

Thank you for to the RPI for inviting me back to speak at this event.

I should always, as ever, declare my allegiances at the outset. My day job is working for Lloyds Bank and as I am a non-executive on British Gas' Customer Fairness Committee.

As ever, I speak in a personal capacity and not for any of the organisations I work for.

I am also a Council Member at the RPI I am not sure whether I was invited, volunteered or press-ganged.

But, more seriously that isn't fair and I apologise to George. When we first discussed this session – and this is reflected in the title – it followed on from a conversation we and others had been having about our shared view of the current malaise in much regulation particularly as applied to retail markets.

I spoke about at this in the most recent Beesley lecture series. At that point I suggested that part of the problem was that politicians had watered down the clear and simple promotion of competition duties that many sector regulators had and given them multiple, conflicting duties.

Other than financial services where they had recently – albeit after much pressure from the ICB and the PCBS - been put at the centre of the new regulatory arrangements.

And that this might be partly to blame for the current state of affairs.

So I had planned to talk about whether the constant tinkering with regulators duties reflected a growing institutional instability that would undermine the problems – primarily around commitment - that independent economic regulation had been invented in the UK to solve.

But that is not what I plan to talk about today as although I still think this is a problem I now think there may be a deeper problem that even a return to simple objectives to promote competition would not solve.

So what is this problem, or more accurately series of problems?

Broadly, what I want to persuade you is the following four propositions:

- (1) There is an emerging framework being adopted that tries to assess what an effective competitive retail market looks like
- (2) This framework is wrong and is based on unrealistic assumptions about how customers actually behave and would find problems in almost any market it was applied to
- (3) That many of the perceived problems revealed by this framework are ones that, given time, the market process can and will find ways to solve
- (4) That regulators are too quick to intervene and often promote remedies that are at best ineffective or at worst actually harm competition and the competitive process; and
- (5) Even if you don't accept my arguments and think this is an appropriate framework it is applied inconsistently and politicians and regulators aren't focussing on the right markets where they could deliver the greatest gains to customers.

At this point I recognise that some of you might be thinking. Hang on a minute. Didn't he say he works for a bank and an energy company? Or to be more accurate, didn't he say he worked for the largest retail bank and largest energy supplier in the UK. Well he would say that and think that wouldn't be.

Well for some of you who know me I hope you will know that I also have form on the other side and have run one or two successful (and less successful) competition law cases and investigations and references so I hope you will give me the benefit of the doubt and at least listen to why I think this.

So let's start with the first two propositions. What is the emerging framework that so concerns me?

Well broadly, it is the one that was established by the OFT before it was subsumed into the CMA and is now being adopted by other regulators with newly minted competition powers such as the FCA.

This framework considers what is necessary for competition to be effective and focuses on the role of customers.

It broadly says that for competition to be effective customers need to be able to *access* information on competing providers offers, *assess* those offers and then customers need to *act* by choosing providers offering the best price, services and quality.

If any of these conditions aren't met then the demand side of the market will not properly discipline providers and even in

markets where there a range of suppliers competition can lead to poor distributional outcomes or “bad forms of competition” competing on the “wrong prices” or in the “wrong way”.

In its more extreme version it can be turned into a “vision” of how a regulator would like a market to work.

Take Ofgem’s vision for how the energy market should work in the many of its most recent publications.

Why is this wrong?

Well, at it’s simplest I think it has two fundamental problems.

It has at its heart a model of how customers behave that still seems deeply rooted in the rational economic man (or woman) model of calculating machines that we now know to be a very poor description of how real people (and customers are real people) process information and make decisions.

This is deeply ironic as most of the regulators adopting this framework claim that behavioural economics is at the heart of their regulatory thinking.

Or, more starkly if this is the test we apply to determine whether a market is effectively competitive we will never find a market that passes the test and will always find things wanting and excuses to intervene to “make things work better”.

And second it ignores the role of the market process and innovation in solving these problems in ways that work with the way customers really take decisions and that, over time, make customers better off.

Let me bring this to life

In the two retail markets I am most familiar with – banking and energy – the framework leads to the following narrative.

The products are relatively complex and so customers find it hard to both access and assess the relevant information.

Many customers are inert so even if can do this many of them don't act and switching is relatively low.

