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Spoilt for choice: competition is intensifying in the banking sector

Challenger banks are growing in strength and number, prompting the incumbents to defend their territory, finds Diane Sim.

Restructuring moves once again provide the backdrop to *Charity Finance's* Charity Banking Survey, as the government tries to strengthen the sector and prevent a recurrence of the failures of the 2008 banking crisis.

The latest measure affecting the six largest UK banks by deposits – namely Barclays, the Co-operative Bank, HSBC, Lloyds Banking Group, RBS Group and Santander UK – is the new ringfencing requirement, introduced by the Financial Services (Banking Reform) Act of 2013.

The measure, which came into force this year, requires banks with at least £25bn of deposits to separate core retail banking services from investment banking. This is intended to aid financial stability by insulating the former from the riskier activities of the latter and to make it easier to manage any failure of a large banking group without having to bail them out.

As well as streamlining the larger players, the government is also trying to develop the smaller, so-called challenger banks to increase competition and choice. Measures introduced in 2013 to make it easier to acquire a banking licence and lower the capital requirements for new banks have seen a steady stream of newcomers.

They include: Virgin Money and OneSavings Bank, which floated in 2014; Aldermore Bank and Shawbrook Bank, which floated in 2015; Clydesdale Bank and Yorkshire Bank, which were demerged from National Australia Bank and listed on the London and Australian stockmarkets as holding company CYBG in 2016; and Metro Bank, which made its stock market debut the same year. Other new entrants include privately financed digital banks Atom, ClearBank, Monzo, N26, Revolut, Starling, Tandem and Tide.

More recently, these smaller banks have begun to strengthen their presence in the UK market by undertaking mergers and acquisitions.

Last October, CYBG completed its £1.7bn acquisition of Virgin Money, creating the UK's sixth largest bank with more than six million customers and £84bn of assets, which is double the size of any other challenger bank. Over the next three years, the combined group will transition to the Virgin Money brand.

Earlier in 2018, Tandem acquired Harrods Bank, while South African

FIGURE 1: BANKS USED AS PRIMARY PROVIDER BY CHARITIES[1]

	Charity income				
Number of clients	< £1m	£1m – 5m	£5m – 20m	> £20m	**Total**
Barclays	4	7	12	96	119
NatWest[2]	6	4	9	68	87
Lloyds Bank[3]	4	8	8	61	81
HSBC	4	7	3	37	51
RBS[2]	1	3		34	38
CAF Bank	20	8	2	1	31
Reliance Bank	21			1	22
Co-operative Bank	10	7		4	21
Coutts[2]			1	13	14
Unity Trust Bank	8	5			13
Bank of Scotland[3]	1	3		7	11
Allied Irish Bank[4]				7	7
Handelsbanken	1	1	1	2	5
Clydesdale Bank / Yorkshire Bank[5]		1		3	4
Triodos	1	3			4
C Hoare & Co		1		2	3
Santander	1	1		1	3
Charity Bank	2				2
Other	2			6	8
Total	**86**	**59**	**36**	**343**	**524**

(1) Based on data provided by 350 members of the Charity 100 and Charity 250 Indexes, plus 194 survey respondents (minus the overlap).
(2) Part of RBS Group
(3) Part of Lloyds Banking Group
(4) Part of AIB Group
(5) Both parts of holding company CYBG, spun off from National Australia Bank in February 2016.

banking conglomerate FirstRand acquired Aldermore. And, this year, OneSavings Bank announced its proposed acquisition of rival Charter Court in a deal that would create one of the UK's largest specialist lenders with a focus on buy-to-let mortgages.

Divestments by Lloyds Banking Group and RBS Group, mandated by the European Commission to meet requirements for entitlement to state aid, have also slimmed down the larger banks and beefed up the smaller ones.

Lloyds Banking Group fulfilled its obligations by demerging Lloyds TSB in 2013 and selling its stake in TSB Bank in two 50 per cent tranches in 2014 and 2015. TSB is now owned by Banco Sabadell, though the Spanish bank recently revealed its intention to sell TSB in the next few years.

