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Treasury Committee

Transparency of Credit Card Charges

First Report of Session 2003–04

Volume I

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Summary

The issues

This report has confirmed concerns about how the industry deals with its customers:

- in providing clarity to users about the interest rates and charges, and
- in charging and marketing methods which can lead users into high personal debt.

Consumers have great difficulty in deciding on best value, in knowing what they will be charged once they use a card, and in understanding why they have received a particular charge. These difficulties, exacerbated by marketing practices, can contribute towards the build up of serious personal debts. The high interest rates charged by some credit and store cards suggest a lack of transparency in pricing which obstructs effective competition

The present consumer credit regime is from a previous age in terms of market developments. We hope the White Paper on consumer credit just published is the start of a period of action by the DTI, rather than just the start of a new round of consultations.

Transparency

There has been wide support for introducing a 'Summary Box'—a clear presentation of the key elements of a credit card offer in a standard tabular form—but little action. So we challenged the industry to bring to the Committee an agreed set of proposals; this they did. The industry stated they were now committed to this by April 2004 and would be reviewing the way it was working by September 2004. There is a case for the inclusion in the Box of examples of the cost of different borrowing scenarios, which should not increase confusion if implemented in a simple and standard way. The Summary Box approach could be extended to apply to monthly statements.

UK consumers cannot use the statutory APR to make comparisons at the moment because of different legal interpretations as to its meaning. We welcome the announcement in the consumer credit White Paper for a new definition to come into force later in 2004, but dialogue should continue to agree a legally acceptable working interpretation in advance.

Different interest calculation methods (eg in the date from which interest starts) can cause wide differences in the amount actually charged. If the effects of differences cannot be explained to the consumer then some degree of standardisation will be required.

Many card issuers apply payments to reduce the cheapest parts of a customer's overall balance first, thereby maximising the amount of interest paid; the order in which payments are applied should become clearer with the adoption of the Summary Box, but the industry should continue to develop methods of clear communication on this point. There is strong concern about the effects of risk-based pricing, under which consumers may not know the actual rate to be charged until after the card has been issued.

Transaction / penalty charges

Transaction/penalty charges are not always clear to the card holder; all relevant charges should be expressed in the Summary Box. Consumer bodies questioned how far charges reflected the actual costs to the issuer. We are not convinced the current level of payments is reasonable; the issue needs further investigation by the DTI. For low income and vulnerable consumers with low credit limits, fees can represent a large proportion of the outstanding balance and unreasonable fees can make debts spiral.

Over-indebtedness and responsible lending

There appears to be a growing minority for whom servicing debts has become a problem. The possible impact needs to be monitored closely. Evidence identified practices as a result of which people were "almost sleep-walking into a situation of over-commitment".

Credit limits should not be raised without appropriate internal and external credit checks and limits should be placed on unsolicited increases in credit limits. Balance transfers at a lower interest rate should not serve to lock consumers into additional debt. Lenders must assess a consumer's ability to repay based on a proper picture of income and commitments and not just their payment history. Statements need to show that paying only the minimum amount will maximise the time needed to clear the debt and the interest paid. The minimum payment must always cover the interest on the outstanding balance.

Irresponsible marketing can give an impression that taking on debt is painless. Lenders must take particular care when marketing cards to young people, vulnerable consumers and those on low incomes. The terms of use of credit card cheques are confusing for consumers; cheques need to be accompanied by clear information regarding terms and conditions. The sending out of unsolicited cheques should be banned.

Not all the fault lies with the lenders. Barclays' Chief Executive told us that there is "no question that credit card borrowing is an expensive way to do chronic borrowing". Users must recognise that credit cards are an expensive way of borrowing for the long-term.

Store cards

To date store card providers and the stores involved seem to have prevented customers from gaining the full facts about the store card necessary to make an informed choice. Customers need to be aware of the high interest rates charged. There is evidence to suggest that competition is not working properly, leading to high rates. We strongly welcome the OFT's decision to undertake a preliminary examination of the store card market.

Conclusion

We hope that the coming months will provide evidence of effective action. This is not to say that nothing has been done already. But this seems largely to have followed pressure from this Committee. There is a need for a more active approach from the Office of Fair Trading to protect the interests of the consumer.

1 Introduction

This Inquiry

1. In our report last session into Banking, Consumers and Small Businesses, the Committee looked briefly at credit card charges and concluded:

> - that there was a "lack of transparency" in the credit and charge card industry which acted "against meaningful competition and is therefore against consumers' interest"
>
> - that "for individuals to understand interest rate calculations requires an unreasonable time and effort"

and that we would expect to carry out further investigation into the issue.[1] This report represents the conclusions of our further investigations. Not only does what we have found appear to us fully to justify our earlier conclusions, but it has given rise to significant concerns about the way in which a large part of the credit/store card industry has dealt with its customers. We expect in the future to continue to monitor developments in respect of these concerns.

2. Little progress had been made in improving transparency for consumers since last year. As a result, consumers have great difficulty in deciding which card represents the best value for their needs, great difficulty in knowing what they will be charged once they start using a card, and in some cases great difficulty in understanding why they have received a particular charge. As we discuss in section 3 of this Report, in a significant number of cases these difficulties, exacerbated by dubious marketing practices, have contributed towards the build up of serious personal debts.

3. We began the inquiry in July, taking evidence from consumer groups,[2] some credit card issuers and their trade body,[3] and store card issuers.[4] During the September sitting period we took evidence from the Department of Trade and Industry and the Chairman of the Office of Fair Trading (Mr John Vickers). In October we held a hearing with the chief executives of the five largest issuers of credit cards in the UK[5] before finishing with concluding sessions with the Chairman of the OFT again and with the Minister for Employment Relations, Competition and Consumers at the Department of Trade and Industry, Mr Gerry Sutcliffe MP. A range of other written evidence was received, much of which is printed with this report, along with the oral evidence.

4. We are most grateful to all those who submitted evidence, including many members of the public whose personal experiences have greatly informed our process of inquiry. As

1 Fifth Report of Session 2001-02, *Banking Consumers and Small Businesses*, HC 818, paras 17-21

2 Consumers' Association, National Association of Citizens Advice Bureaux (Citizens Advice), and National Consumer Council

3 Nationwide, Barclaycard, and the Association for Payment Clearing Services (APACS)

4 GE Consumer Finance (who operate the store card for a wide range of well-known retail groups), House of Fraser and Arcadia

5 Mr Matthew Barrett of Barclays, Mr James Crosby of Halifax Bank of Scotland, Mr Eric Daniels of Lloyds TSB, Mr Fred Goodwin of Royal Bank of Scotland, and General Charles Krulak of MBNA (Europe).

with our report of last year, we are grateful also to Dr Robert Hunt of the Isaac Newton Institute at Cambridge University for his assistance with detailed analysis of some of the material received.

The credit card industry

5. In conducting this inquiry, we fully acknowledge the value of credit cards in providing a very flexible method of borrowing—particularly in the short-term—and an alternative method of payment for millions of people. The credit card industry has evolved dramatically since the UK's first credit card was launched by Barclays in 1966. There are currently around 64 providers of credit cards in the UK, with over 1,600 different cards available. In 2002 there were over 58 million credit cards in issue and over 65% of the adult population had at least one card. The credit card market was dominated by the (then) big four banks until the entrance in the mid-1990s of US issuers. As the industry's penetration of the more affluent sections of the market has approached saturation, many issuers have been expanding into the 'sub-prime' market—i.e. those on low income or those with bad or non-existent credit histories. Total transactions on credit cards were £120 billion in 2002. The latest monthly figures for September 2003 show that consumers in the UK owe approximately £52 billion on credit cards. The rise in these figures, shown in Charts 1 and 2 below, partly reflect increases in the number of cards in issue and also an increase in the transaction value and outstanding balance per account.

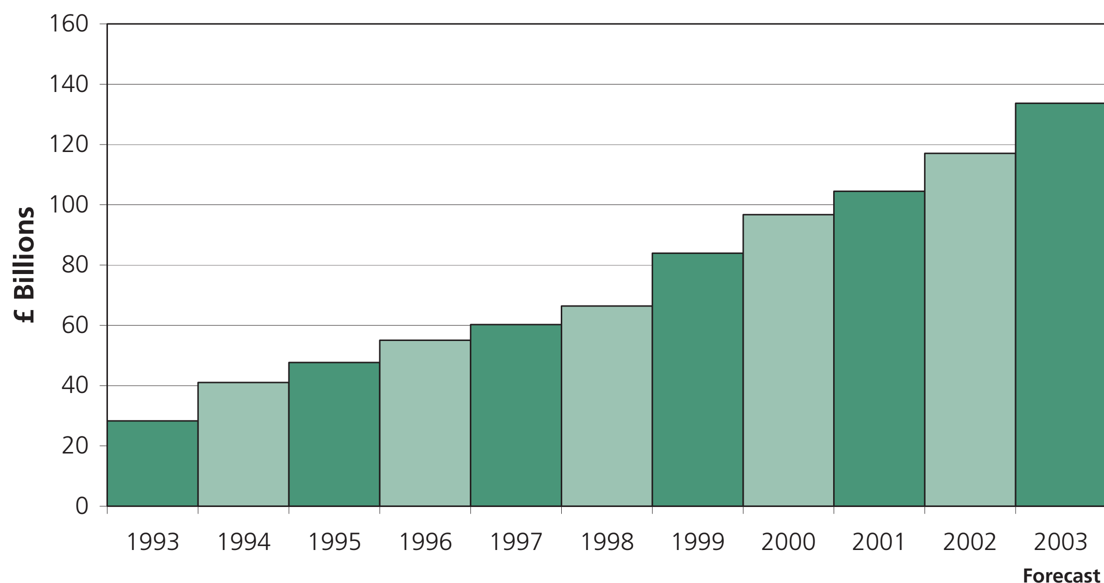
6. Credit cards have increased in complexity since they were first introduced over 35 years ago. Initially credit cards were simple products offering a convenient payment mechanism combined with a credit facility. As the market has developed credit cards have become increasingly complex products, offering features such as balance transfers, promotional interest rates, cashback and loyalty schemes, and credit card cheques. Issuers offer 'gold' and 'platinum' cards as well as affinity cards[6] and 'create cards' (which allow consumers to choose which card features are most important to them). The Banking Code Standards Board told us that "Credit cards have become complex products: such complexity is generally to the benefit to consumers, though it can also encourage 'confusion marketing'."[7]

6 Affinity cards are cards linked to a particular group or organisation, such as a University or political party. The organisation typically receives an income from the bank related to the amount each cardholder spends using the card.

