
- introduce new products paying higher rates, while at the same time also withdrawing existing products from the market and reducing interest rates over time

Such strategies, including the offer of bonus rates, are common in many markets, and can help to encourage switching. However, in circumstances where consumers may be unable to identify whether and to what extent providers tend to decrease the interest rates paid to existing customers, and are not aware of and responsive to the rate reductions, there are grounds for concern that competition will not work to deliver competitive rates overall.

Our initial analysis also suggests that there is a strong link between the sale of PCAs and savings accounts, particularly easy access products. This allows the providers with the largest share of the PCA market to retain in aggregate a significant easy access market share despite, on average, paying interest rates that are materially lower than those offered by the smaller PCA providers. This may suggest that consumers' preference for convenience is helping to protect the largest PCA suppliers from vigorous competition in the supply of easy access products.

Consumers need information in order to assess their options, choose the product or provider which best suits their needs and ultimately drive effective competition between firms. Providers' communications with their account holders provides one way of providing consumers with such information. We have though observed variation in the clarity and content of information shared in these communications.

This chapter outlines our interim findings in relation to how firms compete in this market. The emerging findings are based on discussions with firms, trade bodies, consumer groups, and our review of firm data and strategy documents submitted by firms.

50 Average interest rates weighted by total balances in the accounts.

Providers' overall savings strategies were considered in Chapter 3. This Chapter focuses on:

- firms' pricing in relation to newer and older accounts, in the context of the consumer behaviour described in Chapter 4
- the relationship between the supply of cash saving products and PCAs, and
- how providers disclose product information to consumers

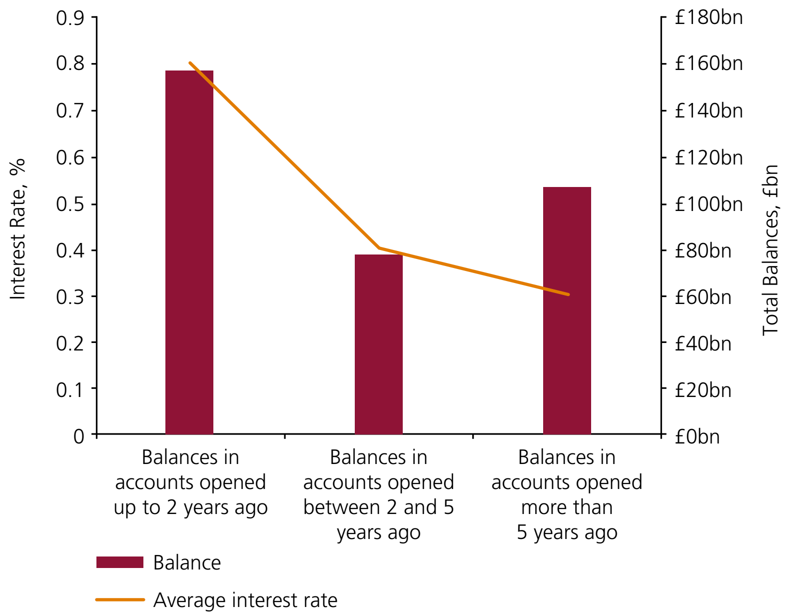
Pricing trends

In Chapter 4 above, we outlined that while some consumers regularly shop around and switch, there are also a larger number of consumers that rarely consider switching and remain with an account for long periods of time.

The evidence we have observed suggests that in response to this consumer behaviour some providers will offer relatively high rates to attract new customers, but are then able to offer lower interest rates to those consumers who have held easy access and no term cash ISA accounts for longer periods of time. While some consumers may switch away, particularly after the rates have been lowered, a large proportion of consumers remain with the provider.

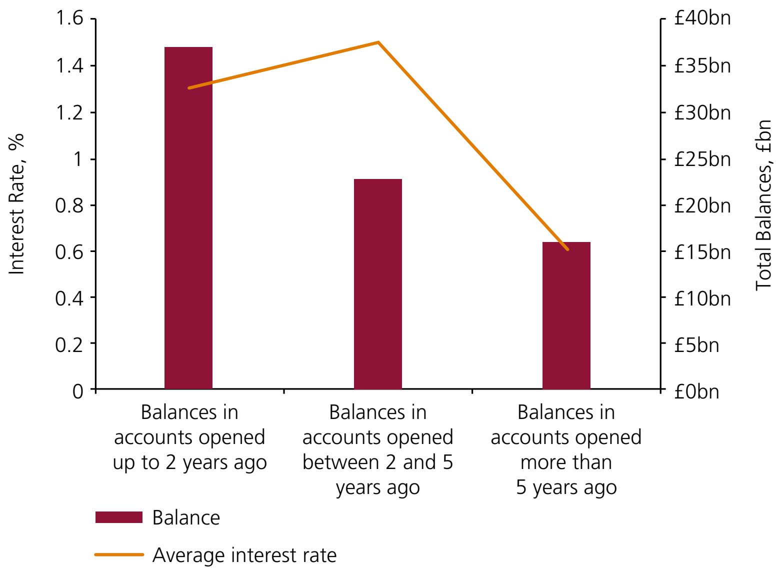
Figures 10 and 11 below illustrates this general trend in relation to easy access and no term Cash ISA products (including those offering bonus rates):