So irrespective of the number of providers or patterns of entry competition isn't effective.

How might the market process solve this problem? Well the evidence over time is fairly clear. First of all in the pre-internet era intermediaries - brokers in insurance, mortgages and other products. They still exist in energy for business customers. They help customers access and assess.

In the digital era the explosion of comparison sites that not only allow you to search the market but increasingly find ways to remove any effort involved in shopping around.

When I see Which publish research saying the problem in retail energy markets is that 7 out of 10 customers can't pick the cheapest supplier I think: but why would you sit down with a pen and paper to do this when one of the companies now has an app that allows you to simply take a photo with your phone of your bill, extract all the necessary information then instantly tell you how much you can save and switch at the touch of a button.

They make it simple and easy and reduce the cognitive effort required to access, assess and act. And they spend huge amounts of money and constantly invent new ways to overcome many of the other behavioural biases that might prevent customers doing this.

And if firms start to try to find ways to exploit customer inertia, market processes find ways to solve these problems too. If energy customers think it is too much hassle to constantly shop the market when prices are going up or down then they can simply sign up to Martin Lewis' Energy Saving Club and be sent an email telling you whenever your current deal is too expensive and there are better offers on the market. You can even set the amount your current deal has to be beaten by to receive the email so you are not bombarded and only get salient information.

And firms can find ways to “solve” these problems – price guarantees – “never knowingly undersold”, mobile phone tariff checkers, annual reviews etc. These all build loyalty and reduce churn which are significant costs for business and so make commercial sense.

This leads me neatly to my next point. Market processes can and do, over time, solve problems of inertia and complexity by creating opportunities for new entrants or entrepreneurs to create new businesses to help customers where there are gains to be made and shared.



And as we have learned from two hundred years of economic history, they will typically be much better at doing this than regulators or politicians.

Regulators who use this framework will always find problems and will always face the inevitable temptation to do something and often when they do they will either have no effect – other than to push up costs to customers by imposing ineffectual remedies on companies that then pass on the costs of implementing them or – at worst restrict or distort competition.

Take energy again – there is clear evidence that Ofgem's significant interventions to make the market simpler, clearer and fairer have had the opposite effect. There are academic papers showing that as predicted, Ofgem's first attempt to fix the market – the anti-discrimination clause – put average prices up not down.

The more recent four tariff straight jacket has forced suppliers to remove products and discounts such as no standing charge products and prompt payment discounts that many customers liked and valued. It is also stifling innovation in allowing suppliers to offer more innovative tariffs and services around new gadgets to control how much energy you use as well as what you pay for the energy you use.

In financial services the two biggest interventions in recent times, the Retail Distribution Review and the Mortgage Market Review are already starting to create unintended consequences. The RDR has led to many financial advisors and companies withdrawing from the market for all but the wealthiest customers giving rise to an “advice gap”. The MMR which was only implemented last week is now starting to attract negative comments as all customers are faced with 2-3 hour interviews to obtain a mortgage and detailed questions about their lifestyle and spending habits. Brokers are already advising customers on what and what not to do before making a mortgage application.

And before moving on from this point. I wanted to give a lovely example from Dan Ariely who is a behavioural economist and the author of several great books that neatly illustrates why regulators should tread carefully when designing interventions.

I think there is an emerging view – and I have been guilty of this myself - that part of the “solution” to the problem in many of these retail markets is better and simpler comparison sites that help navigate customers make better choices.

Don't get me wrong, I still think they have an important role to play, but we have to accept that even they have limits given the

way our brains work and that some responsibility still has to lie with the customer and we have to accept that we don't always want to make the best decision!

So in Dan's story he is about to purchase his first car in his early 30's. Not knowing much and faced with overwhelming choice - and if Which and Ofgem think that the pricing and number of tariffs is a problem in energy – how on earth do customers ever make effective choices on what make, colour, engine size, extras to choose when they buy a car?

Well Dan found the perfect solution. A website where you put in what mattered to you: fuel economy, running costs, depreciation etc and it told you what to buy. So after five minutes it told him the answer – a Ford Taurus – unsurprisingly he was a little disappointed. But he realised quickly he must have answered some of the questions incorrectly, went back and sure enough half an hour later after several attempts the website finally told him that his ideal car was a convertible sports car that he duly bought!