7 Ev 143, para 8

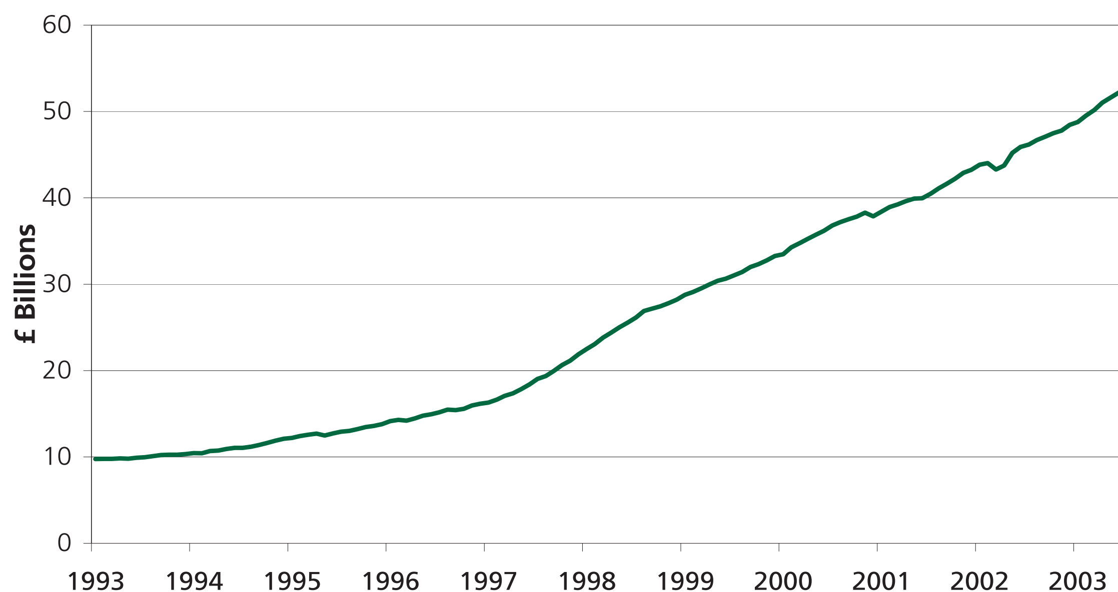
7. Figures for the level of credit card transactions and amounts of lending outstanding are given in the following charts.

Chart 1 : Credit Card transactions



Source: Bank of England

Chart 2 : Credit card borrowing (amounts outstanding)



Source: Bank of England

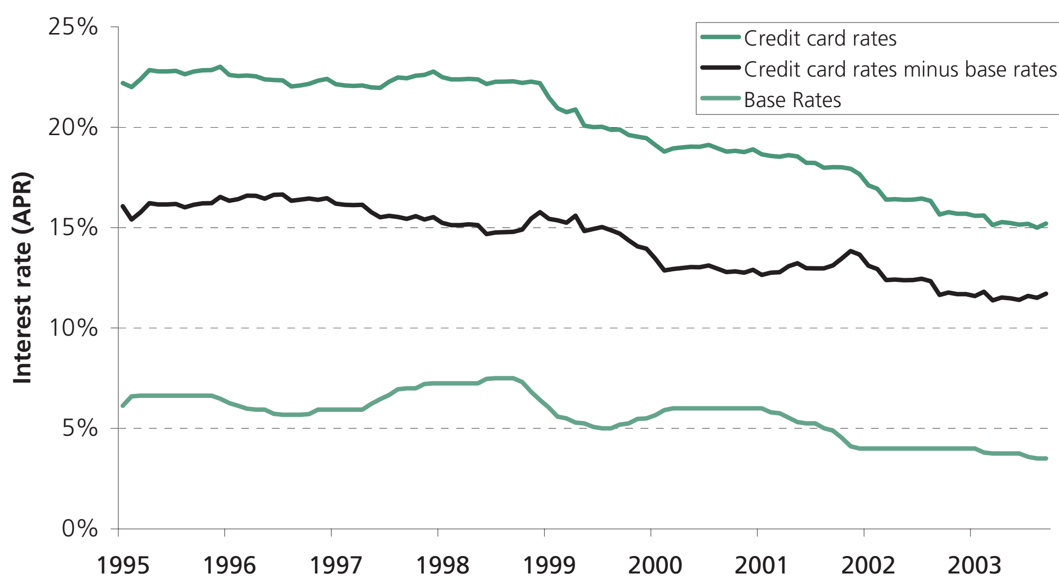
The level of interest rates charged

8. One of the most striking features of the credit and store card market is the size of the gap between the headline interest rates on offer and the level of interest rates set by the Bank of England. Although there is—by definition—nothing 'untransparent' about the headline

levels themselves, some of the reasons for these levels need to be discussed since they are a key part of the context for understanding the issues relating to transparency.

9. The level of interest rates charged on different credit cards varies dramatically, with APRs[8] on credit cards currently available in the range of 6.8% to 29.9%.[9] There are other cards marketed to low-income groups that can have APRs approaching 40%-50%. We questioned lenders as to the factors determining the interest rate charged and why it exceeds the base rate by such a large margin. Mr Hoffman of Barclaycard told us that the cost of funds (i.e. the cost to the issuer of providing the money which it lends to the card user) is only one input into card firms' costs.[10] Other costs included factors such as staff, risk of fraud and bad debts and marketing. Mr Daniels, for Lloyds TSB, told us that "due to the multiplicity of transactions and processing costs and the level of fraud, the risks and costs associated with providing a credit card are therefore considerably higher than for a personal loan. These costs, plus the unpredictable level of interest that will be earned, lead to higher levels of APRs for credit cards versus personal loans."[11]

Chart 3 : Credit card interest rates



Source: Bank of England

10. In practice, the spread between the Bank of England base rate and the cost of credit card borrowing has come down in recent years (see Chart 3 above). This should be expected as over the period the number of cards has doubled, from 28 million to 58 million, the amount spent on credit cards each year has increased threefold, from £40 billion to £130 billion, and the total amount of outstanding debt on credit cards has increased fivefold, from £11 billion to £52 billion. Economies of scale thus allow the card issuers to spread their considerable fixed costs over a larger number of customers.

8 Annualised Percentage Rates: these are intended to indicate the effective level of interest on a card (see paras 40-46 below)

9 www.moneyfacts.co.uk

10 Q 175

11 Ev 262

Intensified competition, with informed consumers shopping around, should also have led to lower spreads. It is also possible (as we discuss further below)[12] that card issuers may be raising more revenue than before from the application of fees and penalty charges which are not reflected in the interest rate.

11. Mr Vickers, Chairman of the OFT, noted that the spread between the Bank of England's base rate and the average retail rate on credit cards had indeed in recent years narrowed, but that "It is still, however, a very large spread".[13] We asked the chief executives of the five largest credit card issuers in the UK what they considered an excessive interest rate. Mr Barrett, for Barclays, told us that "If I have to pay more than I can get elsewhere in the market, I would personally consider I was overpaying. So I would look at what was available out there and if there were cheaper rates then I would go for cheaper rates".[14] General Krulak, for MBNA, told us that "anything above 25%" could be excessive.[15] Mr Crosby, for HBOS, said that an excessive rate was one "that would clearly not stand up to international or historic comparisons…of competitiveness and anything 20% and plus in the current market would probably fail that test".[16] Mr Goodwin told us that "it would depend on risk" but for credit cards it would be a band up near the 20/25 range.[17]

12. **The high interest rates charged by some credit and store cards are excessive, as the banks have conceded, and are a considerable cause for concern. There is an impression that they result in part from a lack of transparency in pricing which obstructs effective competition. Excessive rates would not exist in a genuinely transparent and competitive market. Consumers cannot shop around if they lack the mechanisms to compare products. It is not for Government, or this Committee, to state what rates are acceptable,[18] but it *is* for Government to ensure that competitive forces can work. We hope that the steps laid out in this report will help consumers to make informed choices, and we would expect lower prices to result. If this does not happen, credit card issuers will still be obstructing competition.**

Regulatory environment

Overall responsibility for consumer credit

13. The regulation of credit cards is currently provided by the Consumer Credit Act 1974 and associated secondary legislation.[19] Responsibility for the Consumer Credit Act lies with DTI, with enforcement of the Act conducted by the Office of Fair Trading (OFT) and local trading standards officers. The DTI leads and co-ordinates the on-going programme of

12 see para 64

13 Q 654

14 Q 915

15 Q 923

16 Qq 927–928

17 Q 931

18 Though in extreme cases, as provided for in sections 137-140 of the Consumer Credit Act 1974, they could amount to an extortionate credit bargain, which raises different issues. Rules governing extortionate credit provisions are currently under review by the DTI and are discussed in the Consumer Credit White Paper Cm 6040.