Figure 10: Total balances and average interest rates (weighted by balance) for easy access accounts by length of time account opened



Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study[51]

Figure 11: Total balances and average interest rates (weighted by balance) for no-term Cash ISA accounts by length of time account opened



Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study[52]

51 For easy access accounts, we were able to consider 21 of 26 brands in our sample, and 17 had accounts opened more than 5 years ago.

52 For easy access cash ISA accounts, we were able to consider 20 of 26 brands in our sample, and 14 brands had accounts opened more than 5 years ago.

As would be expected, the evidence submitted by firms indicates that the large providers have a greater proportion of balances held in accounts opened a few years ago than recent entrants. For example, Figures 12 and 13 below show that for large providers 32% of easy access balances and 21% of no term Cash ISA balances are in accounts opened more than five years ago. In contrast, for small and medium sized banks (some of which are recent market entrants) 27% of easy access balances and 6% of no term Cash ISA balances are in accounts opened more than 5 years.

Building societies have the same proportion of balances in easy access accounts opened up to two years ago as the large providers, but they tend to have a smaller share of balances in easy access accounts opened more than five years ago. However, building societies have a much higher proportion of balances in cash ISA accounts opened more than five years ago (43%) than the other two types of providers.

Figure 12: Easy Access Savings Accounts

	Balances in accounts opened:		
Type of provider	**Up to 2 years ago**	**2 to 5 years ago**	**More than 5 years ago**
Large Providers	46%	23%	32%
Small and medium banks	53%	19%	27%
Small and medium building societies	46%	30%	23%

Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

Figure 13: Cash ISA (no term)

	Balances in accounts opened:		
Type of provider	**Up to 2 years ago**	**2 to 5 years ago**	**More than 5 years ago**
Large Providers	49%	30%	21%
Small and medium banks	63%	32%	6%
Small and medium building societies	26%	31%	43%

Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

Some small and medium sized banks have explained that to grow or maintain their market share and to attract and retain new customers, they must offer very competitive rates. In contrast, because some of the large providers retain higher balances in older accounts, and have a customer base that is less sensitive to rate changes (see Chapter 6 below), they face less pressure to pay higher rates to those that remain with the same account for long periods of time. For easy access accounts, the data we have considered supports this analysis, and suggests that the large providers pay average rates of 0.4% on accounts that are between two and five years old, whereas the average rate paid by smaller banks is 1.3%. However, the same trend is not observed in relation to no term cash ISAs, with both large and small banks paying similar rates in relation to accounts that are between two and five years old (1.7% for larger banks and 1.6% for the smaller banks).

The evidence we have observed to date does not suggest that the payment of lower rates to older accounts is the consequence of higher costs in the supply of older accounts. We understand that the direct costs of providing a cash savings account fall in to three main categories and that in each case costs do not generally increase in line with account age:

- account opening costs (including acquisition and the cost of opening accounts) - we understand that the cost of opening an account and maintaining an account are generally fixed and do not typically vary with the account balance or number of transactions

- account maintenance costs (such as annual statements and processing changes of address)

- transaction costs (such as transfers in and out) - transaction costs vary with the number of transactions on the account. An account with a large number of transactions is likely to be more costly to operate, compared to an account with few or no transactions. Based on the evidence seen to date, we understand that easy access accounts are generally more costly to operate compared to accounts with restrictions on the number of transactions.

Pricing strategies

Providers offering better terms (in this case interest rates) to new customers than to existing customers is not unusual or necessarily harmful to consumers and competition. Offering higher rates can help firms, particularly new entrants and smaller players, to attract new business and thus increase switching in the market. It also gives firms more flexibility to respond to changes in the market environment and their business strategies. However, we are concerned that such practices may be harmful to consumers where there is a lack of transparency and consumers are not engaged.

From the evidence we have reviewed so far, we have identified that firms use two main strategies in order to pay different interest rates on the same type of product. Most commonly, firms:

- offer introductory bonus rates on the actively marketed products that revert to a lower rate after a set period of time or

- launch new high interest rate products while at the same time withdrawing the existing products from sale to new customers, and potentially also reducing the interest rates paid to existing customers over time.

