CPS PERSPECTIVE

CENTRE FOR POLICY STUDIES

57 Tufton Street · London SW1P 3QL · Tel: 020 7222 4488 · Fax 020 7222 4388
website: www.cps.org.uk email: mail@cps.org.uk

Greater transparency for UK retail banking

A proposal

ANDREW TYRIE MP

THE PROBLEM

Customers have no idea how much their bank charges them. Nor do they have any practical means of finding out. Banks offer a myriad of complex offers and products, the true value of which no reasonable customer can understand.[1]

The consumer is right to be wary. Many of the so-called offers, such as free banking, zero interest credit and so on are nothing of the sort. The consequence is that many customers do not trust their banks, who they believe levy charges on their accounts behind their backs. Banks are perceived to be "all on the same racket", reducing the incentives to switch banks. Banks are mistrusted because their charges are opaque.

In response, regulators have sought industry-wide agreements on the provision of information to customers in an effort to sustain public confidence and to encourage competition. Despite their best efforts, so far, they have not been as successful as most would like. This is because the fundamental problem of British retail banking has not been addressed: meaningful price comparison and competition is virtually impossible. The information currently provided by banks is of limited use. One measure can go a long way to redressing this.

THE PROPOSAL

Banks should be required to provide customers with a regular itemised estimate of total charges and interest payments on their account. This sum should include the cost of interest foregone on current account surpluses and on deposits, defined as the difference between any interest earned and base rates. The sum should also include transaction charges, regular account charges and any other charges made.

The same treatment should be applied to deposit accounts and to all forms of debit. It should, for example, include the cost of any interest paid on loans or overdrafts in excess of base rates. It should include authorised debit interest on overdrafts, unauthorised overdraft charges, and other charges on borrowing. Similar treatment should be applied to the hidden charges on forex spreads. These should appear in the list of total charges as amounts paid in excess of the central rate.

Customers would discover, for the first time, how much they really pay for their banking services. This extra transparency should enable customers to choose more readily between banks.

---

1 A recent survey of 4,000 visitors to the financial advice website, fool.co.uk, found that that two-thirds of customers of the 'Big 5' banks do not trust their banks to sell them the right products. See http://www.fool.co.uk/news/your-money/current-accounts/2007/04/17/fools-dont-trust-their-banks.aspx, 17 April 2007.

Furthermore, banks should be required to produce this information in an industry-wide homogeneous form. This should enable more useful websites to be produced, on the basis of which banks would be offering annual quotes for standardised services. Organisations such as Which, and other consumer bodies, would also be able to use the website information to provide more reliable guidance on the relative merits of various banking services provided. Any individual would be able to type in his/her annual salary, number of direct debits, any overdraft facilities etc and obtain a quote from a search engine for the required services.

THE BENEFITS FOR THE BANKS

Many banks, particularly the competitive and efficient ones, should welcome such a proposal. At present, the lack of transparency encourages banks to compete by creating misleading products. Offers of allegedly 'free banking' and 'free credit' abound, cluttering the letterboxes of millions of homes. It is these products, and the sense that banks are 'all the same' and have their hands in their customers' pockets on the quiet, which have given banks such a bad reputation with the retail customer in Britain. For the most part that reputation is unfair. Greater transparency along the proposed lines can help to dispel it.

Banks should welcome the proposal also because it should reduce the volume of future regulation. Much of existing and proposed regulation is considered necessary to protect customers from complex, confusing or misleading products. Transparency on customer costs will bring great clarity and simplicity to competition. *Caveat emptor* can then apply. Sunlight, rather than further regulation, would act as a better disinfectant of the many products which mislead and confuse.

The proposal may also create the opportunity for a reduction or simplification of a number of existing regulations. At present the scale and complexity of regulation inhibits competition, creating a barrier to new entrants and putting many smaller players at a disadvantage: not all large banks are always as vigorous in their opposition to regulation as they might otherwise be.

THE BENEFITS FOR CUSTOMERS

As a result of the increased transparency both individuals and businesses would be able to manage their financial affairs better. They would have a much clearer understanding of how much they were paying for financial services. At a time when the number of people with serious debt problems has risen sharply, this would be particularly important.

Banks might claim that the cost of creating and, possibly, even running such a scheme would be high. This will require further investigation but, given the likely benefits, banks should not be allowed to derail the proposal. The cost is unlikely to be prohibitive and the potential benefit in terms of increased competition could turn out to be huge.

DRAWBACKS

The scheme would overcome two of the major hurdles to the sharpening of competition in the retail banking sector. For the first time customers would know the true cost of the services they use. The customer's perception that banks are 'all the same' would also be addressed. They would also have a better means of forming a view as to whether the charges were 'fair' or not. They would be able to see a variety of prices on offer; the price comparison would reveal banks to be different. In theory, customers can already derive this information from schedules of charges available on the internet. In practice, it may often require a near prohibitive investment of time and energy to obtain the necessary information.