19 These include the Consumer Credit (Advertisements) Regulations 1989 and the Consumer Credit (Total Charge for Credit) Regulations 1980

improving consumer credit regulation. In addition, the Financial Services Authority has two statutory objectives that relate to consumers: "promoting public understanding of the financial system" and "securing the appropriate degree of protection for consumers".[20] Sir Howard Davies, the previous chairman and chief executive of the FSA, had told us that there may be a need to look "at the borderline between the FSA and the OFT, particularly if the [EU] Consumer Credit Directive requires an FSA style regime…on certain forms of consumer credit".[21] From October 2004, the FSA will be assuming responsibility for mortgage regulation and it may be practical for policy on secured and unsecured lending to be conducted by the same regulator. Of course, policy in relation to consumer credit cannot be viewed in separation from the rest of consumer legislation and protection, but **the Government should consider (perhaps within the current review of the Financial Services and Markets Act 2000) examining the boundary between the respective responsibilities of the DTI/OFT and the FSA for consumer credit regulation.**

14. Ms Teresa Perchard of the National Association of Citizens Advice Bureaux told us that there was "a widespread consensus that the state of our consumer credit legislation is not fit for the days we live in. It was invented in the mid-1970s and we are currently grappling with products…and behaviour in this market that were not thought of then".[22] In July 2001 the then Minister for Competition, Ms Melanie Johnson MP, launched a review of the Consumer Credit Act saying that "Our credit laws are over thirty years old and need a radical overhaul to protect people in today's credit market. This is a top priority for the government".[23] We questioned the DTI on the progress that had been made in the intervening two and a half years and what practical benefits the typical consumer would have noticed. Mr Jonathon Rees told us that the DTI had:

- taken steps to "improve the ability of the Office of Fair Trading and Trading Standards Department to enforce the law"
- engaged in "extremely widespread consultation with all of the parties who have an interest"
- in the past two years had issued "six consultation documents, six research papers and received 362 responses", and
- several working groups had also been set up.[24]

Mr Vickers told us that the OFT had taken action against misleading advertising of introductory rates as APRs. However, at a later session Mr Vickers accepted that "product design has moved ahead of the regulation".[25] The Minister gave us his commitment that matters will improve and that "the issues raised [by the Committee's inquiry] will be

20 Financial Services and Markets Act 2000 sections 4 and 5

21 21 November 2002, HC (2002-03) 64, Q 7

22 Q 44

23 DTI press release, 25 July 2001, *Johnson announces biggest overhaul of credit laws for a generation*

24 Q 649

25 Q 1041

addressed".[26] A Consumer Credit White Paper resulting from the review was finally published on 8 December.[27]

15. **The consumer credit regime is from a previous age in terms of the developments which have taken place in the market. It is essential that a regulatory regime is in place that keeps pace with developments and protects consumers. The DTI has issued many consultation documents but consumers have seen little practical gain. We expect improvements to be brought forward with urgency. We hope the White Paper is the start of a period of action by the DTI, rather than just the start of a new round of consultations, and that consumers will soon see real benefits alongside increased protection. The Office of Fair Trading has been too passive in safeguarding the rights of consumers in the face of endemic obscurity in the industry on issues the customer had a right to know about and where competition depends on clarity. In future whether the regulator is the OFT or FSA a much more active approach is needed with remedies following the identification of bad practice much more quickly.**

Self-regulation

16. In addition to statutory regulation the majority of credit card issuers subscribe to voluntary industry codes of practice. For the credit card industry the two main codes are the Banking Code and the Finance and Leasing Association Code. The Codes set out key commitments and principles for subscribers to follow. Some major lenders remain outside these voluntary codes and in January 2003 Ms Johnson, the previous consumer Minister, encouraged "those lenders who are not signed up to these codes to do so immediately".[28] Almost a year later, two major lenders—Capital One and American Express—still remain outside the code. We wrote to them to ask when they would be joining the Banking Code. Capital One told us that they intend to "make the systems and procedural changes necessary to subscribe to the code" and that they envisaged "being in a position to do so by July 2004."[29] American Express told us that they had also begun technical discussions with the Banking Codes Standards Board and that they hoped to file their formal application to "extend our membership to include our card issuing business before the end of this year".[30] **Self-regulation through industry codes, if accompanied by monitoring and enforcement, can play an important role in supplementing statutory requirements. We note and welcome the commitment of Capital One and American Express to join the Banking Code in the very near future.**

European regulation

17. The UK consumer credit legislation implements the 1986 European Directive on Consumer Credit.[31] The European Commission published proposals to amend the existing Directive in September 2002. Royal Bank of Scotland told us that the "draft Directive has

26 Qq 1122–1128

27 Cm 6040 Fair, Clear Competitive: The Consumer Credit Market in the 21st Century

28 Ev 185

29 Ev 161

30 Ev 128

31 as amended

been written in ignorance of the dynamic, competitive and complex UK credit market, and much work remains to be done…to improve a flawed and misconceived piece of draft legislation”.[32] The European Parliament issued a highly critical draft report on the draft of the Directive saying that “the proposal had been drafted and adopted without adequate thought being given to its effects…the proposal therefore needs to be thoroughly reworked, in order to prevent significant deleterious effects on consumer credit business in Europe”.[33] Mr Rees of the DTI told us that the important interaction with Europe was “one of the key reasons why the review [of the Consumer Credit Act] has taken so long”.[34] The British Bankers Association told us that it was “important that the FSA should be involved in discussions at early stages, before directives have been drafted. This has tended to happen with FSAP measures, but less so with others, such as the Consumer Credit Directive proposal outside of the FSAP”.[35] The Government has now accepted that the delay in Europe must not be used as an excuse for UK consumers to wait longer than is necessary for improvement in consumer credit legislation.[36] **We welcome the DTI’s commitment that delays in European legislation will not be used as an excuse for UK consumers to wait longer than necessary for vital improvements. The EU draft consumer credit directive needs to be redrafted (and the FSA should be involved at an early stage in the discussions).**

32 Ev 259 (para 9)

33 European Parliament, Draft Report of the Committee on Legal Affairs and the Internal Market on the Commission’s proposals for amendments to the consumer credit directive (23 September 2003)

34 Qq 651-652

35 Memorandum to the Committee for hearing with the FSA on 21 October 2003 (see HC (2002-03) 1211)

36 Q 665

2 Transparency: increasing clarity in credit card charges

Transparency and competition

18. Many card issuers we heard from stressed the healthiness of competition within the UK credit card market. Lloyds TSB told us that "the UK credit card industry is highly sophisticated and competitive".[37] However, while consumer organisations agreed that there was plenty of choice, they felt that competition was unlikely to work effectively without the provision of clear and understandable information. Ms Hanson told us that whilst "there was a huge amount of choice, consumers being able to exercise that choice is not always easy if they cannot compare, contrast and work out which cards are best for them."[38] For Barclays, Mr Barrett accepted that "increased transparency supports better competition…the more informed the consumer is, the better competition will be".[39] Mr Vickers told us that "competition will work better, the more consumers have relevant, practical information of the kind they need and of the kind which is not misleading".[40]

19. **Whilst the UK credit card industry considers itself competitive, we feel that while consumers cannot properly compare products the level of competition is inadequate. We want to make it more competitive, by giving consumers clear information to choose between cards. The industry and regulatory frameworks need to provide consumers with clear and understandable information. This is clearly not happening currently. Important information is buried in small print of often miniscule proportions, written in technical jargon. The APR figure used by consumers to compare cards is calculated in more than one way. The true cost of cards to the consumer is concealed behind complex interest calculation methods not taken account of in the APR. Seemingly unreasonable charges are levied of which the consumer is unaware. While some of these failings reflect a regulatory framework that is comprehensively out of date, there have been no significant initiatives from much of the industry aimed at improving matters. Our inquiry has been a wake-up call to the industry—as some in the industry have already conceded[41]—and we hope that providing customers with clear and transparent information about what are necessarily complex products will now become a priority.**

20. In this section we look first at a specific initiative to improve transparency across the board—the proposed 'Schumer' or 'Summary' Box —and what information should appear in such a Box. We then turn to a range of more specific issues relating to the clarity and intelligibility of the way in which interest and other charges are imposed.