We discuss whether each of these practices can harm competition in turn below.

Bonus rate products are used to attract consumers with interest rates that are typically significantly higher than the rates paid on 'flat rate' products. The 'bonus rate' is generally introductory and after it expires the product usually pays a much lower interest rate.[53]

During the course of the study, we have heard a variety of views on the pros and cons of bonus rate products. We have heard that bonus rates are beneficial because:

- bonus rates allow firms to offer high rates for limited periods of time and thus help firms attract deposits quickly to meet funding needs

53 Although any variable rate product may offer a higher interest rate at launch than is offered subsequently, bonus rate products are marketed to explicitly include the payment of a bonus rate of interest over a specified period of time.

- bonus rates increase switching, as consumers will be more engaged if they can gain more from switching, but it would not be possible to offer comparable rates if the provider had to offer the same rate to all its customers

Some therefore argue that bonus rates are a sign of competition between providers, and have ensured that the top rates in the market remain relatively high even in the current low interest rate environment.

However, others have argued that bonus rates are simply used to induce consumers to open an account, with the intention of then exploiting consumer inertia, as consumers will be unlikely to switch after the bonus rate expires. Furthermore, some argue that presentation of bonus rate products has at times been insufficiently clear, such that many consumers did not realise that their interest rate would decrease at the end of the relevant bonus rate period.

Some providers, including RBS, NatWest and HSBC, have recently announced they will no longer offer bonus rate products.

Product replacement refers to the process of frequently introducing new accounts that supersede existing on-sale products. This can at times enable providers (should they chose to) to pay lower interest rates to consumers of older accounts while offering new customers higher rates.

The strategy appears to provide some explanation for the proliferation of open and closed products offered by provider. For example, as at 31 December 2013, the 21 providers in our sample had around 400 easy access products that were open and just over 2000 that were closed to new customers. Our data shows that firms in our sample launched 300 new easy access products in 2013. However the number of products offered varied significantly between providers.

This product proliferation may be confusing for consumers when comparing their savings accounts with those available in the market (which may be newer 'versions' of the same account offering higher rates).

To the extent that these product replacement strategies facilitate the payment of higher rates initially, followed by lower rates in the years after launch, the advantages and disadvantages from a competition perspective are similar to those highlighted in relation to bonus rate products. We do though note the following differences:

- with product replacement, it is far more difficult for consumers to assess at the point of sale whether it is their provider's strategy to gradually make their rates less competitive over time, for example, by launching new products with better rates and/or reducing the rates paid on their existing accounts; in comparison, the expiry of the bonus rate is generally clearly communicated to consumers before opening the account

- the rates paid on bonus rate products may fall more quickly than when products are replaced, but we will consider this further

The links between savings products and PCAs

As outlined in Chapter 4, a significant proportion of consumers hold savings account with their PCA provider.

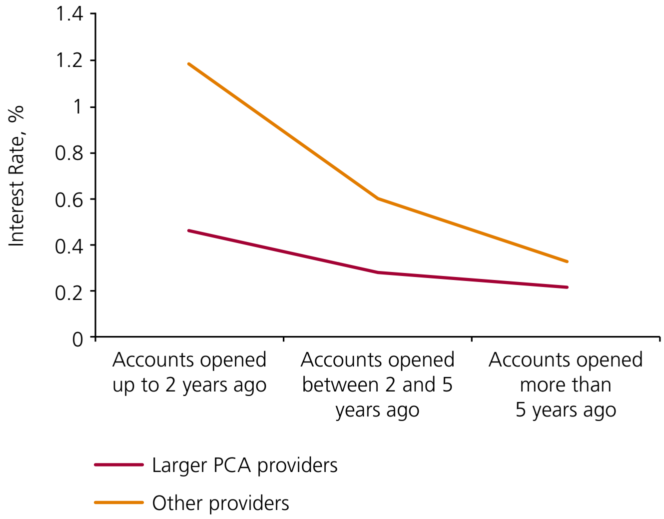
Our data indicates that, for the groups or subsidiaries with the highest number of PCA holders, the vast majority of their easy access and Cash ISA balances are held by customers that hold a PCA with them:

- for a number of larger PCA providers, over 80% of their easy access balances are held by customers who also hold a PCA with them
- for cash ISAs the corresponding proportion of balances held by PCA customers was on average lower, although still above 80% for two providers
- in contrast, for other providers with a lower share of the PCA market, a much smaller proportion of their easy access and cash ISA balances are generally held by their PCA holders

These trends are consistent with provider strategy documents, which highlight the importance of encouraging PCA customers to open saving accounts. This strategy is considered an effective means of establishing deeper relationships with their customers.