However, the scheme would not, at least initially, address two other obstacles to greater competition. It will not address the customer belief, probably largely misplaced, that they benefit from loyalty to one bank over a long period. Nor will it directly address the customer perception that changing banks is difficult (because of the alleged administration involved) and possibly dangerous (because of, *inter alia*, the risk that direct debits might be inadvertently terminated; or that the privacy of banking information may be prejudiced).

Nonetheless, it is important to bear in mind that these concerns can only be assuaged once customers have the requisite minimum information to enable them to make informed choices. This is denied them at present but would be supplied to them under this proposal.

Over time, as effective search engines were developed, and as a pool of people who had benefited from switching grew, it is likely that many of those averse to switching would come to see the benefits. Banks would also, of course, respond by encouraging loyalty through price. Therefore, although price transparency is not a sufficient condition for the extension of competition, it is an essential ingredient. Without it, all other regulatory efforts are likely to fall short of expectations.

A COMPARISON WITH INSURANCE

Comparisons with other industries are never exact. However, it is worth pointing out that obstacles to competition in the car insurance market, 30 or 40 years ago, were strikingly similar to those in the banking industry today.

At that time customers believed, perhaps rightly, that long term loyalty to a particular insurer could be beneficial and had difficulty in comparing the cost of products between suppliers. Today, the retail insurance market is dominated by search engines enabling customers to seek out the best price for their car insurance far more easily. This has eroded the relative inertia of customers who now change insurers more readily than those of previous decades. It has also helped dispel the concern that it would be unsafe or dangerous to move to a new insurer. The crucial catalysts for change in the insurance industry were entrepreneurship and new technology – the full benefits of both are needed in retail banking.

CHANGE HAS TO COME

This proposal is consistent with the direction of a number of other recent suggestions. The Competition Commission, in its investigation of current accounts in Northern Ireland, has recently concluded that banks should provide customers with an "annual summary of the charges and interest payments incurred" on their accounts. It is also pertinent that the OFT, in its February 2007 response to the Banking Code's Review, recommends that "significant change is needed to the banking codes of practice, particularly to address the lack of transparency that pervades the retail banking sector"; and that "concrete steps are taken to give customers relevant information on costs (including foregone interest)".[2] In April, the OFT announced that it was conducting a market study into personal current account pricing, alongside a formal investigation into the fairness of charges for unauthorised overdrafts.[3]

CONCLUSION

This proposal may appear radical. But action to address the current confusion in retail banking is long overdue. The proposal would enable price comparison and competition greatly to improve the quality of services; and to reduce their cost. It would also enable the task of restoring public confidence to begin, and reduce the likelihood of the need for endless further regulation. And the consumer and the industry would both benefit.

[2] *OFT response to Banking Codes Review,* February 2007.
[3] OFT press release, 26 April 2007.

CPS PERSPECTIVE

THE AUTHOR

Andrew Tyrie has been Conservative Member of Parliament for Chichester since May 1997 and Shadow Paymaster General from 2004 to 2005. His publications include *A Cautionary Tale of EMU* (CPS, 1991); *The Prospects for Public Spending* (Social Market Foundation, 1996); *Reforming the Lords: a Conservative Approach* (Conservative Policy Forum, 1998); *Leviathan at Large: the new regulator for the financial markets* (with Martin McElwee, CPS, 2000); *Mr Blair's Poodle: an Agenda for reviving the House of Commons* (CPS, 2000); *Back from the Brink* (Parliamentary Mainstream, 2001); *Statism by Stealth: new Labour, new collectivism* (CPS, 2002); *Axis of Instability: America, Britain and The New World Order after Iraq* (The Foreign Policy Centre and the Bow Group, 2003) and *One Nation Again* (One Nation Group, 2006).

A SUBSCRIPTION TO THE CENTRE FOR POLICY STUDIES

The Centre for Policy Studies runs an Associate Membership Scheme which is available at £100.00 per year (or £90.00 if paid by bankers' order). Associates receive all Pointmakers and pamphlets and (when possible) reduced fees for conferences held by the Centre.

For more details, please write or telephone to:

The Secretary
Centre for Policy Studies
57 Tufton Street, London SW1P 3QL
Tel: 020 7222 4488 Fax: 020 7222 4388
mail@cps.org.uk www.cps.org.uk

The aim of the Centre for Policy Studies is to develop and promote policies that provide freedom and encouragement for individuals to pursue the aspirations they have for themselves and their families, within the security and obligations of a stable and law-abiding nation. The views expressed in our publications are, however, the sole responsibility of the authors. Contributions are chosen for their value in informing public debate and should not be taken as representing a corporate view of the CPS or of its Directors. The CPS values its independence and does not carry on activities with the intention of affecting public support for any registered political party or for candidates at election, or to influence voters in a referendum.

ISBN 1 905389 52 3

Printed by the Centre for Policy Studies, 57 Tufton Street, London SW1P 3QL