37 Ev 222 (para 1.2)

38 Q 2

39 Q 833

40 Q 655

41 See interview with Mr Gary Hoffman of Barclaycard, *Observer* 19 October 2003

Summary Box

The need for a summary of key information

21. In the USA the Truth in Lending Act requires credit card issuers to draw together the key costs and features of the credit card into an easy to read table format. This box is named after Senator Charles Schumer who led the legislation through Congress in 1988. General Krulak explained to us that the Schumer Box came about because previously "In the US, the terms and conditions are provided to the customer only when they receive the plastic itself…Senator Schumer felt that there needed to be some disclosure before that time as they were choosing the card."[42]

22. In the UK consumers are required to be provided with the terms and conditions in marketing material under the Consumer Credit Act 1974. APACS told us that "Credit card issuers are required by law to provide a wealth of information to cardholders about the terms and conditions of their credit agreement, including an explanation of all charges or fees that a cardholder might incur".[43] But this does not mean that the information is easily accessible—indeed, in our view, it is not. Nationwide Building Society commissioned research in which they gave different credit card marketing material to 16 professionals. The participants were asked to use the leaflets to find straightforward information that is typically scattered throughout the small print about the providers' interest rates, fee and charges and payment details. The results revealed that "consumers found it impossible to collect all basic information to enable them to make an informed decision about choosing and using a credit card".[44]

23. There has been wide support amongst consumer groups and many sections of the industry for the principle of the Summary Box in this country. The National Consumer Council stated that such a box would help to ensure "that there is transparency about the charges levied by all credit card issuers, so that consumers can make a more informed decision",[45] and the Consumers' Association also supported them.[46] Mr Barry Gardiner MP has argued in the House for such a box, which he called an 'Honesty Box'.[47] The Prime Minister said that there was enthusiasm for such a box to "set out in advertisements and application forms the key applicable interest rates and charges. I have no doubt at all that that will be an important way to ensure that when people borrow, they borrow responsibly".[48]

24. When we questioned lenders in July as to what recent progress had been made to improve the clarity of information available to their customers, Mr Williamson, of Nationwide, told us that in October 2002 Nationwide had introduced a Consumer Box (a form of Schumer Box) which "allows consumers very easily to pick out the key points of

42 Q 813

43 Ev 130 (In APACS' opinion the amount of information required "is often unwieldy and over-burdensome for the consumer" para 3.4)

44 Ev 249

45 Ev 241

46 Ev 163

47 HC Deb, 25 Feb 2003, cols 24WH

48 HC Deb, 7 May 2003, col 688

information which should enable them to make a knowledgeable decision”.[49] APACS told us that the industry was committed to developing “a set of best practice guidelines describing an approach to presenting credit card product information in an improved and comparable way based on the Schumer Box”.[50] However, there was at that time no agreement amongst the industry as to the content of a box and it was stressed by industry representatives that implementation had to be done in a consistent way at the industry level.[51] We were concerned that negotiations within the industry would become delayed and consumers would have to wait longer than necessary for the Summary Box. Therefore, in July, we challenged the industry to return to the Committee in October with an agreed set of proposals. This they did.[52]

25. APACS’ proposals for the Summary Box provide that it would be “supplied to the consumer when applying for a card to summarise the financial terms of the credit card agreement and to allow the consumer to make a clear comparison between the many card offers on the market”.[53] At our evidence session on the 16th October the chief executives of the five largest credit card firms in the UK (which issue 70% of UK credit cards) confirmed that they were all committed to implementing the Summary Box. MBNA told us that this Committee’s focus on transparency had “solidified industry agreement on the [Summary] Box” and MBNA believed that this was “potentially of great benefit to consumers”.[54]

26. **Over the past two years there has been little or no progress in improving transparency for consumers. Key terms and conditions have been buried in the small print, making it difficult for consumers to compare cards. Many lenders, consumer groups and regulators responding to our inquiry had expressed support for the introduction of a Summary Box, but no firm timescale had been agreed. We now welcome the positive response of the industry to our challenge to bring forward firm proposals. As a start to improving transparency, the Summary Box must now be implemented by April 2004, and in a way which emphasises the provision of information in a clear and simple manner.**

27. APACS told us that the industry was “committed to reviewing the Summary Box within six months of its adoption (i.e by September 2004)” and that the Summary Box is “expected to develop over time in response to consumers’ needs.”[55] Mr Vickers told us that he was “giving active consideration to commissioning consumer research to help inform the debate”[56] in terms of the trade off between simplicity and comprehensiveness in how information is displayed to the consumer. APACS indicated that ultimately the aim is to have the Summary Box included in the Banking Code.[57] The Consumers’ Association told us that they will be urging the inclusion of the Summary Box in the forthcoming review of

49 Q 127

50 Ev 131 (para 4.5)

51 Q 138

52 Ev 136–140

53 Ev 135 (para 1.2)

54 Ev 230

55 Ev 142

56 Ev 256

57 Ev 142

the Banking Code.[58] The White Paper proposes to "revise the format of [credit] agreements to make them clearer and more transparent".[59]Credit agreements will have to state certain key information concerning consumers rights. In addition, the key financial information will be required to be presented "together as a whole and with appropriate prominence".[60] There is no indication in the White Paper as to the appropriate design or appearance of this key financial information, and it is therefore not clear that it will be presented in a clear and comparable way. **The Summary Box needs to develop in response to consumers' needs. To this end, the regulators and the industry should commission consumer research to determine how the box may be made better and clearer for consumers. The DTI's review of the regulations should place the principle of the Summary Box on a statutory footing, and it should be enshrined in the Banking Code in the current review.**

Content of Summary Box

28. The contents of the Summary Box have been agreed by APACS as standard across the industry. They are to include all relevant APRs, fees and charges, any interest free periods, minimum repayments and the order in which payments are allocated to different parts of the balance.

29. There has been some discussion in our evidence as to whether the Summary Box should include scenarios showing the cost in pounds and pence of an assumed pattern of card usage. For example, the Summary Box could show the cost of borrowing on the card for a set period of time. An example, using the Nationwide Building Society's Consumer Box, is as follows:

Cost per card	Cost per annum of assumed average transaction pattern : **£ 150 ^**
^ illustrative only, based on a 'revolver' using ongoing interest rates, with: • Credit limit: £2,000 • Spends £300 per month • Draws cash twice a year, £150 each time • Spends £300 abroad once a year • Has one balance transfer for £500 • Pays late once • Exceeds credit limit once	

30. The Consumers' Association told us that they were "disappointed that the Summary Box won't include illustrations of the cost of borrowing". Nationwide told us that while the Summary Box "is an essential tool for highlighting a credit card's terms and conditions, it does not make it easy to compare the financial impact of different products and different providers".[61] We note that others in the industry currently felt the challenge of producing effective scenarios might be too great. General Krulak, for MBNA, told us that giving the

58 Ev 173

59 Cm 6040 (para 2.25)

60 Cm 6040 (para 2.27)

61 Ev 243 (para 2.10)

cost of different scenarios could increase confusion: there would have to be many scenarios to be useful because consumers "use their card in many different ways".[62] Mr Goodwin, for RBS, made the analogy with purchasing a car where "there are certain pieces of information which would be relevant and useful at the time of purchasing a car, but what it is going to cost you to own that car over a period of time depends on how you use it, how you look after it…", adding that credit cards are "complex products".[63] Nationwide made a similar comparison with cars, but suggested that "the equivalent of the standard MPG fuel consumption figures published for cars (city, extra urban, combined) could be developed for credit cards to enable such comparisons to be drawn [between cards]. It could work in exactly the same way as MPG, with three typical profiles of use".[64] These could include a consumer who pays off the balance each month, someone who borrows each month and a combined profile of someone who sometimes pays the balance off in full and at other times does not.

31. Mr Vickers confirmed to us that the OFT supported the possible inclusion of scenarios in the Summary Box, saying "We do not have a particular prescription…but I think the general point about scenarios and pounds and pence is a point we would wish to make strongly."[65] There was support from some sections of the industry for the inclusion of scenarios, although caution was expressed over the details. Mr Daniels told us that Lloyds TSB believed that "if we can come up with three or four different kinds of scenarios that are illustrative – even though they will not include all of the customers…we think that can add to greater transparency";[66] he also suggested the inclusion of "simple and fair cost illustrations so customers can make an informed choice. These illustrations would be based on the behaviour of the majority of cardholders."[67] Barclaycard told us that they, along with Nationwide, would be "working towards persuading the whole industry to include additional information in the Box in the future, such as a standard worked example for repayment".[68] **While credit cards are complex products used by consumers in a variety of ways, there exists the potential for improved transparency by the inclusion of examples in the Summary Box giving the cost of different borrowing scenarios. This will not increase confusion if implemented in a simple and standard way. The industry should work with consumer groups to develop scenarios for consideration for inclusion in the Box at the time of the review of the Summary Box in September 2004. This process should be informed by the consumer research which we recommended above.**

32. There was also a concern that, as presented, the Summary Box could potentially overload consumers with a wide variety of different numbers. Dr Robert Hunt told us that the first row "for many cards, could end up containing a considerable number of different rates".[69] To show the introductory rate and "go-to"[70] rate for each of purchases, cash

62 Q 835

63 Q 838

64 Ev 243 (para 2.10)

65 Q 1035

66 Q 861

67 Ev 224

68 Ev 155

69 Ev 217 (para 16)

70 i.e. the level to which the rate goes after the introductory rate has expired

advances and balance transfers, and to show for cards with risk-based pricing both the lower and upper values, possibly together with the typical rate, means a potential total of 18 different percentage rates in a single entry of the box. Dr Hunt believed that this could "increase confusion for consumers rather than reduce it".[71] **The large number of different interest rates in the Summary Box could serve to confuse consumers. We would expect to have seen progress towards establishing an effective balance in the amount of information included in the Summary Box by the time of the review in September 2004.**

Format and placing

33. The format of the Summary Box in marketing material and advertising will be important in ensuring that consumers are aware of the information. It is important that the format is consistent so that, as Mr Williamson told us, the customer can "pick up one from Nationwide, walk down the road, pick up one from Barclays and they can make a very transparent comparison".[72] Mr Hoffman, of Barclaycard, told us that the Summary Box had to be implemented in a "consistent way that gives our customers a choice and a way of comparing [products]".[73]

34. The placement of the Box is also important. Dr Robert Hunt told us that "the placing of the Summary Box is of paramount importance. If it is hidden at the end of the terms and conditions then it will be ignored".[74] It is not yet apparent where the majority of credit card firms plan to place the Summary Box. Of the designs submitted to us, Lloyds TSB's is located on a separate page in their main booklet, while MBNA choose to include the Summary Box on a separate sheet of paper.

