House of Commons

Treasury Committee

GOVERNMENT RESPONSE TO THE COMMITTEE'S FIFTH REPORT OF SESSION 2001-02: BANKING, CONSUMERS AND SMALL BUSINESSES

Twelfth Special Report of Session 2001–02

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TREASURY COMMITTEE

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) from Session 1997-98 onwards are available on the Internet at www.parliament.uk/commons/selcom/treahome.htm. A list of Reports of the Committee published in the present parliament is at the front of this volume.

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TWELFTH SPECIAL REPORT

The Treasury Committee has agreed to the following Special Report:

GOVERNMENT RESPONSE TO THE COMMITTEE'S FIFTH REPORT OF SESSION 2001-02: BANKING, CONSUMERS AND SMALL BUSINESSES

1. On 30th July 2002, the Treasury Committee published a Report on Banking, Consumers and Small Businesses as its Fifth Report of Session 2001–02 (HC 818). On 23rd September 2002, we received the Government response, which is reproduced as the Appendix to this Report.

APPENDIX

(a) The Committee notes the banks' verbal commitment to basic bank accounts, but is disappointed by the limited progress made since the last report. The Committee believes the banks need to engage in more pro-active and innovative marketing if they are to be taken seriously on their expressed commitment and to overcome financial exclusion (paragraph 8).

(b) The Committee welcomes the banks' involvement in educating young people in financial matters including school visits for that purpose but believes the setting up of accounts should be separated from that exercise. The Committee recommends that young people should be given a breathing space between an educational visit to a school and the offering of a bank account (paragraph 9).

The Government believes that the availability of basic financial products is essential to ensure access to wider, mainstream services and is an important component in tackling social exclusion. Basic bank accounts have a role to play in providing this access. The Government notes there are initiatives to promote knowledge of basic accounts by banks and other institutions, including the Financial Services Authority. To tackle the problems of financial exclusion effectively, the Government agrees with the Committee that there are specific challenges to overcome to target and inform those that might benefit most from a basic bank account.

We support links between schools and businesses, provided the links contribute towards our educational objectives of raising standards and reducing disaffection and social isolation. We would also agree with the Committee's recommendation that any attempts to set up accounts should be separated from the visits themselves. In addition, it should be for the school to decide whether or not pupils should be given the offer of opening an account, and the banks should make approaches through the schools, not direct to pupils.

The Personal Finance Education Group (PFEG) is a voluntary organisation which helps teachers develop financial capability in young people. Firms which adhere to their code of practice agree to emphasise the educational benefits of any material they might develop, and not to promote branded products or services. PFEG operates a quality mark for material it recognises as recommended resources, and which abide by the practices, procedures and standards they set out.

(c) The Committee welcomes the commitment of the major banks to the "Universal Bank", but concludes that the "Universal Bank" is primarily an attempt to bolster Post Office business and to preserve access to pensions and benefits where such access would be lost by Post Office closures. Furthermore the Committee is concerned that this duplicates rather than complements the basic bank account. We believe that the limited scope of services is likely to be of interest to a minority of potential banking customers, and will in practice for the most part be used for those unable to access banking services through a commercial service provider. The "Universal Bank" is

likely to be a long-term commitment, as it will not be easy for people to graduate to full bank accounts. Consequently the long-term success of the "Universal Bank" may rely upon the continuing strength of the Post Office network. (Paragraph 11).

(d) The committee welcomes the pilot study into branch sharing, and looks forward to receiving the results of this study. However it is disappointed by the lack of enthusiasm shown by the largest clearing banks, and the limited scope of the BBA pilot study. The Committee recommends that, following the pilot study, the BBA publishes a report on the scope for a more comprehensive range of services to be handled in shared branches. In light of this, the Committee may look further at this matter to review progress, in particular we should welcome examples of bank sharing in areas which have lost all banking facilities (paragraph 15).

(e) The Committee considers the Post Office network may have a contribution to make to increase access to business banking services (paragraph 16).

In June 2000 the Performance and Innovation Unit recommended that the Post Office should develop the concept of a Universal Bank. In working up proposals, the "Universal Bank" concept evolved and from September 2000 became universal banking services. Under universal banking services access to a range of bank accounts will be provided through the Post Office network.