RBS Group's abortive plan to divest over 300 branches under the Williams & Glyn brand by the end of 2017 was superseded by "an alternative remedies package" agreed by HM Treasury and the European Commissioner responsible for competition policy. The package requires RBS to spend £835m to pay business customers to switch their accounts to competitors and to fund rivals' growth ambitions. The alternative remedies package also includes a £350m incentivised switching scheme, aimed at encouraging up to 200,000 RBS and NatWest SME customers to switch their accounts to other banks through preferential terms such as free banking or cash offers.

The nine challenger banks currently participating in this scheme include TSB, Co-operative Bank, Starling, Santander UK, Metro Bank, Handelsbanken, CYBG, Hampden & Co and Arbuthnot Latham. Monzo and Nationwide will join the scheme once they have developed a current account for business customers.

The package also includes a £425m Capability and Innovation Fund, charged with awarding grants to challenger banks and other financial services providers to increase their business banking capabilities. The first awards from this fund, made earlier this year by the independent Banking Competition Remedies body, include £120m to Metro Bank, £100m to Starling Bank and £60m to ClearBank. Unsuccessful bidders in the first round, including CYBG, Co-operative Bank and TSB, will be able to apply to a second pool of funds later this year.

HIGH STREET VERSUS CHALLENGER BANKS

While the competitive landscape is undoubtedly changing, increases in choice take time to change customer behaviour.

As figure 1 shows, primary banking relationships with charities are still dominated by the main four high-street groups, with the only real challenges coming from the Co-operative Bank and the specialist banks focused on the not-for-profit sector.

That said, challenger banks – particularly Virgin Money, which is now part of CYBG, along with Clydesdale Bank and Yorkshire Bank – do have a reasonably strong showing in the list of banks that charities use in addition to their main banking provider (figure 2).

> "Charities' primary banking relationships are still dominated by the main four high street banking groups"

Additional banks are used by charities for a wide variety of functions including loans, international payments, foreign exchange transactions, trading subsidiaries and Islamic finance products.

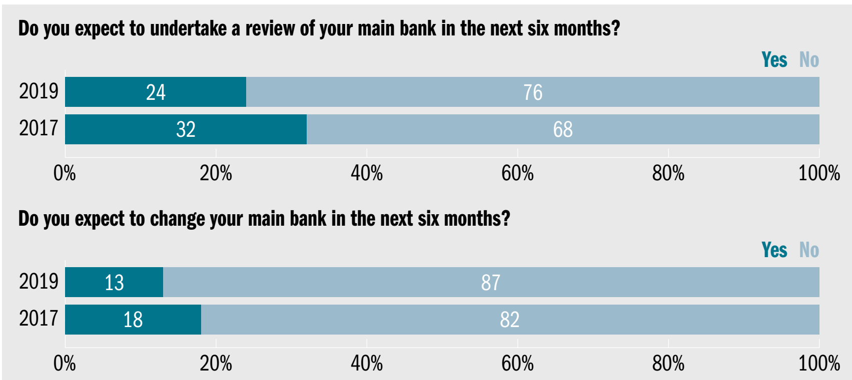
Their main use, however, is for deposits, as charities seek to maximise their cover from deposit protection

FIGURE 2: SECONDARY BANKS USED BY CHARITIES

HSBC	10%
Lloyds Bank	9%
Santander	8%
Virgin Money	8%
Barclays	7%
Nationwide Building Society	6%
CAF Bank	5%
NatWest	5%
Close Brothers	3%
Co-operative Bank	3%
Clydesdale Bank / Yorkshire Bank	3%
Charity Bank	3%
CCLA	3%
Cambridge & Counties Bank	2%
Scottish Widows Bank	2%
Triodos	2%
RBS	2%
Shawbrook Bank	2%
Cater Allen	1%
Handelsbanken	1%
Metro Bank	1%
United Trust Bank	1%
Unity Trust Bank	1%
Other	12%

FIGURE 3: CHANGING BANKS

■ One in four banks will review their main bank shortly but only one in eight expect to switch ■



insurance for balances up to £85,000 and look for higher interest rates than their main bank provides.

