Summary of Discussion Points  
Presented by the Business and Industry Advisory Committee (BIAC)  

to the OECD Competition Committee  

Discussion on Competition and Consumer Protection in the Financial Sector  

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The Business and Advisory Committee (“BIAC”) to the OECD welcomes the opportunity to provide its views to the OECD Competition Committee for the discussion on Competition and Consumer Protection in the Financial Sector.

Introduction

The financial sector has always played a crucial part in the economy. Banks, in particular, by collecting deposits from savers and making credit available to investors, contribute to economic growth: investment that would not have taken place without such financing becomes available.

In light of this role, a banking crisis tends not to be limited to the banking sector only but affects other sectors. The latest financial crisis shows the consequences that decreased wholesale lending (between banks) had on credit to enterprises and consumers.

Reflecting some views that the financial crisis was exacerbated by deregulation and inadequate supervision by regulatory authorities, regulatory supervision has increased and regulatory entities have taken various measures to avoid the re-occurrence of a similar crisis by imposing, for example, higher capital requirements, proposing or separating riskier activities from retail ones, etc. Since the crisis, competition authorities have also increased their efforts in this area; it is notable that until recently there had been a limited number of competition cases involving the financial sector.

Competition and consumer policy

The recent increased competition law enforcement in the banking and financial sector provides an opportunity to discuss the interaction between competition and consumer policies. Both share the common goal of advancing consumer welfare and delivering a well-functioning market or protecting the consumer by removing distortions in the marketplace. While the former tends to look in principle at the supply side (whether companies are delivering what consumers want by competing effectively), the latter focuses mostly on the demand side (whether consumers are being treated fairly and have all the information they need in order to make informed choices).
They both reinforce each other: a well-functioning competitive market will deliver outcomes that consumers want and, if customers are well informed and able to shop around and switch, this will have an impact on the way companies compete.

Financial regulatory and consumer protection authorities have developed tools (such as market studies, surveys and sometimes the use of behavioral economics) to look at how firms conduct their dealings with their customers. They also look at whether existing regulatory measures have adverse effects on competition, for example through making it more difficult for firms to enter markets or expand; they assess the way in which consumers or firms take decisions (in order to avoid consumers not receiving what they need); and, finally, trying to understand the reasons why more consumers do not switch suppliers. Some of these issues overlap with what a competition authority would consider in carrying out its investigations.

The sector that has received the greatest attention from a consumer protection standpoint has been retail banking: this includes personal current accounts ("PCA"), savings, mortgages, personal loans and credit cards. This paper will focus on these products. Each of us will have one if not all of these. And a mortgage is usually the largest financial commitment any of us will ever make. Their importance for consumers has led authorities and governments to pay considerable attention to the way these markets work and whether they deliver the right outcome for consumers.

Consumer protection has always played a key role in retail banking for several reasons:

- Many products are inherently complex for most people. Financial products have several features and, sometimes, complex charging structures. Consumers might not have the expertise or appropriate information to choose the most suitable product for them;

- Financial decisions, especially those involving insurance products, may require assessing risk and the possibility of the occurrence of a future uncertain event. Consumers can easily make mistakes about the probability of an event occurring and, therefore, under or over-insure themselves;

- Some financial decisions, such as choosing a pension plan or mortgage, are made infrequently, if not only once. Without previous experience it is easy to make a mistake and the consequences will become clearer only much later in the future.

To address these issues, both consumer and competition authorities have considered the provision of adequate information to customers, how to foster comparison methods, and examined switching rates and barriers to entry.

**Provision of information**

Banking products are sometimes necessarily complex. They must provide a number of different services and different customers use them in different ways. Customers do not want to devote a lot of time to reading product information and comparing different products from different providers. They do not always know in advance how much they will use particular options offered by different providers, such as overdraft facilities or additional benefits with certain types of credit cards.
As a consequence, it is not straightforward to improve transparency, as there are trade-offs. Providing customers with lots of information about complex products can overwhelm some of them. Developing simpler products may mean that some customers are not offered products that meet their needs\(^1\). And there is also a trade-off between protecting vulnerable or careless consumers who would not read the small print, and giving sophisticated consumers the finely tuned advice and services they want.

It is important to stress that consumers do have responsibility for the decisions they make – although it is also true that they cannot always be expected to have enough financial knowledge, information and understanding of complex products and risks to decide what is best for them. That is an important role for consumer protection rules. And financial education plays a key role and influences consumer protection; the higher the level of financial education, the better the level of knowledge and understanding of consumers, empowering them to access more advanced and innovative financial products and services.

This however does not mean that all consumers should be protected against all risks. A consumer who is willing to invest in a riskier product in order to achieve better returns should be fully prepared to bear the consequences of the expected return not materializing. Assuming the proper disclosure has been made and the provider has performed the duties expected, consumers bear the responsibility to evaluate the information provided to them and ultimately take responsibility for their choices. Consumer protection should not mean protection against all investment risks.