35. Commenting on the proposed designs submitted to us by the five largest issuers, Mr Vickers, for the OFT, suggested they "did not have the consistency between each other" and "clearly greater consistency will be needed subsequently".[75] **Banks have a duty to implement the Summary Box in the spirit of its purpose—to present information to consumers in a clear and transparent way. Its purpose, after all, is to allow easy and genuine comparison of the costs of credit offered by the various providers. The format of the Summary Box must be fully standard and consistent, and the placement clear and prominent. We expect the banks to cooperate constructively in achieving this. The consumer research we have recommended above should include consideration of format and placement.**

36. The size of print in credit agreements is a problem for many people with poor eyesight and especially some older consumers. Important information that consumers need to be aware of is spread throughout small print that can be as little as 1mm high. Mr Barrett admitted that Barclays' plans were "an eye test for sure".[76] The Summary Box will solve

71 Ev 217 (para 16) In addition to the APRs, in the short term the Summary Box could also contain a considerable number of monthly interest rates: according to APACS, until a single definition of APR is agreed (see paras 40–46 below) monthly rates are a more reliable comparator (Ev 137–140).

72 Q 138

73 Q 138

74 Ev 218 (para 20)

75 Q 1035

76 Q 1007

some of these problems by ensuring that key information is brought together in a standardised form. However, APACS told us that presentation of the summary box should be both “clear and legible” but overall size and fonts are not specified. The Schumer Box provision in the US requires the contents of the box to be provided in a “clear and conspicuous manner”. However, no specific minimum font size was laid down and the result was that (as Senator Schumer acknowledged) consumers “can’t shop around for credit card deals if they need a magnifying glass to find simple information concerning card rates and conditions”.[77] In October 2001, changes were introduce requiring long term APRs to be displayed in minimum 18pt type (e.g 15.9% APR); all other APRs and information are required to be in minimum 12pt type. **The Summary Box must not be allowed to become part of the small print. A minimum font size of 18pt should be specified for the APRs. All other text in the summary box should be minimum 12pt.**

Information on monthly statements

37. The Summary Box will provide an aid to consumers when shopping around for a new credit card. However, the majority of the population already own at least one credit card and to foster competition it is essential that they are able to compare terms and conditions to decide whether they could obtain a better deal with another card. The Consumers’ Association told us that “consumers should be reminded of the essential price information on their periodic monthly statements. This ensures that consumers are aware of the details of the credit card they are using”.[78] A recent survey found that two-thirds of consumers did not know what interest rate they are being charged on their credit card. Over 75% of consumers had never switched cards.[79]

38. APACS told us that requirements to show clearer information about interest rates, and amounts of indicative interest charges if the borrower only made the minimum repayment, were already in place. Some in the industry had chosen to go further. HBOS told us that from 2004 they will begin including a “Clarity Box” on their monthly credit card statements. This will be “prominently displayed on the front of our monthly statements” and include interest rates applicable to balance transfers and new purchases, information about fees and charges and the minimum repayment.[80] Mr Vickers told us that, suitably modified, the Summary Box approach could be extended to apply to monthly statements. Mr Goodwin told us that much of the information required in the Summary Box was already presented on the back of RBS monthly statements but by “making it a standardised format across the industry does make it easier to find the [information] and read across”.[81] **To improve competition, consumers need to be kept informed of the charges and interest rates applicable to their credit card. This will enable them to compare products and determine whether they could get a better deal elsewhere. The Summary Box should be extended so that it appears on monthly statements. APACS should develop**

77 Senator Schumer, press release, *Federal Reserve Board approves “Schumer Box” Truth in Lending regulations*, 28th September 2000

78 Ev 172 (para 7)

79 Research from More Th>n, reported by the BBC

80 Ev 209 (para 2.2.2)

81 Q 826

these proposals by the time of the proposed review of the Summary Box in September 2004.

39. Some witnesses raised the possibility that monthly statements could be used to inform consumers of the consequences of the debt they have taken on and how long payments will take to clear the debt. The OFT believed that the monthly statement should "alert consumers to the implications of making only the minimum repayment by indicating clearly how long it would take to repay the current balance on that basis and how much it would cost"; they also suggested that statements could show "how much the consumer would need to pay each month to repay the outstanding balance over, say, three years".[82] The White Paper signalled the DTI's intention to "discuss with industry and consumer groups the scope for introducing details of various repayment scenarios in customers' regular statements."[83] **We welcome the DTI's intention to explore with industry and consumer groups the scope for using the monthly statement to educate consumers about the implications of the debt they are taking on. This could include examples of how long the debt would take to repay for a given monthly payment. Statements should also make consumers aware of the financial implications of only making the minimum repayment each month (see para 99).**

Annual Percentage Rates (APRs)

40. The Annual Percentage Rate of the total charge for credit (APR) is a requirement of the Consumer Credit Act.[84] The APR is supposed to be a measure of the overall cost of credit and must be displayed with greater prominence than any other rate or charge. Credit card advertising material prominently displays the APR of the card as required by the Consumer Credit Act. Most witnesses agreed that the level of the APR (along with any introductory rate) is the figure used by consumers to compare cards. The Banking Code Standards Board told us that their research "revealed that consumers tend to have a sketchy understanding of what APR means, but that they use them as an all-purpose basis for comparison between products."[85] Even the consumer help section of the FSA web-site contains the following advice on credit card APRs – "You do not need to know how to work out an APR. The important thing is that APRs show the cost of borrowing on a standard basis. So you can compare one APR with another".[86] Yet, as we have learned during the course of this inquiry, this is not currently the case in the UK credit card market; in practice, consumers have been confused and potentially misled.

41. UK consumers cannot use the APR to make a comparison on a standard base at the moment because there are different legal interpretations between the industry and the OFT as to the meaning of the statutory requirement. The OFT told us that for a personal loan with a "defined schedule of repayments…an APR can be calculated relatively easily. By contrast, with a credit card the borrower has discretion as to how much of the facility to

82 Ev 251 (para 16)

83 Cm 6040 (para 2.31)

84 The Consumer Credit (Total Charge for Credit) Regulations 1980, made under section 20 of the Consumer Credit Act, lay down the rules governing APR

85 Ev 143 (para 8)

86 http://www.fsa.gov.uk/consumer/index.html

draw down, within the overall credit limit, and how much to repay subject to minimum repayments. Inevitably, therefore, certain assumptions have to be made in calculating an APR."[87] It is these assumptions that are in dispute between the industry and the OFT. Most of the industry, including APACS, believes that the APR should be calculated over a one year period in all instances. In contrast, the OFT believes that the APR should be calculated over the theoretical lifetime of the balance, assuming that the full credit limit is borrowed on day one and then paid back gradually at the specified level of minimum repayment. As a consequence, where a card offers an introductory or promotional rate for a period before reverting to a standard or 'go-to' rate, the OFT approach uses a 'blended' APR which takes account of both the introductory and the 'go-to' rate. The APACS approach calculates the APR solely on the basis of the 'go-to' rate. While the APACS approach is difficult to manipulate, the OFT approach can easily be manipulated by the credit provider, for instance, by decreasing the minimum repayment percentage lowers the calculated APR. Examples of the different effects of the two methods are below:

Assumptions Credit card limit: £1000 Monthly interest rate: 1.167%	Annual fee: £15	
Monthly Minimum Payment Terms	APR	
	OFT Approach	APACS Approach
Minimum Payment: 5%	17.2%	16.7%
Minimum Payment: 3%	16.6%	16.7%
Minimum Payment: 2%	16.1%	16.7%

Assumptions Credit card limit: £1000 Introductory rate : 0% Term of intro. rate: 6 months	Annual fee: £0 Standard rate: 16.9%	
Monthly Minimum Payment Terms	APR	
	OFT Approach	APACS Approach
Minimum Payment: 3%	13.9%	16.9%

Source: APACS Ev 140–141

42. We questioned the OFT and the industry as to what events led to there currently being two methods of calculating the APR in use. APACS claimed that an OFT regulatory intervention on introductory rates in 2001 introduced "legal uncertainty"[88] and "directly resulted in the use of two methods of APR calculation".[89] Mr Vickers told us that the intervention "did not introduce legal uncertainty. That uncertainty had always existed and was a product of ambiguities in the Regulations", adding that there had been "differences

87 Ev 250 (para 7)

88 Ev 136

89 Ev 141

of opinion within the industry over APR calculation dating back to the early 1990s".[90] We asked regulators how long such differences had been permitted to persist. Mr Vickers told us that in 1998 the OFT "when new…regulations were being drawn up, … reminded DTI of our concerns regarding areas of ambiguity…and suggested that the opportunity be taken then to address these as part of new regulations".[91] Mr Rees, for the DTI, told us that the changes in 1998 represented a minor technical amendment and Ministers at the time decided not to go for a full scale review.[92] The previous consumer affairs Minister, Melanie Johnson MP, was aware of the situation in February 2002 when she said "currently APRs quoted for credit cards are confusing and do not allow consumers to compare products like for like. This needs to change".[93] **We were astonished to discover that the APR figure most commonly used by consumers to compare credit cards is allowed to be calculated in more than one way. This is clearly unacceptable, impedes competition and damages consumers' ability to compare products. The fact that such a situation has been able to persist for several years reflects badly on all participants.**

43. The major credit card issuers also believed that the situation was detrimental to consumers. MBNA told us that "It is clearly unsatisfactory and potentially confusing for consumers when different credit card issuers calculate their APRs in different ways".[94] Lloyds TSB told us that a "customer comparing two products based on APRs calculated in two different ways will be comparing 'apples and pears'".[95] The major credit card issuers also strongly supported efforts to move towards a single method of calculating APRs. General Krulak believed the situation had "got to be resolved" and MBNA told us that they fully supported the need for the industry to converge on a common APR calculation and presentation method".[96] Mr Hoffman told us that Barclays "regarded the APR legislation currently as a nonsense for customers and we should simplify it".[97]

