Retail banking and competition.

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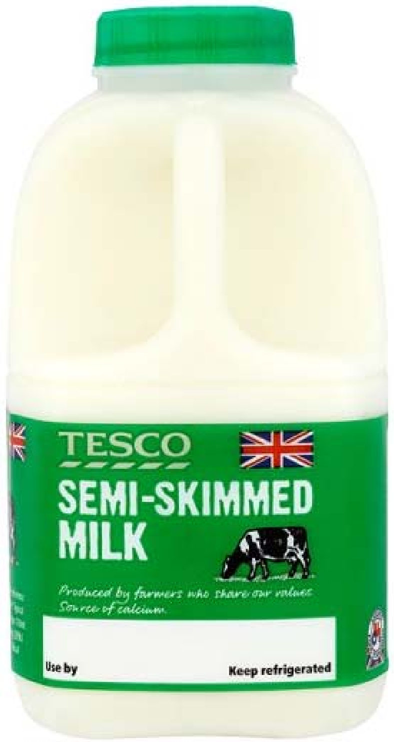
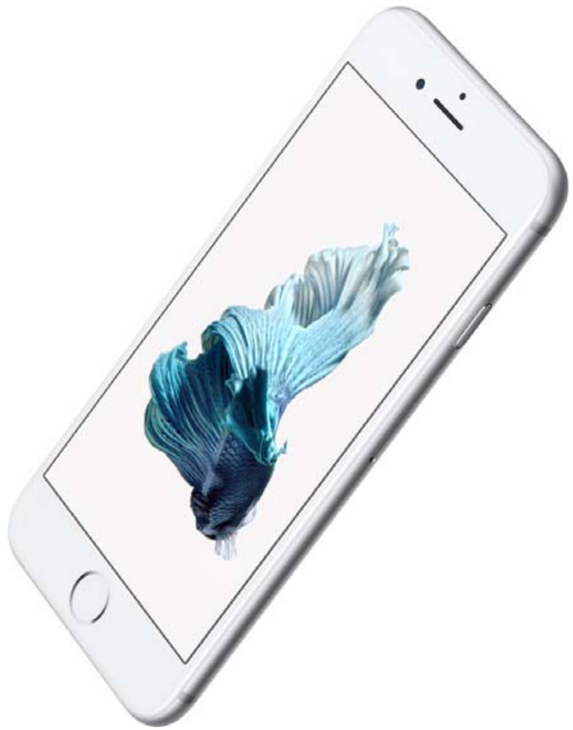
Is a bank account more like:

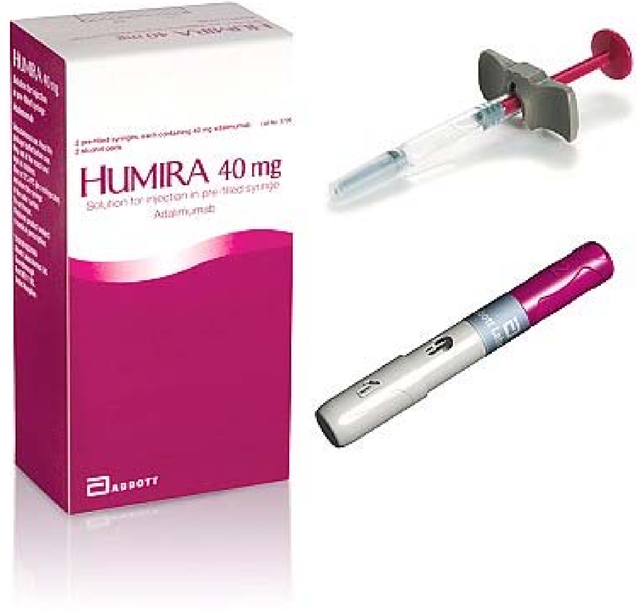
a)



b)



c)



Westminster Business Forum Keynote Seminar: Banking Reform - culture, competition and financial stability, 3 November 2015

Mark Falcon, former Executive Director, Regulatory Policy and Strategy, Payment Systems Regulator

Retail banking and competition

Thank you Lord Turnbull. Good afternoon.

I have just one slide, which is a multiple-choice question:

- Is a bank account more like:
    - milk, half a litre of semi-skimmed
    - a smartphone, the iPhone 6, the world's biggest selling smartphone
    - a pharmaceutical, here Humira, the current biggest selling drug, an anti-inflammatory
- This is a serious question: in economic speak, are bank accounts more like an undifferentiated commodity good or a highly differentiated product?
- The answer matters a great deal for the way that competition works and how regulators might seek to intervene to encourage competition and innovation, or other regulatory interventions.
- My contention is that bank accounts are much closer to a) than b) or c). This is characteristic of much of the financial services, ie that most financial products are highly undifferentiated across different providers.
- Why is this? Well it seems that financial services find it much more difficult to create patents or other intellectual property than these other industries. In contrast, Apple and Samsung spend all their time fighting patent battles to protect their market positions.
- So, when banks do innovate, the good innovations usually immediately get copied. When Midland Bank launched "free if in credit" banking in 1984, it was copied within weeks by the other banks.
- This creates a big disincentive to innovate, a chilling effect, if it's not easy to capture the benefits, like these other industries.
- Also, when banks make bad innovations, like whoever invented PPI, these also get copied rapidly across the industry. Either way, the incentive to do the right thing is often weak. A classic "prisoner's dilemma" type problem. This also explains much of the culture challenges in banking.
- So it's not surprising that customers aren't engaged with retail banking, anymore than they are with buying milk.
- But unlike milk, retail banking has big fixed costs of supply, like branch, ATM or payment networks. And this makes them look much more like essential infrastructure utilities, such as energy, water or telecoms, than just milk or beans.
- In this case, regulation has a multitude of critical roles:
    - ensuring access to customers, such as a financial inclusion or universal service obligation
    - Ensuring access for competitors, especially new entrants, such as access to payment systems
    - Promoting collaborative innovation, such as interoperability, common standards, and ease of switching.
    - Protecting financial stability

    - Protecting consumers undue consumer harm or loss.
- These are all huge tasks for all of us as regulators and in the industry.
- The other important commercial challenge is that banks are at high risk of being disrupted by technology firms if they don't become better at capturing the value of innovation.
- Thank you

Supporting a diverse financial system - competition, innovation and accessibility

In light of the CMA's recent market investigation into retail banking - which identified low levels of customer engagement and account switching, and weak incentives for banks to compete for customers - what more can policymakers, industry, and regulators do to encourage competition and innovation within UK banking?

In what ways are new developments in the sector, including technological change, product development, and increasing switching rates impacting on market stability?

What should be the next steps for ensuring access to financial services for consumers and small business customers, particularly in relation to transparency, information and identifying best value offers for personal current accounts and business current accounts?