From a regulatory perspective it is therefore essential that consumers are treated in a way that is appropriate for their level of financial knowledge and understanding and that companies treat customers fairly. This means that products and services marketed to them are designed to meet the needs of identified consumer groups. It also means that consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale; the advice they receive is suitable and takes account of their individual circumstances; they are provided with products that perform as firms have led them to expect and do not face unreasonable post-sale barriers imposed to change product, switch provider, submit a claim or make a complaint.

Price comparisons

But while the provision of information is important, it is not sufficient. Customers should be able to compare products and services and choose the one that suits them most.

One obvious comparison criterion is price, but it is not the only one and consumers should be aware of other facts that are also important to make an informed decision, including factors such as the quality or level of service provided. There are now many price comparison websites that attempt to rank the various products by price, or give consumers the option to rank it in this way. While this might be appropriate for products that are easy to compare such as savings, it leads to difficulties issues in relation to other products, such as insurance products.

If the comparison is only on price, whoever has a low headline price will be placed at the top of the list. Consumers could then buy the cheapest insurance product, but this could well turn out

\(^1\) Competition in the market brings products and services that are different from one provider to the next – standardized products and services are not the best outcome for consumers.
to be a low quality product with many small print exclusions or excesses and not appropriate for that specific consumer. Therefore the suppliers at the top of the list my not be the cheapest or best value when the total deal is taken into account.

With complex products, making the comparison easy is not always simple and the customer has to look at all the details of the product and not just the price. But there is a limit to what can be done by a single financial institution: information needs to be comparable and available across different products and providers and this requires coordination among competing providers to agree on a common format. In this area, there have been several regulatory initiatives to make comparison of certain product easier for example by obliging providers to offer a similar fact sheet with the key information but more can be done.

Once consumers have the appropriate information and can compare products, they should be able to switch.

**Switching**

The ability to switch is of course important. Customer mobility and choice are essential to stimulate competition in retail banking. Customers must have the ability and willingness to switch banks in order to drive and stimulate competition in retail banking.

Sometimes business feels that authorities put too much weight on the importance of switching in the banking sector to assess whether the market is competitive or not. Authorities believe that the degree of customer mobility is low, that customer-bank relationships are usually long-term because of customers’ inertia and because switching costs (both financial and non-financial - for example costs related to physical change of accounts, transfers of bill payments, lack of information, contract costs) are usually high. There is a perception that banks do compete for new customers for example by offering higher initial deposit rates, but later on, once the customers are locked in, those rates are reduced. Ease of switching then becomes for an authority the key to solve these problems.

It is important to stress that switching levels alone are not a good indicator of how competitive a market is or of whether customers get good outcomes. A competitive market where customers get good service and competitive prices would have low levels of switching. A market where service levels and customer outcomes are poor may have high levels of switching. Relatively low levels of switching are not sufficient to conclude that markets are uncompetitive or that consumer outcomes are poor.

Clearly, switching rates vary between products and tend to be higher for savings and, in some countries, mortgages. Many authorities however are concerned that there is little switching in PCA mostly because customers are not sufficiently confident in the switching process. Consumers should not be put off switching, because of perceptions about the length of time it takes to switch, errors in the switching process or the inconveniences triggered by these. In PCAs, consumers may be nervous about the risk of errors in transferring payment instructions.

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2 One issue closely related to switching is the difficulty encountered in some countries to open an account. While the reasons are in many instances laudable (to avoid money laundering or to stop tax avoidance), it can raise barriers to switching for some customers.

3 It should also be noted that there is no clear benchmark in assessing the appropriate level of switching in different retail banking products and services and whether the given level is related to better service and more competition in that particular market.
to the new account, which could result in missing debit payments for important household bills. Errors in the switching process come from many sources. Some of the largest numbers of errors come from non-bank direct debit originators (e.g. utilities). As causes of these errors lie outside banks’ direct control, this could add to the complexity and cost of building solutions for addressing the switching problems.

In the UK in September 2013 a 7 day error-free switching process has been introduced. The new and the old bank will do all the work for the customer and for a certain period any direct debit landing on the old account will be automatically redirected to the new account. It will be interesting to see the impact on switching rates.

Regulation as a barrier to entry

In recent years, financial regulatory authorities have been keen to avoid a repeat of the crisis and therefore they have introduced further new onerous requirements on financial services, for example higher capital requirements, more supervision of their activities, higher burden to get a banking license and the separation of riskier activities from retail ones. All those requirements, while laudable from a financial stability point of view, clearly make it more difficult for new entrants.

Governments always welcome more competition in this sector and they should consider carefully these new requirements. For example in 2013 the UK Treasury asked the FCA and the Bank of England to review the prudential and conduct requirements for new entrants to the banking sector to ensure that they are proportionate and do not pose excessive barriers to entry or expansion. The outcome of the review was the introduction of reduced capital requirements at the authorization stage, removal of new bank liquidity premium, and a changed authorization process to ease business start-up.