As competition intensifies, challenger banks are raising their profile among charities. Monzo, for example, has recently partnered with The Big Issue on a scheme called Pay It Forward, which enables *The Big Issue* magazine to be resold by readers, with the proceeds of every subsequent sale credited to the original vendor.

RESPONSE LEVELS

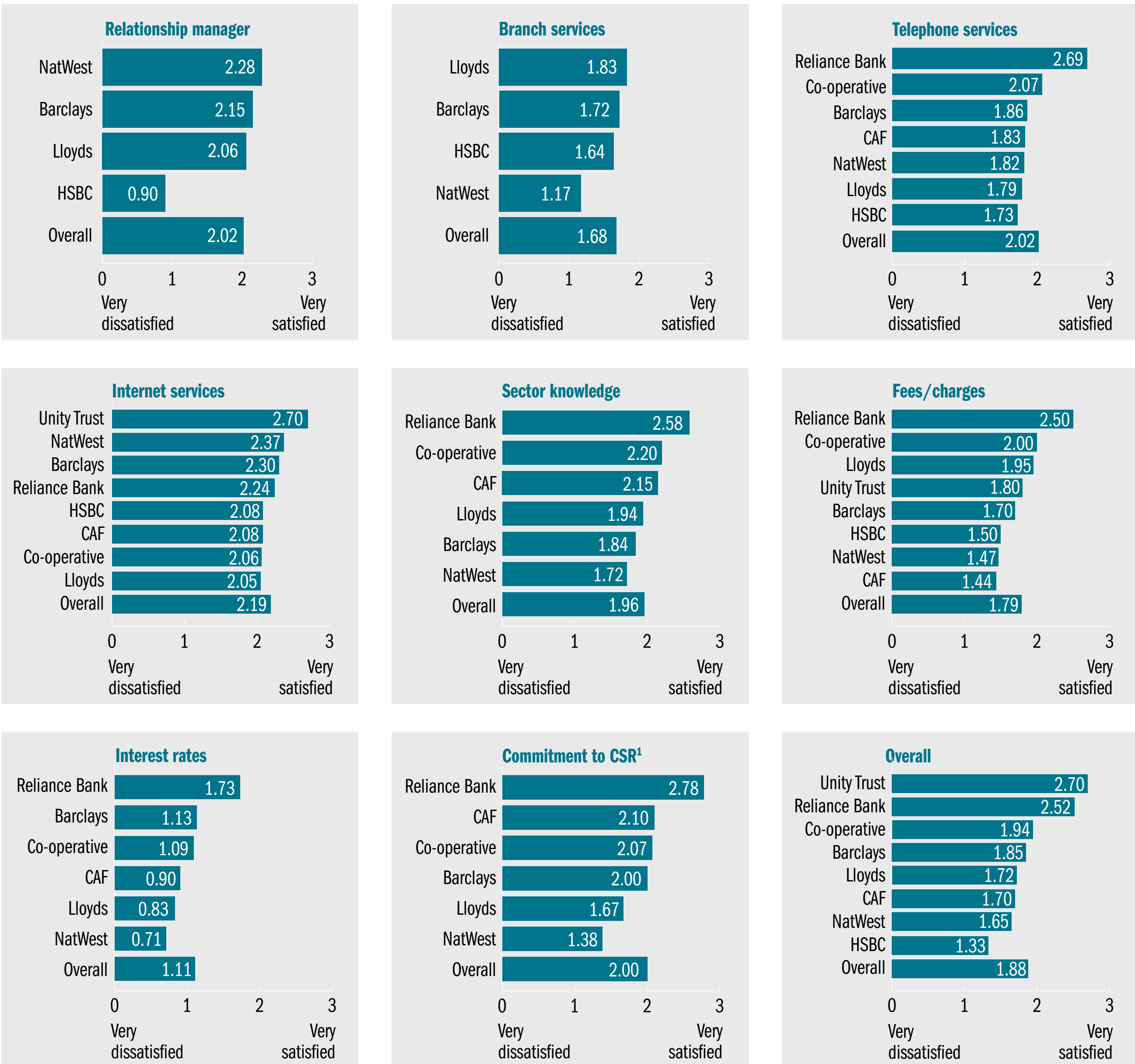
Almost 200 charities participated in *Charity Finance's* annual banking survey. Small charities with an annual income of under £1m are well represented and make up 44 per cent of the survey sample. The remainder is split between: charities in the £1m-£5m income bracket (30 per cent); those in the £5m-£20m income bracket (19 per cent); and large charities with an income of over £20m (7 per cent).

