

Competition

Annual report 2017/18

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1 Introduction

When competition works well it benefits both consumers and society. Strong competition leads to good outcomes for consumers and improves economic growth.

Parliament gave the FCA responsibility for regulating the conduct of the UK's financial services industry through a single strategic objective to ensure that relevant markets function well. The FCA also has three operational objectives to:

- **protect consumers** – to secure an appropriate degree of protection for consumers
- **enhance market integrity** – to protect and enhance the integrity of the UK financial system
- **promote competition** – to promote effective competition in consumers' interests

In addition to our competition objective, we also have a duty to ensure we promote competition in the interests of consumers, so far as is compatible with meeting our consumer protection and market integrity objectives. This means that where we are furthering those objectives we must pick the most pro-competitive way to enhance market integrity or protect consumers.

All our objectives have equal priority in our work, and our competition duty means that competition is an integral part of our thinking. This ensures that we:

- consider the impact on competition when we discharge our general functions when we advance our market integrity and consumer objectives
- actively monitor markets through market studies and reviews to ensure that competitive processes are working well for consumers, and
- support new entry and innovation within a controlled environment to ensure an appropriate level of consumer protection

We have powers to enforce EU and UK competition law for the provision of financial services. These powers are additional to our ability to use Financial Services and Markets Act (FSMA) powers to achieve our competition objective.

Our willingness to step in to prevent harm and put things right when things go wrong gives consumers and markets confidence. At the same time we have to ensure that regulation keeps pace with innovation and does not stifle competition. Our competition objective, therefore, makes us look forward in order to be ahead of the game. In particular:

- **Fintech** is challenging traditional business models and changing the face of financial services in a number of areas. We published a [discussion paper](#) on Distributed Ledger Technologies (DLTs) to add to the dialogue about the regulatory implications of DLT developments in financial services. In December 2017, we published a [feedback statement](#) on responses. This is part of our role in monitoring potential risks while maintaining a proactive and supportive approach to technological innovation.
- **Advances in smart data, digitalisation and data analytics** are increasing firms' capacity to process large amounts of information, opening up new service and product possibilities. The use of application programming interfaces and developments like the Competition and Market Authority's (CMA) Open Banking initiative, together with the implementation of the Second Payment Services Directive (PSD2), will promote opening up access to clients' account data. This will enable personal customers to compare products on the basis of their own requirements which will improve competition between providers. This also leads to the need for us to remain

alive to the way in which consumers interact with new goods and services and how it shapes behaviour in the future.

- **The UK's decision to leave the EU** creates uncertainties for firms and may impact UK financial markets. Given this uncertainty, we have a role to play in supporting an orderly transition as part of withdrawal and avoiding cliff edges where possible, promoting global markets as a way to support competition and innovation, continuing close cooperation with EU and international regulators and working with industry stakeholders to ensure adequate preparation.

We aim to ensure that customers are given the information they need to make informed decisions when shopping around, buying products or switching. We will also intervene where customers' and firms' interests are not well aligned, or where there are particular risks from specific business models and where it may be profitable for firms to treat customers unfairly.

This means taking steps to improve the way the market works in so far as we act in a compatible way with our consumer protection and market integrity objectives.

This report

In July 2015 the Government asked us to publish an Annual Competition Report on how we are delivering against our competition objective across financial services, to set out clearly the steps being taken to drive more competition and innovation and to help ensure that the right incentives exist for new banks to enter the market.