The evidence suggests that the largest PCA providers are able to retain in aggregate a significant share of easy access sales despite on average offering interest rates that are materially below the levels offered by other providers (see Figures 14 and 15 below which compare the interest rates offered by the groups and/or savings brands that have the highest shares of the PCA market with those paid by others). Although differences in service level (and supply costs to the provider) may explain the differences in rate to some extent, the consumer behaviour described in Chapter 4 suggests that consumers' preference for the convenience of holding a number of accounts with the same provider is likely to be a significant factor in the large PCA providers' ability to sustain in aggregate a large share while at the same time offering, on average, relatively low interest rates.

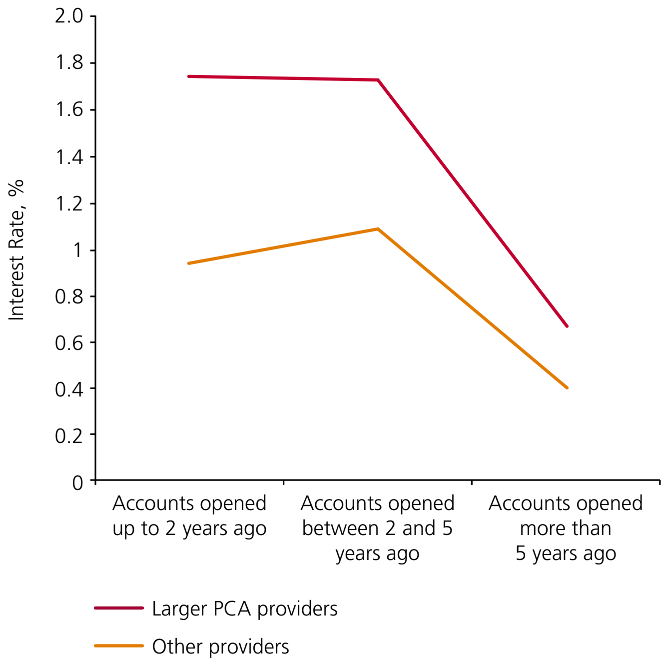
Figure 14: Interest rate paid on easy access accounts by larger PCA providers and all other providers in our sample



Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

In relation to no term Cash ISAs, the aggregate data suggests that to retain (in aggregate) a significant market share, the largest PCA providers are required to offer interest rates that are comparable with or higher than those offered by other providers. This may be because consumers are more likely to shop around in relation to Cash ISA products (see Chapter 3 above) that will on average hold higher balances than easy access accounts, such that the larger PCA providers are required to offer more competitive rates to retain a significant share of cash ISA balances.

Figure 15: Interest rate paid on no-term Cash ISA accounts by larger PCA providers and all other providers in our sample



Source: FCA Data collected from a sample of 21 firms as part of the cash savings market study

Our initial analysis therefore suggests that:

- As a consequence of a widely held preference for the convenience of holding multiple products with a single provider, the largest PCA providers are able to retain in aggregate a significant share of easy access balances despite paying interest rates that are on average materially lower than those offered by other banks, which suggests that the largest PCA providers may face a reduced competitive constraint in the supply of easy access products.

- Consumers' preference for the convenience of holding multiple products with their PCA provider does not appear to be having the same impact in relation to the supply of Cash ISAs.

Transparency and disclosure

An important factor in assessing the effectiveness of competition is the availability of information to consumers. Consumers need to have access to the right information at the right time to be able to assess options and make effective choices.

We have therefore considered what information providers make available to consumers in terms of product information and interest rate both prior to opening a savings account and post-sale in the form of notification letters and annual statements.

We find that there is variation in the clarity and content of disclosures made by providers to consumers. We will consider whether improvements should and could be made to the information provided to customers and whether behavioural insights can help us design more effective disclosure materials. Some providers and consumer bodies have already suggested that the FCA should consider how it can ensure improvements are made to providers' communications of rate changes.

Provision of interest rate information

In the main, we found that where interest rates are displayed, they are usually displayed in a transparent manner:

- **Financial promotions:** Interest rates were not always explicitly displayed within the financial promotions or product literature we reviewed and instead were usually provided in a supplementary information sheet. When interest rates were displayed, and where there were introductory bonus rates, both the bonus rate and the underlying rate were generally made clear.

- **Rate change and bonus rate expiry letters:** In letters notifying customers that their rate is changing or that their introductory bonus rate is ending, firms in the main displayed both the customer's old and new rate explicitly.