Universal Banking consists of two strands. The first is access at post offices to *basic bank accounts* offered by the banks —enabling people to withdraw cash from their accounts at post offices. Basic bank accounts are simplified accounts primarily designed to meet the needs of those who are new to banking and do not want or need the features of a standard account. In particular they provide no overdraft facilities and thus minimise the risk of accounts being overdrawn and incurring bank charges. Because basic bank accounts have no overdraft facilities a customer's credit history should not generally prevent them from opening an account. The vast majority of people who have difficulty opening a standard bank account should therefore be able to open a basic bank account. Use of the Post Office network would build on and extend the accessibility of these accounts to areas without bank branches or ATMs, encouraging take-up and reducing financial exclusion.

The second strand is the *card account at Post Office* —a stripped-down account accessible at post offices, exclusively for benefits and tax credits recipients who are either unable or unwilling to open even a basic bank account. The features of the card account are minimal—to avoid duplication with and to complement the banks' own basic accounts. Only benefits and new tax credits may be paid into the card account and cash may only be withdrawn from the account at post office counters. The intention is that this account should be a stepping-stone to bank accounts provided by financial institutions—and to financial inclusion.

These two strands of universal banking services will ensure that following the move to making all benefit payments by automated credit transfer, starting in April 2003, all those who want to will be able to continue to access their benefits in cash at post offices. Complementing this, the Post Office is also in discussion with the banks about "network banking" which would extend Post Office access to conventional bank accounts.

The major financial institutions, including the four largest clearing banks have agreed to contribute to the costs of the card account at Post Office and to make their basic bank accounts available at post offices.

Implementation of universal banking services is progressing and is on track for delivery in April 2003.

(f) The Committee believes that the lack of transparency in the credit and charge card industry acts against meaningful competition, and is therefore against the consumers' interest. The Committee recommends that credit and charge card companies should publish, with equal prominence, all the variables that make up the actual cost of credit. This should be done in a way which allows consumers to make straightforward comparisons between the costs of credit offered by all credit and charge card products (paragraph 19).

The Government agrees that credit card products are among the most complex forms of consumer credit and that there is a need to improve transparency. We recognise that the way the APR is calculated for credit cards does not always facilitate meaningful comparisons between different products and consequently it can be difficult for consumers to identify the best value deal that suits their circumstances. Credit card APRs are based upon typical examples and do not reflect the consumer's actual usage of a product.

The Government is currently undertaking a number of initiatives to address this issue. Since July 2001 we have been reviewing the Consumer Credit Act 1974. One of the main aims of the review is to improve the transparency of credit products, and this will include an examination of the current rules on APRs. The DTI has held a number of meetings with members of the Association for Payment Clearing Services about credit card APRs and we shall continue to consult closely with them as we develop our proposals. The European Commission has recently published proposals to amend the Directive on consumer credit, which is implemented in the UK by the Act, and detailed negotiations will follow. The Directive contains provisions on the calculation of the APR and we will also use this opportunity to address credit card issues.

In addition, the Government's task force on tackling overindebtedness recommended that a working group should look at revising the form and content of the credit agreement to ensure it is clear and transparent to consumers, and reflects the type of credit being offered. The working group identified what key information should be clearly presented in the body of credit agreements to improve transparency of the conditions and costs. It also commissioned research to determine how the layout of the agreements might be improved to aid consumers' understanding of them and the best way to present the key information. The working group has recently reported back to the task force and the task force itself will reconvene shortly to review progress on its original recommendations and make further proposals on the way forward.

(g) The Committee recognises that product differentiation can be an important feature of competition and satisfying customers' differing needs, but is concerned that for individuals to understand interest rate calculations requires an unreasonable amount of time and effort. The Committee recommends that every credit and charge card statement shows the "estimated interest charge if only the minimum balance is paid by the due date", as a number do already (paragraph 20).

(h) In light of confusion revealed over interest rates and charges on credit and charge cards, the Committee expects to carry out further investigation of this matter (paragraph 21).

The Government believes that improving the information in credit card statements offers consumers a better opportunity to understand how these products work. We welcome moves by credit card companies to provide pre-estimations of future interest charges in statements.

As part of our review of the Consumer Credit Act 1974, we shall be examining information requirements under the Act. The Act and its Regulations require lenders to give credit card customers regular statements of account and also prescribes the form and contents of these statements. We will look at how we can improve the quality of the information contained in these statements with a view to how the statement can be enhanced to facilitate consumer understanding of the product.

(i) The Committee welcomes the recommendation of the Competition Commission for a behavioural undertaking, by the eight main clearing groups, to include transparency of overdraft charges on bank statements (paragraph 23).

(j) The Committee is disappointed by the lack of clear progress made by the banks in reducing the overall clearing time for cheques (paragraph 24).