This, our third Annual Competition Report, covers the period 1 April 2017 to 31 March 2018. The format of this report differs from our previous reports, to align with the decision-making framework set out in the FCA's Mission, and is structured as follows:

- **Identifying potential harm** – identifies the potential 'harms' from weak competition that we have focused on this year within financial sectors
- **Diagnosing the cause of harm** – outlines those areas where we have applied a competition focus to our work in order to diagnose the causes of these harms
- **Choosing remedies to address harm** – considers key actions that we have taken to remedy harm and support competition and innovation, and
- **Measuring our impact** – reports on the outcomes of work to evaluate the success of our interventions

The report draws on examples of our work – further detail on specific market studies and our approach can be found in:

- Annual Report and Accounts 2017/18: This is published alongside this report and covers the period 1 April 2017 to 31 March 2018.
- Business Plan 2018/2019: This gives details of the specific areas of work the FCA is prioritising for 2018/19. It includes information about the FCA's intended competition work for 2018/2019.
- Our Approach to Competition: This sets out our statutory remit, competition powers and aims in advancing our competition objective. We consulted on this document earlier this year and will publish it in its final form later in 2018.

- Competition and Market Authority (CMA): [Annual report on concurrency](#): This was published in April 2018 and describes the work of UK regulators that have concurrent powers with the CMA, including the FCA's market studies and competition enforcement work.
- The FCA website: An overview of our work can be found on the [Competition](#) pages of the FCA website, while new publications can be found on the [Market Studies](#) pages.

2 Identifying potential harm

We identify harm using a number of criteria and sources of information. [Our Approach to Competition](#) explains the market characteristics that can suggest weak competition, which in turn leads to poor outcomes for consumers. These include, for example, firms' market concentration, barriers to customers' switching and the complexity of products.

As well as directly identifying harm through our day to day work, we also use intelligence we collect about sectors and markets. For example, our [Sector Views](#) bring our collective intelligence together and give an overall FCA view of how each sector is performing. Our [Financial Lives Survey](#) also gives us a better understanding of how competition is working in financial services markets. The intelligence gathered in the course of forming our Sector Views, supported by our findings through the Financial Lives research, has prompted us to open some further exploratory areas of work this year in the area of retail lending and pensions. In particular:

Motor finance

Motor finance is particularly important given its rapid growth. The number of point-of-sale consumer motor finance agreements for new and used cars has grown from around 1.2m in 2008 to around 2.3m in 2017. We were concerned that there may be a lack of transparency, potential conflicts of interest, and irresponsible lending in the motor finance industry. We launched an exploratory piece of work that looked at who uses motor finance products and assessed the sales processes, whether the products cause harm, and the due diligence that firms undertake before providing motor finance. We analysed millions of anonymised credit reference agency records, as well as firms' sales practices and processes. We have also worked closely with the Bank of England and the Prudential Regulation Authority, who are considering the risks from the growth of motor finance within their regulatory remit. In March 2018 we published an [update on the review](#), setting out our findings so far and the areas we will cover in the next part of the review. We will set out our findings and plans to tackle any areas of concern by end Q3 2018/19.

Competition in non-workplace pensions

In February 2018 we published a [discussion paper](#) to better understand the market for non-workplace pensions. We are looking at how the differences and similarities between the workplace and non-workplace markets affect competition and outcomes for consumers. We think it possible that the competition weaknesses previously identified in the market for workplace pensions may exist, in whole or in part, in the market for non-workplace pensions. Later in 2018, we plan to publish a paper which will provide feedback from the responses.

3 Diagnosing the cause of harm

To diagnose the cause of harm we gather and analyse evidence to establish whether competition is working in consumers' interests and how consumers may be suffering harm as a result.

Using the most appropriate tool

This diagnostic process can take a variety of forms and we use the most appropriate tool available. We conduct a thematic, or multi-firm, review through our supervisory function where we consider harm might be arising due to the conduct of firms. We typically undertake a market study where we consider that the drivers of harm might go further than this and arise due to how the market itself functions. This may be due to how consumers interact with the market or the way in which the market is developing in terms of entry and exit.

For example, some stakeholders in the **wholesale insurance broker sector** had concerns about the way that competition was working. We decided a market study was the best diagnostic tool to assess this, as it would provide perspectives from a wider range of stakeholders. In November 2017 we launched a market study on the wholesale insurance broker sector. We aim to publish an interim report by the end of 2018.