- **Annual statements:** Most of the statements we reviewed did display the customer's current interest rate however this was not always displayed on the front page. For accounts with tiered interest rates, the customer was not always informed of the interest rate they were receiving (i.e. given the level of their balance).

- **Price comparison websites:** The search functionality on price comparison websites differs with some making it easier for customers to distinguish between fixed, variable and bonus rates. Transparency around bonus rate products varies even within the same website; sometimes the bonus rate is explicitly cited upfront alongside the interest rate; and sometimes the fact it is a bonus rate product is only disclosed within the underlying information.

A small number of firms provided further detail alongside interest rate information, such as cash illustrations of the impact of interest rate changes. For example, a reduction in interest rate from 1.25% to 0.5% for a balance of £10,000 would result in the consumer receiving £50 in interest rather than £125 (before tax). Some firms also provided some consumers with certain information on how their variable interest rate may progress in future, for example by referring to some form of 'rate guarantee' or 'rate promise'.

Ability to close or switch the account

The majority of annual statements did not provide customers with information as to how they could switch to a new product or provider. Information regarding suitable alternative products offered by the firm was also rarely included in annual statements (some firms cited marketing restrictions as to why they did not include promotional materials).

When looking at rate change notification letters we found that 16 (out of 21) firms informed customers of their ability to close their account or switch it to another product or provider, and 12 firms explicitly informed customers that they could do this penalty free. No firms provided such information when notifying customers that their bonus rate was coming to an end, although some suggested that consumers should contact them if the product no longer met their needs. Again firms rarely provided information about suitable alternative products they offered.

A number of firms applied the same process to existing customers opening or switching accounts as for new customers, including the need to provide documentation such as proof of address or identity. However some firms provided existing customers with what appeared to be relatively straightforward methods of switching or opening new accounts within the same firm, for example online with just a few 'clicks' or via completion of a 'tick-box' form for which the firm provided a pre-paid envelope.

Such switching methods were more likely to be included for fixed-term products at maturity. Before a fixed-term product matures, customers are normally invited by their firm to choose how to use their maturing funds. Many firms operate automatic renewal where if a customer does not decide what to do with their funds before the maturity date the firm reinvests the customer's money into a new fixed-term product. The FCA previously considered the automatic renewal of fixed-term bonds in a thematic review in July 2013.[54] We will consider fixed-term products further in the next stage of our work.

Notifications and notice periods

Currently the rules around notifying customers of disadvantageous changes to their interest rate or the end of a bonus rate differ depending on whether the account is designated as a 'payment' or 'non-payment' account:

- When the account is a 'payment account,' the PSRs apply and the firm is required to notify all customers and to provide them with two months' notice.

- When the account is a 'non-payment account,' BCOBS rules apply and guidance states that firms should notify customers when they make a 'material' disadvantageous rate change or when an introductory rate is about to expire. They must inform customers in good time and industry guidance considers this to be a minimum of 14 days in advance.

In total 13 firms said they alerted customers of all disadvantageous interest rate changes regardless of materiality. However, the notice period firms provided seemed to differ depending on whether the account was a payment account and whether the firm was notifying a rate change or the end of a bonus rate.

Following notification we saw some examples of firms sending reminders to customers, for example by text. However these customers had usually chosen to receive such notification and this practice was far from routine.

Terms and conditions

We found terms and conditions generally difficult to navigate with a number of firms providing one generic set of terms and conditions covering all retail banking products and then providing a number of account-specific supplementary information sheets such as a summary information document, a fees and charges document and a document outlining interest rates.

54 FCA (2013) Automatic renewal of fixed term bonds – Identifying and mitigating the risks: http://www.fca.org.uk/static/documents/thematic-reviews/tr13-04.pdf

6.
Barriers to entry expansion

The existence of inertia amongst a significant cohort of savings customers has been cited by new and growing firms as a key barrier to expansion in this market. Because many of the existing customers of larger providers are not inclined to switch account and/or provider, it is difficult for other providers to attract these consumers. This limits new and expanding firms' ability to attract retail deposits at a similar cost to the major incumbents.

This chapter sets out our interim finding in relation to the key barriers to entry and expansion in cash savings. This chapter outlines:

- the extent of observed entry and expansion in the supply of cash savings products
- the barriers to entry and expansion of wider relevance to retail banking (including cash savings) that have previously been identified by the OFT, Independent Commission on Banking Standards and FCA
- our interim findings in relation to the barriers to entry and expansion that are specific to cash savings

Entry and expansion in cash savings

As set out in Chapter 3:

- the market for cash savings is not particularly concentrated – the largest six firms account for around two thirds of the balances held in cash savings products
- although there has been some market entry over recent years, the larger 'challenger banks' have typically entered the market and/or grown through acquisition
- market shares have remained relatively stable in recent years

Barriers to entry and expansion in retail banking

Certain previous studies (including those by the Independent Commission on Banking[55], the Office of Fair Trading[56], and the FSA and Bank of England[57]) have highlighted a number of barriers to entry and expansion relevant to retail banking generally.