44. We examined the barriers to the industry moving quickly to a single method of APR calculation, which would allow consumers to compare like with like. Mr Vickers told us that it was a "genuine difference of view based on different legal interpretation [of the regulations]" and that "the regulations do not unambiguously answer the question".[98] Mr Pearson of APACS agreed and stated that the industry held the strong view that "the regulations are ambiguous…the necessary cure is clear regulations". The Minister told us that the Consumer Credit White Paper would "confirm the Government's commitment to achieve a single, consistent approach to the calculation of APRs" and expected to "publish regulations containing the agreed formula by the end of the year. The new regulations are scheduled to come into force in October 2004".[99] The White Paper sets out proposals to require "a single set of assumptions to be used by credit card issuers in calculating the

90 Ev 253

91 Ev 253

92 Q 1137

93 DTI press release, 15 February 2002, *Johnson moves to strengthen credit laws for the 21st century*

94 Ev 231

95 Ev 223 (para 3.3)

96 Q 943, Ev 231 (para 2)

97 Q 350

98 Qq 1040–1041

99 Ev 186

APR.” The proposals require the APR to be based solely on the “go-to” rate, not taking account of any introductory rate. This approach is close to the approach advocated by the industry through APACS.[100]

45. We were concerned that consumers should not have to wait until October next year and pressed the industry and regulators on whether the differences could be resolved earlier. Mr Fred Goodwin told us that RBS “had legal advice telling us that we would be in breach of the Consumer Credit Act” if they changed the way they calculated the APR before the DTI had amended the regulations. Mr Rees told us that the DTI had to allow “12 weeks for consultation” on the new regulations. There will then be a “two, three, four weeks when we will need to absorb the results of the consultation”…”the regulations will then be laid [before Parliament] and then there “will be a 12-week implementation period” before they come into force, in line with the Government’s “better regulation” principles”.[101] By our calculation this timetable takes us to early July 2004. The Minister gave us his commitment that he would “make sure that the timetable, whilst meeting the requirements of the parliamentary process, will be speeded up and will be seen as a priority”.[102] **Despite continued efforts, it is unlikely that the industry can change to a single method of calculating the APR before the regulations are amended. The DTI plans the new regulations to come into force in October 2004. It is regrettable that the potential for consumers to be misled and confused will continue to that date. The DTI, OFT and the industry should continue dialogue in an attempt to establish a commonly and legally acceptable working interpretation in advance of October 2004. This should be implemented as soon as possible. We welcome the Minister’s commitment that the October 2004 deadline will not be missed, and that the work will be seen as a priority. We will be monitoring developments closely. Until the industry converges on a single method consumers will not gain full benefit from the Summary Box.**

46. We took evidence over which method of calculation is clearer for consumers. Mr Vickers, defending the OFT approach, told us that “If the ‘go-to’ rate determined the APR then a card with a far worse introductory rate than another (or even none at all), but with the same go-to rate would misleadingly have no worse headline attractiveness. This would not be good for transparency.”[103] RBS told us that in the example above the OFT method would quote the consumer an APR of 13.9% and that “the consumer might easily mistake this rate as their cost of borrowing, although once the introductory rate has expired their cost of borrowing will in fact be the monthly interest rate relating to 16.9% APR.”[104] Dr Robert Hunt regarded the 13.9% APR as a “rather artificial combined figure” and, worse, advertisements would probably contain three different rates (0% introductory, 16.9% standard, 13.9% APR) leading to confusion. Consumers would fail to understand where the APR had come from. There seems to be some evidence of credit card firms taking advantage of the OFT method to confuse consumers. We have received marketing material from one firm[105] that offers a 0% introductory rate for six months on purchases and gives

100 Cm 6040 (para 2.8)

101 Qq 1149–1152

102 Q 1153

103 Ev 252

104 Ev 260

105 Capital One

an APR of 14.9% which is described as "long-term". However, hidden in the small print is the fact that after the introductory period the interest rate for purchases is actually equivalent to 20.7%, which is significantly above the industry average. The 14.9% figure represents the blended rate. We believe an APR calculated in this way is highly misleading for consumers, although the effect could be mitigated if issuers were required to display the "go-to" rate in a prominent position. **The final decision to be taken on which method of APR calculation to use should be based on the objective of clarity for consumers rather than complex legal and technical judgements. We believe the proposals in the White Paper to calculate the APR using the "go-to" or standard rate for purchases after any introductory period will provide a clearer and more understandable basis for consumers on which to compare cards than any blended rate.**

Interest calculation method

47. Credit card marketing prominently displays the APR, with the implication that the lower the APR, the cheaper the card will be for the consumer. However, in addition to the interest rate, a key determinant of the overall cost of credit to the consumer is the method used to calculate the interest. This covers factors such as when lenders begin to charge interest on purchases made and when they stop charging interest once a repayment has been received from the consumer. In evidence, the Consumers' Association identified 10 different charging methods currently in use in the UK credit card market.[106] They estimated the cost in interest of a series of transactions over two months, which found that "customers of 2 cards with the same APR could be charged up to 76% more by one card than another for the same borrowing, depending on the method used".[107]

48. The method used to calculate interest is required to be set out in the terms and conditions of the individual cards. This is typically a section of the small print and generally no more than 1-2mm high. We reproduce extracts from the terms of two leading credit cards below:

> "We apply the interest rates to your average daily balance and charge it to your account each month. So the earlier you make a payment the less interest you have to pay. However, if you pay the total balance showing on your current statement (and have paid the total balance on the previous statement) by the payment dates, we will not charge you interest on purchases shown on your current statement. Other than as described above, we will charge you interest on purchases and cash advances from the date of the transaction and for cheques, balance transfers and all other amounts from the date we first charge the amount to your account. If you have not paid an amount shown on one statement at the date of the next statement, we will add the interest we have charged on that amount to the balance we charge interest on." [HBOS]

> "We will charge interest on all amounts making up the Balance on a daily basis at the relevant rate set out in condition 4 from the date each Transaction and Charge was put on the Account. Interest will be charged until the Balance has been repaid in full.

106 Ev 166–170

107 Ev 166

> We will not, however, charge interest on Purchases listed in your last statement, if you pay the Statement Total on or before the Payment Date.” [Egg]

49. For an example set of transactions, the Consumers’ Association analysis of these two cards suggests that applying the first method could end up costing the consumer up to 37% more than applying the second method. This difference would not show up in the APR, the number which most consumers use to compare cards. It should also be noted that as well as being in technical language the two quotes both appear in the middle of the small print which is typically 1mm high. Even if a consumer manages to track down and understand the relevant condition it might prove difficult to work out the difference in cost for their typical pattern of card use, without detailed mathematical knowledge. The Consumers’ Association believed that “it would be virtually impossible”[108] for consumers to understand what differences in methods meant in practice and to compare cards using it. They suggested that “Standardising the way in which interest is applied would allow consumers to compare like with like. Ideally we would like to see credit card providers doing this voluntarily…if they are unwilling to do this, we suggest that the OFT mandates a standard method of applying interest”.[109]

50. We wrote to industry and regulators to gain views on whether standardisation of interest calculation methods would be feasible. The industry argued that standardisation would have a detrimental effect on competition. MBNA believed that “standardisation would restrict our ability to innovate, but more importantly, it would prevent competition and, in doing so prevent consumer choice”.[110] Mr Daniels told us that he agreed that “it is confusing; however, the answer is not standardisation but greater transparency”.[111] APACS warned that “such standardisation might preclude products of the type that have no interest free period but a very low APR, which is particularly suitable for certain types of consumers.”[112] Dr Robert Hunt told us that “it would clearly be anti-competitive to insist that every card had the same interest-free period…However, it cannot be regarded as anti-competitive to insist that all cards start charging interest on the same date (either the purchase date or the transaction date): consumers are rarely even aware of which method their card uses. The fundamental difference here is that the interest-free period appears in the Summary Box – and the consumer is therefore aware of it – whereas the date on which interest begins is buried in the terms and conditions, meaning that the consumer is probably unaware of it.”[113] Mr Vickers told us that “if a product characteristic is invisible to consumers then it cannot be a dimension of competition.”[114] The Consumers’ Association added that it was difficult to understand why some in the industry argue that “interest calculation is a competitive issue in this consumer market when consumers are not aware that such variations exist. Instead, this freedom seems to be used by some providers to

108 Ev 166

109 Ev 166

110 Ev 230

111 Ev 224

112 Ev 142

113 Ev 219 (para 26)

114 Q 1059

charge consumers more than the APR suggests they are, a move which is both anti-consumer and anti-competitive."[115]

51. Mr Crosby, for HBOS, told us that he was not sure that he saw "real competitive advantage and scope for an effective market in gaining competition in this particular area"; he added that "there was scope for industry-wide co-operation in this area, over time, to get the same sort of answers" and differences were "a function of history".[116] For the OFT, Mr Vickers suggested that "there may be merit in exploring the pros and cons of an industry 'standard' for the calculation of interest…with firms being free to deviate from that subject to appropriate transparency" and that this information could be placed in the Summary Box.[117] Mr Hoffman subsequently wrote to us saying that Barclays was "interested in the OFT's thoughts around creating benchmarks, and will be exploring their ideas with them and within the industry."[118] The White Paper acknowledged that card issuers employ different methods for calculating the interest on the use of a credit card. The DTI plans to "discuss with industry ways in which this can be standardised and made more transparent, without inhibiting competition" and "will conclude these discussions by February 2004".[119] An alternative approach is to use scenarios, as already discussed, which irrespective of the method of calculation of interest show the actual cost to the consumer.