The lines are not drawn strictly, however, and there are some areas where we consider a cross-functional approach would be more appropriate. One example of this is our **Strategic Review of Retail Banking Business Models** that we launched in May 2017. The sector has experienced a range of changes including 'lower for longer' interest rates, Open Banking, increased use of digital channels by consumers, regulatory interventions such as ring-fencing, and the remedies introduced by the CMA. The review is examining retail banking business models in greater depth and where and how banks earn their revenues and returns. This will enable us to consider how different retail banking business models may be affected by market changes in the future and what the potential implications are for consumers.

Our competition objective encourages a forward looking perspective and the review aims to enhance our understanding of the state of competition and conduct in retail banking markets at a pivotal time of change. The review, however, goes broader than the competition objective and will inform our wider work on conduct and consumer protection within the context of new banking models. We expect to publish an update of the project explaining our preliminary analysis in Q1 2018/19.

Assessing competition in evolving markets

Deciding how to use pension savings is one of the most important financial decisions people will make in their lives. Given what we know of the extent of knowledge of financial matters

amongst UK adults and the degree of complexity attached to pension products, this is an area in which it is important that competition works effectively in consumers' interests. Following the pension freedoms, our **Retirement Outcomes Review** is assessing how competition is evolving, particularly the outcomes for consumers who do not take regulated advice. Our interim findings, published in July 2017, found a number of emerging issues with implications for effective competition. These include a lack of innovation in the market and low levels of shopping around in the non-advised drawdown market.

Our subsequent proposals aim to strike the right balance between promoting competition while ensuring the right level of consumer protection. They include firms providing more relevant and effective information and ensuring consumers have the tools to assess and compare products and shop around. We publish our final report in Q1 2018/19.

4 Choosing remedies to address harm

Where we identify harm to consumers, we may implement any of a package of remedies. These can include rule changes, publishing guidance, supervision or enforcement work and publishing data. We give full details of these remedies and how and when we might use them in [Our Approach to Competition](#).

Remedies aimed at improving competition

Our package of remedies following the **Asset Management Market Study** aims to make competition work better, and protect those least able to actively engage with their asset manager. They include making changes to the [rulebook](#) to give protection to investors who are less able to find better value for money, supporting an [institutional disclosure working group](#) to encourage consistent and standardised disclosure of costs and charges to institutional investors and making a Market Investigation Reference (MIR) to the CMA on investment consultancy and fiduciary management services. This was the first time that we have made an [MIR](#) to the CMA and shows a willingness to use a variety of tools to improve markets. In June 2017 the Final Report of the Asset Management Market Study outlined our intention to do further work on the investment platforms sector. The following month, we launched an **Investment Platforms Market Study** to understand how investment platforms compete for both advised and non-advised retail investors. We plan to publish an interim report in Q2 of 2018/19.

We are committed to designing interventions that work in the real world. In April 2017 we introduced new rules requiring insurers to disclose last year's premium on insurance renewal notices provided to consumers. We based our proposals on findings from a large-scale randomised controlled trial that we conducted with three firms in the home and motor general insurance markets, as well as our wider research.

We also used consumer behavioural research to design rules for firms to inform consumers how much they could gain from shopping around and switching provider, before they buy an annuity. Firms were required to implement these changes by 1 March 2018. This work followed our **Retirement Income Market Study** where we found that the retirement income market was not working well for consumers.

In June 2017 we published a [policy statement](#) setting out new rules following our **Investment and Corporate Banking Market Study**. In this market study we identified that some banks use clauses in contracts, mandates or engagement letters that oblige clients to award or offer future primary market services to that bank. These primary market services may include debt capital market services, equity capital market services and merger and acquisition services. We found that these clauses can restrict a client's choice in future transactions and may, as a result, hinder effective competition in the interest of those clients. We considered a range of interventions and proposed that these restrictive contractual clauses should be prohibited where they relate to future primary market services.

In our work to promote competition in retail banking, we worked closely with industry participants, consumer groups and digital comparison services to explore what information about service should be published by banks and building societies so that consumers are able to assess the differences in quality of service firms provide. We published a [policy statement](#) in December 2017 setting out our final rules requiring banks and building societies with more than 70,000 personal current accounts (PCAs) or 15,000 business current accounts (BCAs) to publish objective service information from August 2018. The information we will require firms to publish complements [the information the CMA will require larger providers to publish](#).