55 Independent Commission on Banking (2011) Final Report Recommendations: https://hmt-sanctions.s3.amazonaws.com/ICB%20final%20report/ICB%2520Final%2520Report%5B1%5D.pdf
56 Office of Fair Trading (2010) Review of barriers to entry, expansion and exit in retail banking: http://webarchive.nationalarchives.gov.uk/20140402142426 http://www.oft.gov.uk/shared_oft/personal-current-accounts/oft1282
57 Financial Services Authority and the Bank of England (2013) A review of requirements for firms entering into or expanding in the banking sector: http://www.fca.org.uk/your-fca/documents/barriers-to-entry

The barriers to entry and expansion previously identified in relation to retail banking include the following:

Regulatory and/or prudential

- An implicit subsidy provided to systemically important banks - those banks perceived by investors as being 'too big to fail' may benefit from a lower cost of funding, reflecting their lower risk to investors.

- Certain aspects of prudential regulation requiring smaller banks and/or more recent entrants to hold proportionately more capital due to their greater perceived riskiness compared to larger banks. Sources of this greater riskiness can include:

  - strong regional concentration for some firms (thereby making them more susceptible to economic developments in a particular region)

  - lack of a 'track record' (including, for example, the management team's running of the business, or default rates in the firm's lending book) and

- The prudential regime also requires firms to regularly consider the adequacy of their liquidity resources, including in periods of stress, which involves categorisation of their retail deposit balances as either Type A (more likely to be withdrawn in a period of stress and therefore "non-sticky") or Type B (less likely to be withdrawn in a period of stress, and therefore "sticky"). For recent or new entrants into the market, the deposits they attract while building up their business may tend to be classified as "non-sticky", as faster growth of deposits is usually generated via best buy rates of interest sought by more rate-sensitive customers. Entrant banks potentially face the challenge of managing a greater proportion of rate-sensitive deposits compared to those of incumbent banks with an established franchise because of the characteristics of the customers using best buy tables.

- The FSA and Bank of England review of barriers to entry in retail banking has also previously identified a number of (largely) process-related barriers to entry that we have sought to mitigate by refining the authorisations process. In July the FCA and PRA published a report to update on developments since those changes were introduced.

Structural barriers

- A number of consumers express a preference for banks with a branch network. Larger banks have built up extensive branch networks over time. It is therefore more difficult for new banks with a limited branch network to compete for those consumers that prefer to manage their accounts through a branch (without incurring significant cost).

Consumer behaviour

- The OFT study set out above found a familiar brand can be an important factor in attracting consumers as consumers tend to be wary of switching to an unfamiliar banking brand.

Barriers to entry and expansion in cash savings

Given the recent consideration of regulatory barriers by other organisations, and feedback we have received on these so far, we have focused on barriers of specific relevance to cash savings.

Our initial analysis indicates that the entry barriers most pertinent to the cash savings market relate to the consumer behaviour identified in Chapter 4, which appears to limit the pool of consumers that challenger firms are able to attract:

- The analysis set out earlier indicates that there is a cohort of consumers (with significant balances) that are longstanding customers of the larger (or longer-established) banks and building societies. This cohort of customers will typically receive a relatively low rate of interest on their savings balances but, despite this, they do not shop around and/or switch accounts. The inertia of these consumers is such that other firms, including challengers, are unable to attract their deposits despite the offer of materially higher interest rates. This provides the larger or longstanding firms with a relatively cheaper source of funding than can be achieved by their competitors.

- As set out in Chapter 4, consumer research suggests that a material proportion of customers typically open savings accounts with the provider of their (primary) PCA. This has the potential to limit the size of the savings balances accessible to smaller banks and building societies that do not offer a PCA or who have a relatively small share of the PCA market. The preference of many consumers to retain savings with their PCA provider is such that other firms, including challengers, are unable to win their custom despite the offer of materially higher interest rates.

Consumer research suggests that larger providers have a consumer base that includes a significantly lower proportion of 'rate chasers' compared to smaller providers in general and new entrants in particular.[58] According to this research, 'rate chasers' represent around 10-15% of customers of the largest providers, compared to over 40% of customers of some smaller providers and new entrants. Such customers are more likely to switch to another provider when higher interest rates are available.