Maybe you are persuaded at this point? Maybe not.

For those of you in the audience who still think the access, assess, act framework is reasonable let me try one final line of attack.

How do we decide which markets to apply the framework to and what level of “detriment” warrants intervention? Well a reasonable starting point might be to take a look at typical expenditure for households with different wealth profiles and then look at what they typically spend each week or month, and what the potential gains might be from making better choices or changing behaviour? This is an interesting exercise and one we did at Lloyds. The answers are quite interesting. Some of the biggest gains we could and should go after are behaviour change rather than shopping around and switching. Relatively simple things like encouraging customers to pay by direct debit to get significant discounts on their regular bills.

And the markets where poor choices or inertia cost customers the most certainty aren't the ones that fill the headlines – energy and personal current accounts.

I will now give an example of where we are inconsistent. I raise this for debate and do it with slight trepidation as what I am not advocating is a change in Ofcom's approach or more intervention along the lines seen in other markets!

But why do we deem retail energy and banking to be such a problem when assessed by this framework and not mobile telephony? Where there aren't 4 tariffs but a million. Where many customers who don't switch at the end of their contract might be paying £300-400 more than they need to because they are still paying the contract price that included the subsidised cost of their phone? Where customers can go abroad, forget to flick a switch on their phone to turn off data and come home to a bill of several hundred or even a thousand pounds? And where the switching process involves long, complicated numbers, phones that are locked to networks and where you can lose service for up to 24 hours when you switch?

This matters and here I think there is more of a role for consistency in thought, approach and action between sectors and a better sense of priorities in assessing whether problems are real, incapable of being solved by market processes and material enough to warrant scrutiny or intervention. I hope that the CMA will rise to the challenge if it does, as expected, review energy and retail banking as two of its first serious investigations.

I promised I would end by convincing you that this wasn't all self-serving special pleading given my current employers. So I should end by stating that I do think there is a legitimate role for

competition authorities and for sectoral regulators using competition powers to intervene in retail markets.

But they need to focus not on seeking to direct, shape and distort the competitive process but on creating the conditions where the competitive process can take hold.

First they should focus on lowering barriers to entry and lowering barriers to switching providers. This can be invasive and expensive – so the new, world leading seven day switching service recently implemented in banking that I helped persuade Lloyds to develop and persuade others to adopt has cost the industry several hundred million pounds to develop.

Then reducing the time, effort and costs required to gain the necessary licences/approvals to enter the market.

Reducing regulatory rule books and guidance is a must. I am struck that the new FCA competition team have been honest enough to admit that the 6ft 3 inch rule book that any new entrant must read and understand before entering the market might be a problem and might prevent the sort of disruptive new entry in financial services that digital technology is driving in so many other consumer industries.

I have to forget all the hard work I did at Ofgem over two years to reduce the supply licence's length and obligations has been unwound and we know have rules and guidance stretching to hundreds of pages and going into minute detail on what is and isn't allowed (and when and how many nectar points you can award your customers).

And looking at essential networks necessary to enter the market – be they physical networks in telecoms, gas and electricity or payment systems to make sure they have non-discriminatory access and pricing terms that support and do not stifle new entry or new entrants. The new payments regulator in banking is long overdue.

If you do all of these things you create the conditions where entrepreneurs who spot problems - such as inert customers overpaying, unnecessary complexity, poor service to enter and create new businesses and models to make things better. If getting in to the market and customer switching is expensive and slow they are likely to go and do this in markets where this isn't the case.

Finally, on the role of regulators in designing information remedies I am still torn. I can see some role for interventions

that might improve the market process. But I would urge caution, humility and would urge regulators to make much more use of proper, randomised controlled trials before imposing significant and expensive informational remedies whose impacts are uncertain and costs will be passed on to customers.

That, you will be delighted to hear, is broadly all I have to say. Thank you for listening to me. I hope I have persuaded you that the tests we are applying to judge whether markets are competitive need to change. And if I haven't I hope I have persuaded you we need to be more systematic and proportionate in determining which sectors require intervention

And I look forward to what I hope will be a healthy debate on this important subject.