Balancing our statutory objectives

Whenever we propose to take action we consider the impact that our intervention will have on competition even where our action is not focused on competition but on our consumer or market integrity objectives. For example, in June 2017 we published new proposals on advice on **pension transfers** where consumers have safeguarded benefits, primarily for transfers from defined benefit to defined contribution pension schemes. The proposed changes included requiring transfer advice to be provided as a personal recommendation, and replacing the current transfer value analysis with a comparison to show the value of the benefits being given up.

In coming to a view on these changes to the rules we fully explored and consulted on our expectations of how these changes, while protecting consumers, would also be consistent with our competition duty. Providing consumers with individually tailored advice would give them greater confidence to explore their options, potentially increasing competition between advised and retirement product markets. Making our expectations of advisers clearer will also reduce barriers to firms wanting to advise on pension transfers, so improving competition and acting to reduce prices.

We have also used our competition tools to advance our consumer protection objective. There are over 30 million credit card holders in the UK. Our [Credit Card Market Study](#) found significant concerns about the scale, extent and nature of the persistent debt for a significant minority of them. As these customers are profitable to credit card firms they have had little incentive to intervene to help them. In February we published [new rules](#) to help these customers, including firms intervening earlier to give these customers information and showing forbearance.

While our proposals were not directly addressed at encouraging greater competition, they may nonetheless do so. Interventions that are forcing consumers to consider their debt position at certain points may make them more receptive to competing offers of balance transfer deals than they would otherwise have been.

We also take steps to provide greater clarity about our rules. For example, in July 2017 we published a [consultation paper](#) on checking prospective customers' **creditworthiness**, including whether they can afford consumer credit products. In the same month we also consulted on a [package of rules and guidance](#) to help consumer credit firms identify and manage their risks around **incentive schemes and performance management**. The clarification of our expectations in these areas ensures a consistency of approach and can improve competition by creating a level playing field between competing firms.

Supporting competition through entry and innovation

New entrants – or even the threat of new entry – can put pressure on an existing firm and result in lower prices, higher quality and more choice for consumers. Existing firms' expansion can also exert similar pressure. But while regulation is an essential safeguard against misconduct, anticompetitive practices and consumer harm, it can also create unnecessary barriers to entry. So we need to strike a balance between encouraging competition and innovation and advancing our other operational objectives.

We have previously reported on the New Bank Start-up Unit, launched with the Prudential Regulation Authority in 2016. The Unit provides a one-stop shop for both newly authorised, and potential, banks. This year we have authorised 10 new UK banks.¹

The asset management sector is also important for the UK economy. We currently regulate more than 3000 asset managers and approved 300 new firms in 2016. This year we have looked to see how we can support new entry and in October 2017, we launched a new Asset Management Authorisation Hub. This supports new firms throughout the authorisation process and beyond, ensuring they are able to meet the same rigorous standards as current firms before they receive authorisation.

We also continue to encourage and support the development and take-up of innovative technology through our Innovate programme. This includes the Direct Support Team, the Regulatory Sandbox and the Advice Unit. In December 2017, we announced we had accepted 18 firms into the third cohort of the Regulatory Sandbox to test innovative products, services, business models and delivery mechanisms. These include businesses which use technologies such as artificial intelligence, smart-contracts, blockchain, application programming interfaces and DLTs.

Supporting competition through regulation

We have also implemented regulation to support competition in consumers' interests. Examples include implementing PSD2, the Insurance Distribution Directive and Ring-fencing legislation that can help create more competitive and innovative financial services markets.