In the Terms of Reference, we also said that there may be advantages to incumbents from holding a stock of existing savings, which may affect the way they compete to attract new savings accounts. We wanted to explore whether the large incumbents can prevent expansion of the smaller providers by adopting the pricing strategies described in Chapter 5 (i.e., introductory bonus rates and paying lower interest rates to customers who have been with the provider for longer periods of time).

As set out in Chapter 5, the evidence does not suggest that the larger banks are in general using a larger stock of existing savings to fund interest rates to new customers that challenger banks cannot compete with, and this is not a concern that challenger banks have raised with us to date. In the next phase of the study, we will investigate the pricing dynamics further, and whether these strategies can be expected to encourage or discourage entry and expansion.

The other barriers to entry and/or expansion highlighted by some challengers include:

- identification requirements for new accounts
- the ISA transfer process
- the quantity of conduct regulations, and
- barriers to entry/expansion in the PCA market (which, as a 'gateway product', is important for a 'challenger' to offer)

We will further consider their significance in the second phase of the study.

58 RFI (2013) UK Savings Council, Annual Research Survey, provided by Aldermore in response to an information request

7. Next steps

During the next phase of the study, we will:

- gather further evidence in relation to the issues highlighted above, and complete our analysis
- continue to engage with firms, trade bodies and consumer groups
- subject to our emerging findings, we will begin our consideration of the different forms of remedy that could be adopted
- publish the final report, setting out our findings and any potential remedies

Further detail on each of these steps is set out below.

Further work planned

Further work and evidence gathering will be carried out before our findings are finalised and the final report is published. This includes:

- **Second information request to firms.** We are grateful to those firms that have responded to our information requests so far. We will issue a second information request to a sample of firms. This request will focus on data from firms that will help us better understand customer switching behaviour, and the extent to which a large cohort of 'passive' customers of the larger banks is inaccessible to 'challenger' banks.
- **Consumer research.** Earlier this year we appointed a market research firm to undertake a consumer survey to gather further evidence on consumer behaviour and attitudes to switching. The final results are due later in the summer. This will be an important input into our overall analysis of the market.
- **International comparisons.** We have commissioned a consultancy to carry out independent research into a number of overseas cash savings markets. The study seeks to identify notable features of other countries' markets, with the aim of helping us to determine whether any regulatory changes could be made to improve the functioning of the UK market. This research will feed into our assessment of the appropriateness and effectiveness of any remedies.
- **A randomised control trial (RCT).** We have been contacting providers to seek their involvement in a field trial that aims to test whether behaviourally informed changes to the way firms communicate bonus expiry or rate cuts could make the communications more effective at encouraging consumers to review their accounts, shop around and switch. We

are currently undertaking a trial with one provider, and the results will be considered as part of the final report.

- **Further discussion with providers and consumer groups.** We will be getting in touch with providers and consumer groups to invite them to provide their views on the content of this report.

Potential remedies

We will continue to develop our thinking on whether the FCA should intervene in this market, and what interventions would be most effective in improving competition to the benefit of consumers.

We will consider how intervening to improve the interest rates paid to consumers with older accounts would affect the interest rates paid on more recently opened accounts. Some parties have suggested that it would not be possible to intervene to improve the overall interest rates paid to consumers, and this is an issue that we would welcome views on. At this stage of the study, we consider that an intervention that improved consumer engagement could result in more effective competition and improved terms overall and we are not convinced that improvements to the terms for some consumers would be cancelled out by worse terms at the time an account is opened. In particular:

- If more consumers are active and willing to switch between providers, it will be easier for new and expanding firms to grow their market share and this should improve competition.
- If consumers were better able to compare products at the point of sale, and identify those providers more likely to pay higher rates on older accounts, it could strengthen competition and allow these providers to gain market share.

In considering possible interventions we will consider the extent to which we might be able to promote greater consumer engagement and encourage them to become more active, for example:

- What could be done to ensure that more consumers are aware of the rates they receive, the rates on offer on other accounts, and the ways that they can switch account
- whether it is possible to give consumers greater insight into how their interest rate is likely to evolve over time, so they can make an informed long-term choice between providers when opening an account
- whether changes could be made by providers to make it easier for consumers to manage accounts that are held with multiple providers and
- what could be done to make it easier to move savings to a new account or provider.

However, if we consider that such measures would be likely only to prompt a marginal number of consumers to become more engaged and/or active, we will consider whether other interventions are necessary to improve outcomes for consumers overall.