52. **For card issuers to compete on price, consumers need to have reliable information to compare the costs of different products. The different methods that card issuers currently use to calculate the total interest charged are technical and opaque. Many consumers are unaware that such differences exist and lack the means to calculate what impact they have on the total cost of using their credit card. As a result, many are being misled. There is a clear need for greater transparency and if the differences and their effects cannot be explained to the consumer then some degree of standardisation will be required. We welcome the DTI's intention to discuss with the industry ways in which interest calculation methods can be standardised and made more transparent without inhibiting competition. The DTI aims to conclude discussions by February 2004 and we will be looking for prompt action after that date has passed. The onus will be on the industry to prove that a measure of standardisation will not be beneficial.**

Risk-based pricing

53. Under risk-based pricing consumers are offered varying interest rates based on the perceived risk to the lender of default. Those with bad or non-existent credit histories would typically be charged a higher interest rate than those with good records of using credit. Cards using risk-based pricing will normally advertise the lowest rate available, followed by a 'typical rate'—e.g "from 12.9% APR [typically 17.9% APR]". UK regulations require firms to advertise the typical APR (that received by over 50% of borrowers) with equal or greater prominence than the lowest rate. The practice of risk-based pricing is

115 Ev 179

116 Q 966

117 Ev 256

118 Ev 160 (para 4)

119 Cm 6040 (para 2.28)

common in the US and PricewaterhouseCoopers recently identified a “clear trend in the UK market” towards risk-based pricing.[120]

54. When an application is received, lenders will calculate a risk score for the customer based on a credit reference check and allocate customers an APR within the range they offer. Risk-based pricing thus poses a particular challenge for those seeking to promote transparency in the credit card market, because, as acknowledged by Mr Barrett, customers only “find [the rate that applies] when we send them the card”.[121] This means that consumers will not know what actual rate they will be charged (within the specified range) until after the card has been issued, making shopping around and determining whether they could get a better deal elsewhere impossible. They are regularly offered a card with a much higher rate of interest than that attached to the card for which they applied. The Consumers’ Association believed that this problem was exacerbated as “personal credit scoring is lowered when each credit check is performed”.[122] If this is the case then shopping around for a number of different providers could therefore harm a consumer’s credit rating and could make them ineligible for some of the lower rates. Mr Crosby of HBOS told us that there were “real issues with risk-based pricing because, even with the Summary Box, it gives a range of rates that makes it very difficult to get clarity”.[123]

55. Issuers operating risk-based pricing will now have to display the full range of APRs available in the Summary Box, along with the typical APR (e.g “9.9%APR - 24.9%APR typical 14.9%APR”). Barclays compared risk-based pricing with the pricing of insurance “where the price of the insurance is dependent on the risk of loss to the insurance company”.[124] There is, however, an important difference: consumers typically contact a number of insurance companies to ask for quotes before taking the best offer, whereas no mechanism yet exists for consumers to do so in the credit card industry (except by applying for a number of different cards, which will affect their credit reference).

56. Barclays told us that risk-based pricing enables them “to offer cards to people who would not be offered them under a system where there was only one rate. This is consistent with the Government’s financial inclusion agenda”.[125] Mr Hoffman told us that these customers “otherwise would have taken credit from less salubrious providers”.[126] He confirmed that Barclays lend “on a commercial basis” but that an important by-product was the financial inclusion agenda.

57. **Risk-based pricing is a practice which raises serious transparency issues, as consumers are often unaware of the rate they will be charged until after the card has been received. This is an unacceptable practice. We are also concerned that the very act of shopping around by applying for several different cards can damage a consumer’s credit rating. The OFT should monitor the proportion of customers who obtain the**

120 PricewaterhouseCoopers, Precious Plastic 2002, page 7

121 Q 833

122 Ev 164 (para 21)

123 Q 843

124 Ev 157

125 Ev 157

126 Q 197

favourable rates advertised and those who end up on the higher rates. It should ensure that a system is put in place to prevent consumers being misled.

58. Consumer groups also flagged the practice of implicit risk-based pricing. This is the practice of promoting platinum cards with attractive rates of interest, but offering customers who don't qualify a more expensive product. Ms Perchard told us that such practices attracted the consumer "to apply for [the card] that looks the cheapest but then offer them something more expensive, and not necessarily provide very good or clear reasons why."[127] **Where a range of products is offered, consumers should not be offered a more expensive product without clear written reasons. We believe the issuer should also be required to obtain a positive acceptance from the consumer before issuing the card. Exclusions that apply to cards, such as minimum ages or annual incomes, should be clearly advertised in the marketing literature.**

59. There have been some recent regulatory developments in the US concerning risk-based pricing. The Senate Banking Committee has considered proposals for lenders to provide customers with a free copy of their credit reference where credit had been denied, or where risk-based pricing was used to offer it under less favourable terms. When lenders provide consumers with a card with a higher interest rate than the one they have applied for, they are now required to provide a copy of the customer's credit record free of charge, so that the customer can correct any errors. Ms Harrison told us that in the US "consumers actively develop their credit reference as a passport to better rates", whereas in the UK the relationship between the consumer and the credit reference agency is "shrouded in secrecy".[128] **With the increasing use of risk-based pricing, errors on credit references could end up costing consumers money. Previously a consumer would have been turned down, whereas now they may instead be offered a higher price, which could in the longer run end up costing them hundreds, even thousands of pounds. On the other hand, provided lenders act responsibly, in particular in relation to credit limits, it may offer an opportunity to secure a credit card in circumstances where it would not otherwise be available. Consumers offered less favourable terms than the typical APR should be provided with a free copy of their credit reference by the lender. The regulators and the industry should develop a strategy for promoting awareness and a sense of ownership amongst consumers of credit references and the factors that affect their credit score. Consumers should be actively encouraged to provide the firm with positive information to reduce the rate charged. Firms should also share both positive and negative data with the credit reference agencies.**

Order of payments

60. Many credit cards now offer balance transfer and other promotional interest rates as well as applying different rates for cash advances. This therefore requires card issuers to decide the order in which payments made by the consumer are allocated to reduce different parts of the outstanding balance. Nationwide told us that some issuers apply "payments to reduce the cheapest balances [first], thereby maximising the amount of interest a customer ends up owing".[129] For example, any payments will go to pay off a

127 Q 72

128 Q 77

129 Ev 244 (para 3.3)

balance transfer at a promotional rate before paying off the balance charging interest at the standard higher rate for purchases. General Krulak regarded the order that payments were applied as a "commercial decision" but pointed out that the order was specified in the Summary Box.[130] Previously this information tended to be in the small print of the credit agreement, with few firms choosing to flag up the fact in promotional material that payments would go towards clearing the transferred balance first. The order in which payments are applied to reduce different portions of the outstanding balance has often been confusing for consumers, and Mr Vickers told us that he did not think the Summary Box was "sufficiently clear" concerning the allocation of payments and that "greater prominence would be desirable".[131] **The order in which payments are applied should become clearer with the adoption of the Summary Box. In the past this information was not clear, and was normally buried in the small print in impenetrable language. It is possible that many consumers were actively misled by cards not making it clear that payments would first be used to clear the balance at the promotional interest rate. The industry should continue to develop methods of clear communication on this point. It may be that wherever payments do not go towards paying off the highest interest elements first there should be a clear indication of this preceded by the word 'Warning:…'**

Transaction / Penalty charges

Transparency

61. Credit card companies often levy account charges following a borrower's breach of the terms and conditions. These penalty charges are typically for:

- Late payment: charged when the monthly payment is not received by the due date on the statement
- Exceeding credit limit: applied when the outstanding balance exceeds the agreed credit limit
- Payment refused: applied when a cheque or direct debit used to pay the account is refused.

62. Consumer groups expressed concern that the level of these charges was often not made clear to the card holder. For many cards the information is effectively buried in the small print. Some examples were submitted by Ms Harrison of the National Consumer Council, one of which said "You agree to pay us a charge if we do not receive your minimum payment by the due date shown on your monthly statement". As Ms Harrison observed, this statement contained "no reference at all to how much [the charge] would be, so there is absolutely no transparency there".[132] Mr Williamson of Nationwide believed that "there was no excuse for that type of behaviour",[133] while Mr Hoffman of Barclaycard told us that

130 Q 902ff.

131 Q 1036

132 Q 2

133 Q 390

there "should be no such thing as hidden charges".[134] **We agree that there should be no such thing as hidden charges. Stating that in certain circumstances "charges will apply" without giving further details is not acceptable. Consumers need to be aware of the extent and the exact amount of any possible transaction charge or penalty fee. All relevant charges should be expressed in the Summary Box, allowing consumers clearly to compare levels between products.**

The level of fees charged

63. A further area in which clarity is lacking is the basis on which the level of charge is set. We sought to examine whether the amounts charged in penalty fees represented a reasonable charge to the consumer for breaching the card's terms and conditions. The level of transaction/penalty fees can vary substantially between issuers. The charges for the six issuers from whom we heard oral evidence are shown in the table below. Defaqto Ltd provided us with data for the majority of cards available in the UK. These ranged from zero to £25, and almost two-thirds of cards charged £20 or over. The average fee has increased by over 50% in 5 years, from £12 in 1998 to nearly £19 in 2003.