The survey data has been supplemented with data sourced from the UK's top 350 charities, which are routinely tracked for the purposes of compiling the haysmacintyre / *Charity Finance* Charity Indexes.

Figure 1 is based on this combined sample and, while it does not purport to represent the charity banking market as a whole, it provides fairly comprehensive coverage of large charities with annual incomes of over £20m and more selective coverage of small and medium-sized charities.

The large-charity segment is dominated by the big four high street banks, namely Barclays, HSBC, Lloyds Banking Group (comprising Lloyds Bank and Bank of Scotland) and RBS Group (comprising NatWest, RBS and Coutts). Together, these four are the main banks to 93 per cent of charities with annual incomes of over £20m.

FIGURE 4: CUSTOMER SATISFACTION RATINGS



(1) Corporate social responsibility

Note: Banks with fewer than ten charities rating their services have been excluded. Satisfaction ratings have been calculated by assigning responses with values and then calculating an average: "very satisfied" = 3, "fairly satisfied" = 2, "slightly dissatisfied" = 1, "very dissatisfied" = 0

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Barclays is the main single provider to charities in this income bracket with a 28 per cent share of main relationships. RBS Group has a 34 per cent share split between NatWest (20 per cent), RBS (10 per cent) and Coutts (4 per cent). Lloyds Banking Group has a 20 per cent share of main banking relationships with charities in this segment, split between Lloyds Bank (18 per cent) and Bank of Scotland (2 per cent), while HSBC has an 11 per cent share.

Compliance with ringfencing requirements from the start of this year has undoubtedly been a major undertaking for the main high street banks. Leo Jones, head of charities and not-for-profit organisations at HSBC UK, says: "On 1 July 2018, we successfully moved 17 million accounts and 22,000 colleagues to our new bank, HSBC UK, making it one of the biggest new banks our UK regulator has ever authorised."

For some banks, ringfencing has had a direct impact on their relationship management strategies. Barclays head of charities and citizenship Nazreen Visram says: "Following the successful completion of our structural reform programme, charities with income greater than £6.5m are served by Barclays Bank plc, and charities below this threshold are served by Barclays UK."

The vast majority of charities surveyed this year have felt no impact from ringfencing beyond a change in sort code, though a very small minority report problems including the loss of historic data during the transition and a change in service levels.

The Co-operative Bank has just a 1 per cent share of main banking relationships with charities with annual income of over £20m. This has gradually fallen over the last few years from 6 per cent, likely reflecting high-profile financial challenges and the gradual shift of ownership from the Co-operative Group to private investors between 2013 and 2017.

The bank is keen to point out that, while its ownership has changed, its ethical banking credentials have not. The bank's ethical policy, introduced in 1992 and incorporated into its constitution in 2013, means it will turn down business from companies whose values do not align with its own. Says head of SME Ryan Etchells: "We are the only UK high-street bank with values and ethics embedded into our articles of association. Our customers constantly reinforce this as a reason they either continue or choose to bank with us. This is particularly the case with our charity customers."

The smaller specialist banks that focus on the not-for-profit sector enjoy a strong position in the charities market, albeit not in the large-charities segment, and have done a good job of communicating the social benefit that they claim usage of their products and services creates.

CAF Bank, for example, purports to deliver both social and economic benefit to its customers by giving its surpluses back to its owner, the Charities Aid Foundation (CAF). Head of charities Neil Poynton says: "For many charities, the ability to use a socially focused bank, such as CAF Bank, is very important. It ensures that there is a continued and ongoing commitment to the sector by a bank that understands charities."

> "Compliance with ringfencing requirements has clearly been a major undertaking for the high street banks"

Reliance Bank, which was founded in 1890 as the Salvation Army Bank, also gives its profits back to its charity owner, in the form of either direct donations or retained earnings.