(k) The Committee welcomes the willingness of Abbey National, HBOS and National Australia Bank to try and improve transparency in their literature, and looks forward to reviewing the revised literature. The Committee hopes that this positive attitude is shared by all banks. The Committee urges all the banks to review their promotional material with a view to achieving genuine transparency (paragraph 26).

The Government notes the conclusions and recommendations made to the industry on transparency. In relation to bank literature the Government notes that there are commitments in the Banking Code, to which all high street banks subscribe, concerning the provision of information to consumers which should be clear and in plain language.

(l) The Committee believes it is vital that SMEs have confidence that any switch of bank accounts will be trouble-free and timely. The Committee recommends that the five-week target for account switching (where no borrowing is involved) is strengthened to a guarantee, with non-delivery triggering a compensation payment to the SME (paragraph 29).

The Competition Commission considered what a suitable target for account switching should be and recommended tougher targets (5 days for a substantial percentage of cases where no borrowing is involved, 10 days where borrowing is involved) with compensation if those timescales are not met. The Government accepted this recommendation and the DGFT is seeking undertakings from the banks to this effect.

(m) The Committee welcomes the proposal for portable credit history to be included in the Business Banking Code, monitored by the Banking Code Standards Board (paragraph 30).

(n) The Committee found that the SME banking sector is still dominated by the major four clearing banks, despite new entrants, and that insufficient competition exists. The cost of this monopoly situation is borne by SMEs, a vital component of the UK economy, and as such remedial action is required (paragraph 34).

(o) The Committee notes the criticisms of the methodology used by the Competition Commission put forward by the four main clearing banks. However, HBOS, Abbey National plc, and National Australia Bank did not complain about the methodology employed by the Competition Commission; indeed National Australia Bank commented that "it is a calculation which is broadly sound" (paragraph 39).

(p) The Committee welcomes the proposed behavioural remedies but is concerned that they will not on their own be sufficient to increase competition. In light of these concerns the Committee recommends that the Director General of Fair Trading reassess competition in the industry after the remedies have been implemented and to report further to Parliament by March 2003 (paragraph 43).

The Government has asked the DGFT to monitor the implementation of the package of remedies and to monitor the state of competition in the market. Given that the remedies will only begin to be implemented from no later than 1 January 2003 for the interest rate or free banking remedy, and from a variety of dates but none earlier than the end of September 2002 for the behavioural remedies, a report in March 2003 would seem to be too early to observe an effect. However, as the Chancellor made clear in his statement to the House on 15 March 2002, the DGFT is free to review all the remedies at any point that he sees fit, with 3 years from implementation being the latest time at which such a review should be carried out.

(q) The Committee has sympathy with the Competition Commission's view that because the behavioural remedies will not have a significant impact for a few years, additional remedies should be considered to benefit SMEs in the short term (pararaph 45).

(r) The balance of the evidence suggests that lack of portability and transparency are the main barriers to increased competition in the SME banking market and this has generated calls for price controls. The Committee was not convinced that price controls were the appropriate solution, and shares the misgivings of the Bank of England about their effectiveness in securing competition. However, we accept that in the short term the reduced charges will have a beneficial effect on SMEs. We are concerned that crude controls of this kind could damage rather than improve SME financing, and could well deter entry of the smaller banks into SME lending. The Committee is also concerned that regulation of charges could hinder competition, by reducing or eliminating a differentiating feature of new entrants' products in particular (paragraph 48).

The Competition Commission recommended interest on current accounts or free banking as a transitional measure to ameliorate the effects on SMEs arising from the complex monopoly situation, bearing in mind that behavioural remedies would take time to have an effect on the market. The Government agreed with this recommendation and felt the remedy should not interfere with the development of competition in the market.

(s) In view of the Chancellor's original wish to have the transitional remedy in place ahead of the behavioural remedies, we look to Ministers to make an early announcement of this matter.

(t) The Committee notes that it has been over four months since the Competition Commission report was laid before Parliament, with a timetable of six months for implementing all remedies. The Committee believes that the largest clearing banks should not profit from procrastination, and recommends that the DGFT should report to Parliament by the end of September 2002 on the progress made on implementation of the transitional remedy, including if necessary further proposals (pararaph 51).

The DGFT reported to Ministers in July that the four largest banks had given undertakings to implement the transitional remedy. The DGFT advised that there were some technical issues that the banks needed to overcome and that a suitable deadline should be for the banks to begin paying interest or offering free banking on SME accounts in England and Wales by no later than 1 January 2003. The onus remains on the banks to implement the remedy as quickly as they can. There are likely to be competitive advantages to be gained by those banks that decide to bring the remedy in ahead of the others.

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