However, as always, there has to be a tradeoff. The prudential requirements are there to protect consumers from providers that would not have appropriate expertise or sufficient capital. At the same time building that expertise and raising sufficient capital raises barriers for new entrants.

Competition perspective of structural separation

Following the crisis, there have been discussions on the structure of the banking sector. For example in the US, the debate has concentrated on the so called Volker rule, which prohibits banks from engaging in proprietary trading that is not customer related. In the UK, the discussion has been on ring-fencing, which is the separation within the bank of the retail arm from the rest of the activities. France and Germany have looked at slightly different options. Following these national initiatives, the European Commission has launched recently its proposals in this area.

The rationale behind these reforms is that, by separating riskier activities from retail banking, vital retail services would continue even in a crisis, it would be easier to manage and resolve such banks in case of difficulties, and government might not need to intervene as much as they had to do during the recent crisis.

While all of this is laudable in principle, it comes at a cost. Under current UK proposals, some functions in the ring-fenced bank will have to be independent of the rest of the bank, giving rise
to obvious duplications. Centralized IT systems might have to be split to ensure the continuity of the retail bank if there is a crisis. And customers seeking a variety of services will have to be moved between banking legal entities. It is obvious there will be considerable implementation costs and those will be borne ultimately by consumers.

But one interesting aspect of the reform is that, in the interest of fostering stability, the impact of such proposals on competition has not received the appropriate attention. The banking sector has become more and more globalized. A globalized world economy needs global banks capable of handling every type of transaction as well as traditional lending. Different proposals in different jurisdictions will have an impact on the competitiveness of the banking sector in that jurisdiction. Investors, in a global market, might prefer to deal with universal banks rather than ring-fenced banks. This is an example of when a well-intentioned reform can sometimes have unintended consequences.

Behavioral economic

In the past, consumer policy and competition policy ran along quite separate lines, with little interaction between the two; in recent years economists have shown a greater interest in consumer policy. First, the modern consumer arguably faces more difficult decisions, involving more choices, than in the past. Second, the economic profession has recently seen a dramatic rise of behavioral economics, which takes into account imperfect consumer decision-making more than in earlier analysis.

Regulators sometimes get frustrated because they don’t fully understand how and why customers behave as they do, and this results in them sometimes focusing on the wrong things, or proposing ineffective remedies.

Behavioral economics brings together two very complementary toolkits into something that provides a deeper understanding of what people do: economics and psychology. If we could better understand real consumers, we have a chance to better understand how and where competition works effectively and how and where intervention may be required.

Behavioral economics can offer some insight on the way firms should provide information, adjust how choices are presented to consumers, require products to be promoted or sold only through particular channels or only to certain types of clients or require products to contain specific features.

However, authorities should be careful when using behavioral economics as a basis for their decisions as the possibility of errors is quite great. There are inherent limitations and this applies not only to the methodologies used but also to the evaluation of the survey data they often rely. They could lead to errors and inappropriate conclusions.

Conclusion

Many of the issues that authorities active in consumer protection look at or the remedies that they implement are similar to what a competition authority assesses and enforces.

In some countries competition authorities also deal with consumer protection (such as the Australian Competition and Consumer Protection, the Danish Competition and Consumer
Authority, the Office of Fair Trading in the UK\(^4\), the Federal Trade Commission in the US), while in others the functions are divided between two distinctive authorities. Moreover, in some countries competition agencies incorporate regulatory functions (such as in Spain and The Netherlands), while in others, regulatory entities have competition functions. For example, (1) in the UK, the FCA (Financial Conduct Authority) has the duty to promote effective competition when addressing consumer protection objectives; and (2) in the US, the Consumer Financial Protection Bureau (the US’s first federal agency focused on protecting consumers in the financial marketplace) encourages fair and competitive operation of consumer financial markets and promotion of fair competition by consistent enforcement of consumer protection. This means that in some cases regulatory bodies exercising consumer powers must achieve their desired outcomes by using solutions that promote competition. The various systems have each advantages and disadvantages. For example, it has been argued that achieving intense competition in the financial sector could be detrimental to stability (as it might lead to excessive risk taking), while too much regulatory oversight could chill investment activities.

While the application of both competition law and consumer protection in this sector is laudable, it has the possible downside of two different authorities looking at the same issue and prescribing conflicting outcomes. This increases the burden that companies may face while being investigated by different authorities, triggers the risk of substantive and jurisdictional conflicts between antitrust, consumer protection and financial regulation and enhances regulatory uncertainty. It would therefore make sense for the financial and competition authorities to work closer together and coordinate their activities.

The co-ordination of consumer protection and competition policies has obvious benefits for companies and consumers. The application of one policy should not interfere with the other one. On the contrary, these policies should mutually sustain each other in identifying conduct that harms consumers. Consumer protection concerns arising in the financial sector should have to be balanced with competition issues, and vice versa.

\(^4\) The OFT will cease to exist on the 1\(^{st}\) of April 2014 and replaced by the CMA, Competition and Market Authority which will lose some of its consumer protection powers.