Unity Trust Bank is a commercial bank with a social conscience, something that resonates with charities, says its director of commercial banking Steve Clarke. "Every loan approved by the bank must deliver community, economic, social or environmental benefit as well as meet our risk criteria," he adds.

Triodos Bank only lends to or invests in organisations that positively affect people's lives, protect the planet or build strong communities," according to Paul Nicoll, social and cultural lending team leader at Triodos Bank. "Being ethical is at the heart of what we do and is our main point of difference for charities who want to choose a bank that aligns with their mission."

Similarly, Charity Bank, which is owned by charitable foundations, trusts and social purpose organisations, will lend only to "charities, social enterprises and organisations tackling social and environmental issues".

OPEN BANKING

Another government initiative intended to increase competition and choice in the banking market is

FIGURE 5: BIGGEST COMPLAINTS

Withdrawal of services / facilities	18%
Internet / online services	14%
Low interest rates	14%
Fees	13%
Call centre / back-office support	6%
Understanding needs of charities	6%
Lack of dedicated contact	5%
Poor customer service	3%
Change in relationship manager	2%
Other	3%
No complaints	16%

FIGURE 6: IMPORTANT FACTORS WHEN CHOOSING A BANK

Good reputation in charity sector	36%
Internet / online banking	33%
Historic relationship	32%
Competitive fees	29%
Ethical / socially-responsible approach	28%
Ease of access	27%
Recommendation	17%
Offers specialist charity services	16%
Range of services	13%
Attractive interest rates on cash deposits	9%
National representation	5%
Credit rating	4%
Sponsorship / support	1%
Other	2%

Note: Respondents could choose more than one category

Open Banking, which came into force in 2018 as part of the EU's second Payments Services Directive (PSD2).

Under the terms of PSD2, the nine largest UK banks and building societies are legally required to allow customer account information to be shared securely online with other regulated companies, subject to the account holder's consent.

The initiative is intended to help account holders to access other financial products and services (such as current accounts, cash management, savings and loans), which may be more suitable for their needs based on their account history. The information sharing is facilitated by application programming interfaces (APIs), which enable different software applications to communicate with each other.

Banks interviewed in the course of this year's survey are uniformly positive about the benefits that Open Banking will provide charities. "We are very much embracing Open Banking because we believe these regulations provide a unique opportunity to offer our customers innovative solutions that have not been possible before, such as bringing all of their financial information together in one place," says Jones at HSBC UK.

For their part, the charities surveyed this year are largely unaware of the initiative. Of the 50 per cent commenting on Open Banking, fewer than 20 per cent give it a positive reception, with the rest expressing uncertainty or concerns over security and privacy. It is a telling indication that increased choice – even if in the interests of the consumer – clearly does need time to affect behaviour.

FIGURE 7: ETHICAL BANKING

■ The importance placed by charities on ethical banking has declined over the last few years ■