Enforcing the Competition Act

We aim to promote a 'culture of compliance' in which firms in the financial sector know that they must abide by competition rules or face legal consequences. This year we have conducted two investigations under the Competition Act 1998. In November 2017, we issued a statement of objections to four asset management firms. We alleged that the four firms shared information by disclosing the price they intended to pay, accepting this information, or both, for one or more of two Initial Public Offerings and one placing, shortly before the share prices were set. This is the first case we have brought using our competition enforcement powers.

We closed our investigation into conduct in the aviation insurance sector as the European Commission took this over.

¹ An additional four banks have been authorised for the purposes of implementing Ring-fencing legislation.

In addition to formal investigations, we have issued three 'on notice' letters to firms where evidence suggests competition law has been potentially infringed, but where our other priorities mean that we are less likely to open an investigation.

Working with the CMA and other authorities

We continue to work with the CMA to improve competition in financial services markets. This has included working with the CMA on implementation of the remedies from the retail banking market investigation. We also continue to sit as an observer on the Open Banking Implementation Entity that was set up as one of the CMA's retail banking remedies. Open Banking will enable personal customers and small businesses to share their data securely with other banks and with third parties. This will enable them, for example, to manage their accounts with multiple providers through a single digital 'app', to take more control of their funds (for example to avoid overdraft charges and manage cashflow) and to compare products on the basis of their own requirements.

We have provided expert input on the financial services sector to the CMA throughout its digital comparison tools market study which looked at car insurance, home insurance and credit cards. We have also provided sector expertise to the CMA as part of their investigation into the use of certain retail most favoured nation clauses by a price comparison website in relation to home insurance products. We have continued to provide support to the CMA following our Market Investigation Reference (MIR) on investment consultancy and fiduciary management services, as mentioned above.

We have continued to work with other competition authorities through the UK Competition Network and European Competition Network.

5 Measuring our impact

We always aim to design remedies that address consumer harm, are proportionate and that are realistic in terms of likely response by both firms and consumers. Wherever relevant, we aim to test out our remedies in the real world and use our extensive behavioural economics work to achieve the best outcome for consumers. However, it is rarely possible to predict with total certainty how remedies will play out in practice. It is important we revisit what we have done to evaluate how effective our remedies are in meeting their objectives. To that end, we published [a discussion paper](#) at the start of April 2018 that set out our framework for measuring the impact that our interventions have had. We are also starting to evaluate our early competition interventions and expect to publish the first of these shortly.

Evaluation is particularly important in fast-moving and dynamic markets. We have, for example, been working on additional rules for the crowdfunding market since the publication of our [interim feedback](#) in 2016. We will finalise the proposed new rules and publish them for consultation in 2018.

As part of our Mortgages Market Study, we have reviewed the impact of certain previous regulatory interventions in the mortgages market. We are keen to understand how well important aspects of the market are working, in part to help assess the impact of certain parts of the Mortgages Market Review (MMR). For example, we are considering whether our Handbook rules and guidance around advice may need to be amended to help ensure that more customer-facing innovation is encouraged in the mortgage sector.

Evaluating the impact of the pay day lending cap

Following our findings into the impact of high charges and weak affordability checks in the high-cost-short-term credit market (HCSTC – commonly referred to as payday lending), we introduced a price cap in January 2015. Last year, we reviewed the cap to look at the impact on both current consumers and consumers who were excluded from HCSTC as a result, and the state of the market. We found that current consumers pay less for loans and are now more able to repay them on time than before we took over regulation of the market and set the cap. Fewer consumers are seeking help from debt advice charities about HCSTC products, though some consumers continue to face problems with their loans. We found no evidence that consumers who have been unable to get HCSTC products since the cap have generally had negative consequences as a result. These consumers largely reported that they consider it to be positive that they were not able to get a loan, and have not generally turned to other forms of high-cost credit or illegal money lending. Looking at the developments in the market, there were more HCSTC firms currently in the market than we expected when we set the cap. Following a significant decline in the size of the market in 2014, we saw a slight increase in levels of lending. We also identified signs that competition is strengthening with significant changes in market shares during 2015-16. As a result of this evaluation, we decided to maintain the cap at the existing level and to conduct another review of the price cap in 2020.



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