If we conclude that we need to take action, we will consider what intervention or package of interventions would be most effective in promoting effective competition. Before we adopt any such measure, we will consult with interested parties on the relevant costs and benefits. The possible measures are:

- policy or regulatory changes
- rule-making, including changes to or potential withdrawal of existing rules [59]
- publishing guidance or
- proposals for enhanced industry self-regulation

Final report

This is the interim report for the cash savings market study. We expect to publish the final report in late 2014. The final report will set out our findings and, if appropriate, any proposed remedies.

Stakeholder views

We would like to hear your views on this report, including on the need for intervention and, if so, your views on what form it should take. Please send us written comments by 8 August 2014.

If you would like to email feedback or set up a meeting to discuss, please contact us at cashsavings@fca.org.uk.

59 Before making any rules, we must consult the Prudential Regulatory Authority (PRA) and publish draft rules, with a cost benefit analysis and an explanation of the purpose of the rules, and consider any representations about proposed changes.

Annex A.
Views from stakeholders

In the terms of reference, published in October 2013, we asked stakeholders to submit views or evidence on the matters covered by the study. We received responses from nine parties including one trade body, three consumer organisations, and three firms. Two firms also submitted a cover response with their views on competition in the market as part of their response to our request for information.

Additionally, we met a wide range of stakeholders including banks and building societies, trade associations and consumer groups both after the study was announced and after the Terms of Reference were published to discuss competition in the market.

Views expressed by providers

Views on competition in the market and on issues outlined in the Terms of Reference varied across the different firms we engaged with. However, all firms and trade associations agreed that in recent years the market dynamic had been affected by external factors, including the low interest rate environment and introduction of the Funding for Lending Scheme (FLS).

Large providers

In general, the large providers believe that competition is working well and that the market place is very dynamic: there are many providers in the market, including some recent entrants, and consumers can choose from a wide range of savings products.

The large providers emphasize that the market study should not be focused solely on interest rates offered to consumers, as the quality of the service proposition and loyalty to the brand can be equally important to the customer. They feel this is particularly true in the current interest rate environment, as many consumers cannot gain much from shopping around and switching.

Some providers believe that bonus rates encourage consumers to shop around, while others think that bonus rates are not always very transparent and fair, and have therefore stopped offering them.

Small and medium sized building societies

The building societies, particularly the smaller building societies, did not raise any significant concerns about competition in the market, though they noted that they tend to be more reliant on retail funding (i.e. deposits) than the larger players in the market.

Many building societies think that there is a place for bonus rates, though some raised concerns that bonus rates were not always transparent and that offering bonus rates did not sit easily with their aims to provide long term value to members.

Small and medium sized banks

A number of these banks have entered the market recently but did not perceive any significant barriers to entry that are specific to cash savings. They did, however, state that new entrants are more likely to rely on customers who particularly value higher rates of interest than those who value other factors such as convenience and so are likely to remain with a provider with whom they hold existing relationships. This may create barriers to these firms expanding in this market.

Some firms argue that the market is polarised, with intense competition among some firms in relation to the custom of 'rate chasers', compared with another part of the market characterised by high consumer inertia and limited competition.

While some small and medium sized banks think bonus rates can work in favour of many consumers, one believes they are 'fundamentally designed to exploit savers'.

Views expressed by consumer bodies

The consumer bodies we engaged with supported the FCA's market study and shared our concern that providers may be able to reduce interest rates on existing savings accounts without needing to worry about consumers switching away. Consumer bodies felt that competition is not always working in the interests of consumers.

In particular, consumer bodies were concerned about the following:

- **Product complexity and proliferation in the market.** Consumer bodies felt that the vast range of complex savings accounts inhibit the ability of consumers to exercise choice and switch within the market. For example, they put forward that there are many 'zombie' savings accounts paying very low interest that are now closed to new customers and have been superseded by accounts open to new customers, and gave a few examples.

- **Bonus rates.** One consumer body felt that 'teaser rates' 'exploit people's natural tendencies to discount the future in favour of the present and are not compatible with 'Treating Customers Fairly'.[60] Overall, this body felt that savings accounts which drop too far below market rates are 'fundamentally unfair and should not be sold'.

- **Lack of transparency.** Consumer bodies suggested that several changes be made to the current FCA rules and industry guidance concerning how firms communicate with their customers. In particular, consumer bodies suggested that providers should be required to send annual statements, publish interest rates on all paper and online statements, and tell their existing customers whether they offer an account earning a better rate of interest. Consumer bodies also felt that there is wide provider discretion in the notification of bonus expiry, and that it is unclear how effective this is as a prompt for consumers to consider moving their savings accounts.

60 'Treating Customers Fairly' is a framework that sets out what we expect from firms by specifying the core six consumer outcomes. For more information, see www.fca.org.uk/firms/being-regulated/meeting-your-obligations/fair-treatment-of-customers

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