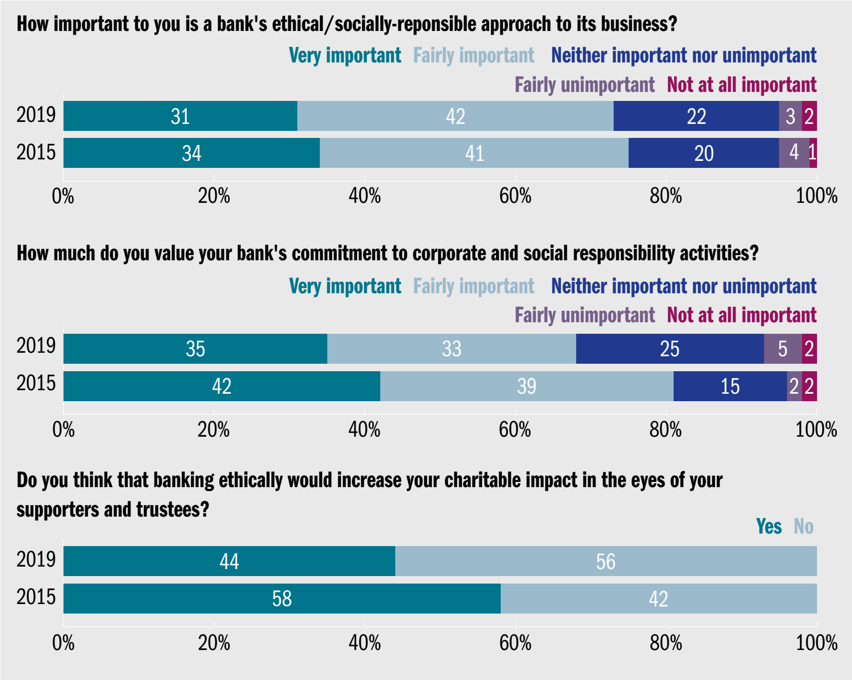
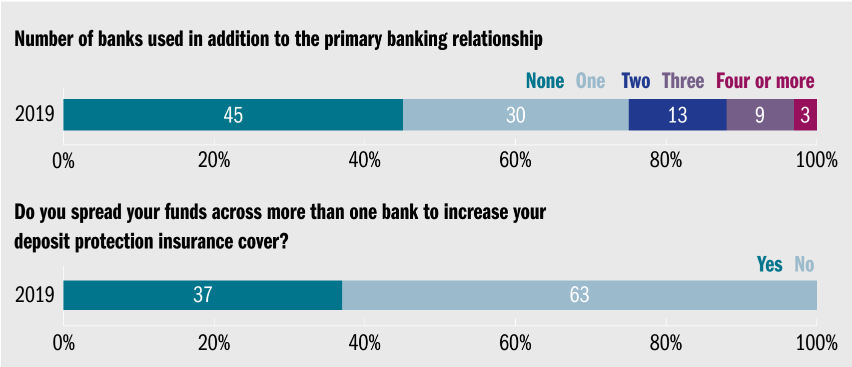


FIGURE 8: USE OF ADDITIONAL BANKS

■ Most charities use more than one bank but not necessarily for deposits ■



BRANCH CLOSURES

The most frequent cause for complaint about high-street banks among the charities surveyed this year related to branch closures (figure 5).

The number of UK bank branches has declined steadily over the last 30 years from 20,583 in 1988 to 7,586 at the end of 2018, according to figures compiled by *Which?* This is a particular concern for charities, which frequently need to deposit cash and cheques collected via shops and fundraising activities.

Many banks supplement their networks by making services available via the 11,500 branches of the Post Office, although the facilities offered are limited.

Reflecting the fact that this is an industry-wide issue, NatWest, Lloyds and Barclays have teamed up to pilot shared business banking hubs. The hubs, which will be open from 8am to 8pm seven days a week, have been designed to "enable businesses that manage cash and cheque transactions to pay in large volumes of coins, notes and cheques and complete cash exchange transactions". The first hub opened for business in Birmingham in March and five more in London, Manchester, Leicester, Crosby and Bristol are due to follow.

DIGITAL BANKING

A more common approach to the issue of branch closures, however, is the development of digital banking facilities, both collectively by the industry and by individual banks.

At industry level, the development over the last two years of image-based cheque clearing, which enables cheques to be deposited digitally and funds to be cleared within two working day rather than six, has been significant.

A number of the banks surveyed this year are developing their own digital capabilities and encouraging take-up by their charity clients.

"Barclays has reintroduced the business process review for new as well as existing customers, largely as a result of continuous change in the way day-to-day banking transactions are undertaken, particularly in the new digital arena," says Nazreen Visram.

"Examples of our recommendations when undertaking reviews with our clients include straight-through [automated] processing of payments made, better use of lower-cost channels such as faster payments [which reduces clearance times to seconds] and SEPA [single euro payments area, which facilitates cross-border transfers in Europe], and improved integration between the bank and back-office systems for reconciliations," she adds.

Meanwhile, Hugh Biddell, head of charities and not for profit at NatWest and Royal Bank of Scotland (both parts of RBS Group), says: "Relationship managers work closely with charities to review their operating models and see how banking solutions can be embedded into their processes to optimise efficiency."

Following a successful pilot last year, the bank has recently launched NatWest APtimise, cloud-based accounts payable software that combines invoice automation and payments to boost productivity and optimise cash flow. Earlier this year, RBS start a pilot of FreeAgent accounting software via the Open Banking platform to enable RBS and NatWest customers to access and integrate their banking data. "This initiative will help charities comply with the recent Making Tax Digital requirement," says Biddell.

Lloyds Bank has invested significantly in improving the digital skills of its customers. In 2017, it met its target of recruiting 4,000 digital champions to help 700,000 charities and businesses acquire digital skills.

According to area director for education, charity and social enterprise Steve Hutton: "The digital champion network has grown to 24,000 and the bank is committed to training 1.8 million charities and businesses in digital skills between 2018 and 2020".

Lloyds has measured the digital capabilities of SMEs and charities since 2014. Last year the *Lloyds Bank Business and Charity Digital Index* reported that "in 2014, 24 per cent of charities and 8 per cent of SMEs were digitally excluded – in 2018, 99 per cent of SMEs and charities are now online".

According to senior relationship director David Kearney: "Charities tend to be late adopters of technology, so have most to gain from this hands-on approach to developing digital skills."

FRAUD AND CYBERCRIME

Intrinsically linked with digital banking is the need for protection from fraud and cybercrime.

According to Hutton at Lloyds, charities are particularly susceptible to online fraud. "Fraudsters target charities and educational establishments because there are generally high volumes of incoming and outgoing payments and the use of volunteers can mean that standard procedures and protocols are not always strictly adhered to," he says.

Sarah Smith, senior operations manager of CAF Bank, concurs: "Fraud mitigation continues to be one of the greatest challenges for charities. Sector wide, the numbers of fraud attempts are increasing, especially around invoice and CEO fraud.

"CAF Bank has introduced text alerts to further enhance our online banking security features, and is now rolling out two-factor authentication in the form of SMS or app codes." ●

FIGURE 9: BANK LOANS (PERCENTAGE OF RESPONDENTS ANSWERING YES)

■ Charities' appetite for borrowing is diminishing ■

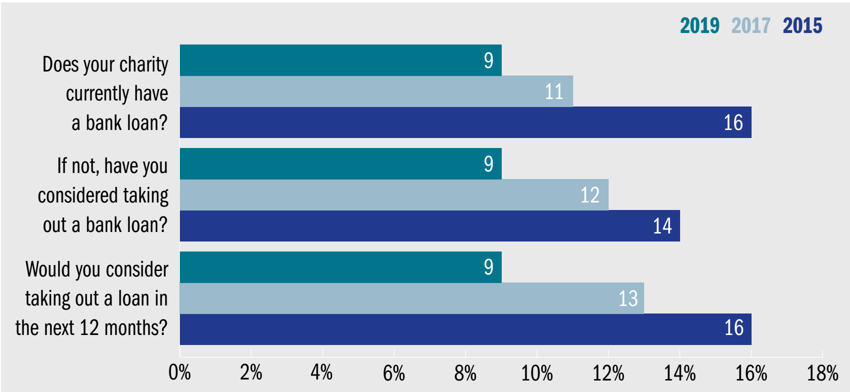


FIGURE 10: OVERDRAFT FACILITIES

■ Charities' use of overdraft facilities is minimal ■

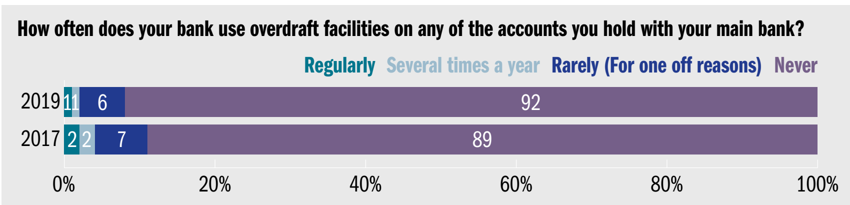


FIGURE 11: SOCIAL FINANCE

■ Only one in six charities actively consider social finance as an option ■