Type of Charge	HBOS	MBNA	Barclaycard	Lloyds TSB	RBOS	Nationwide
Late Payment	£25	£25	£20/£24*	£20	£20	£12
Exceeding credit limit	£25	£25	£20/£24*	£20	£20	£12
If a direct debit/cheque is not paid	£25	£25	£20/£24*	£20	£10	£12

* The higher fee is for the Barclaycard Initial—A card with a higher APR than standard and a lower credit limit

Source: Marketing literature from the relevant issuers (October 2003).

64. A recent report from PricewaterhouseCoopers stated that "[Credit card] issuers are becoming increasingly reliant on these fees as a source of revenues. Few consumers consider these fees when assessing cards and [they] are usually unaware of the costs until they exceed their credit limit. Issuers have recently been increasing these charges."[135] Indeed many issuers have sought to replace standard annual fees with penalty fees. Barclays told us that Barclaycard "had replaced its annual fee with charges for late payment and exceeding agreed credit limits, as we felt it was unfair that the majority of our customers effectively paid for the result of imprudent account management by a minority".[136] We asked Barclaycard how much profit the firm made from the application of penalty charges and how this income compared with that received when it levied a standard annual fee. Mr Hoffman told us "we do not make any profit" but that revenue "did increase" in 2001, immediately after Barclaycard replaced its annual fee with penalty charges.[137] Barclaycard

134 Qq 390–392

135 PricewaterhouseCoopers, Precious Plastic 2002, page 7

136 Ev 148 (para 10.2)

137 Qq 181–182

subsequently increased its penalty fees in June 2002, from £15 to £20. Mr Hoffman told us that recently "the number of customers paying these charges has reduced over the past few months".[138] Barclaycard told us that they were "unable to provide…any further information" (even in confidence) since they "do not release this information in detail to our shareholders via our accounts and therefore we are unable to supply it to you".[139]

65. Consumer organisations questioned the extent to which the charges levied related to the actual costs of the customer breaching the terms and conditions such as paying late or exceeding the credit limit. Ms Harrison told us that she was not convinced that the "penalties that are imposed are actually a genuine pre-estimate of [the lender's] loss or their actual loss".[140] The Foundation for Credit Counselling told us that "companies sometimes exploit the knowledge that most consumers do not read the small print to levy charges, which can be unreasonably high".[141] The FSA has indicated that it is minded to outlaw penalty fees in the mortgage market which are not a genuine estimate of the loss or the actual loss. The Minister told us that in his personal opinion the level of some of the charges was "outrageous" and that the DTI would seek legal advice regarding the level of penalty charges.[142]

66. We asked lenders to submit details of penalty fees and when they were last increased. They asserted that the fees are an accurate reflection of cost that they incur when customers breach the terms and conditions. Lloyds TSB told us that their "charges reflect the costs we incur when customers fail to make payments or fall into arrears";[143] MBNA told us that their charges "represented a genuine pre-estimate of part of the cost incurred and loss suffered by MBNA";[144] HBOS said that "the level of our charges is driven by the costs associated with running our collection department who communicate with the relevant customers to bring the accounts back to good order."[145] No issuers provided us with any figures of the amounts raised in charges or the costs that they incurred to justify these assertions. Mr Feldman of Nationwide, which charges a fee of £12, told us that the "cost of managing someone who has gone into debt will not be that far off the charge that we make".[146] When asked why it cost Nationwide £12 and Barclaycard £20 Mr Hoffman told us that the level of fees was a "competitive issue".[147]

67. **Flat fees impact particularly badly on poorer customers. While many lenders claimed that their charges represented a fair recovery of the costs involved on any breach of contract, none supplied any figures to support this assertion. Barclaycard refused to provide us with data concerning the amount of revenue raised from penalty fees. We are therefore not convinced that these charges are reasonable. To reassure us**

138 Q182

139 Ev 155

140 Q 59

141 Ev 193

142 Q 1216 and Q 1223

143 Ev 225

144 Ev 231

145 Ev 213

146 Q 395

147 Q 397

and the general public we call on all lenders to place information on the amounts raised from penalty fees and the costs involved in the public domain. The DTI should investigate this issue. We encourage consumers to question the application of penalty fees and to switch providers if they believe they are unreasonable.

68. There is another issue relating to the ways charges are imposed, relating to their impact on low income and vulnerable consumers with low credit limits.[148] For such card users, these fees can represent a large proportion of the outstanding balance. For example, in the case of a customer with a low credit limit of £200 - £300, a single charge for late payment can represent over 10% of the outstanding balance. These charges can also be levied in combination. Citizens Advice provided an example of a client with a credit limit of £200, where a payment was received late, resulting in an £18 charge which then caused the borrower to exceed their credit limit and incur a further £18 charge; in one month these added almost 20% to the outstanding balance.[149] Ms Harrison told us of a single mother on benefits for whom the amount outstanding had increased from £190 to £424 in six months, mainly due to the application of penalty charges.[150] The Foundation for Credit Counselling told us that "such charges run the risk of causing mounting debts for those customers already in difficulty".[151] The Minister told us that "the industry has to…explain…how [charges] can accumulate…in terms of making the situation worse" and that in his view this was "not responsible lending".[152]

69. In the US penalty charges are applied but some firms vary these according to the size of the outstanding balance. For example, MBNA levies a charge of US$15 for a customer exceeding a credit limit of US$500 or less.[153] This is equivalent to charging a customer £9 for exceeding a credit limit of £300 or less. A similar borrower in the UK (usually one on low-income or a student) would be charged £20 by Capital One and £24 by Barclaycard. **While it is true to say that penalty fees will be incurred by those customers who manage their accounts imprudently, they are also likely to be incurred by people in financial difficulty. It is unacceptable that the application of unreasonable penalty fees can make debts spiral out of control. Card issuers should charge lower fees for customers with low credit limits or low outstanding balances when payments are received late, as is the case in the US. In levying penalty fees, the industry should adopt the principle that the fee should not exceed the cost to the lender of the relevant breach of the contract.**

Promotional rates

70. The way in which introductory rates are advertised can be confusing. It is important that equal prominence is given both to the introductory rate and to the go-to rate, and that the introductory rate is not expressed in misleading terms.

148 This discussion relates also to the next section of the Report, on indebtedness, but for convenience is considered here with the other points relating to fees and charges since the issue of transparency is also relevant.

149 Ev 238 (para 10.1)

150 Q 28

151 Ev 193

152 Q 1221

153 See for example, http://www.mbna.com/creditcards/index.html

71. Arguably, a special offer launched in August by Barclaycard, called "0% forever", has been a clear example of how misleading an offer can be and is in some ways symptomatic of some of the problems which we seek to highlight in this report. The offer gives customers a 0% APR on balance transfers provided consumers spend at least £50 a month on the card. Any payments made go towards clearing the transfer balance first, with the debt from current spending accruing interest. The Consumers' Association expressed concern regarding this product, in that it "encourages consumers to run up further debt, charged typically at a high rate, that cannot begin to be cleared until the balance transfer, which they are incentivised to delay clearing, is paid off".[154] The offer was also criticised as having unprecedented complexity and as virtually impossible for consumers to compare with other deals on the market.[155]

72. We attempted to go through an example with Mr Barrett, the CEO of Barclays, of a consumer who transfers a balance of £1,000, spends £500 in the first month and then makes a payment of £500. Mr Barrett called in aid the Barclaycard Chief Executive, Mr Hoffman, who confirmed that the interest rates payable would be "0% on £500, which is the £500 remaining of the £1,000 and the typical rate…on the £500 they have spent additionally, which is the new debt….we pay off first the offer balance".[156] The leaflet shows an example cost of £0 of interest payments based on an outstanding balance of £3000 over 12 months. We asked Dr Hunt to estimate the cost of an offer for a consumer transferring a balance of £3000, making the required purchase of £50 per month and paying the minimum payment. Dr Hunt told us that for a consumer on "the "typical" APR of 17.9%, with each £50 purchase falling roughly in the middle of the month, this would cost approximately £52 in interest charges over one year," At the end of one year the outstanding debt would be £2,850. On 18 November 2003, the OFT took action against Barclaycard regarding the advertising of the 0% forever offer, and Barclaycard agreed to withdraw the advertising and marketing material (but not the offer itself). **Special offers are a legitimate part of marketing. But misleading promotional material is not. This applies to both the terms and the consequences of the offer. Describing the cost in the leaflet for Barclays' "0% forever" offer as £0 was highly misleading and Barclays should review its practices. We welcome the action of the OFT in taking action over this leaflet and Barclays' decision to withdraw it. But a product still exists that potentially encourages consumers to get into more debt in order to take advantage of special offers. This amounts to sharp practice. Both the OFT and the DTI, in its review, need to address the regulatory aspects governing such products and their promotion. We would also like to alert the Advertising Standards Authority to the issues raised by this inquiry.** While we accept that Barclaycard is only one of the many divisions of Barclays for which Mr Barrett is responsible as Chief Executive Officer, it is disappointing that he appeared unable fully to understand the consequences of the offer to which his firm has signed up many consumers, often in little more time than he had at our public evidence session to understand the offer.

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154 Ev 174 (para 15)

155 Ev 174-175 (paras 16-17)

156 Q 874ff and Q 999ff

3 Over-indebtedness and responsible lending

73. Lack of transparency, as we have discussed in the preceding paragraphs, is undesirable in itself. But for some card users, particularly in the context of some of the lending and marketing practices in the industry, it can exacerbate or create significant personal debt problems. We look at issues relating to over-indebtedness and relevant industry marketing practices in this section of the report.

Over-indebtedness

74. There is no generally accepted definition of over-indebtedness. Although the amounts outstanding in consumer credit and mortgages have risen dramatically in recent years, this has been partly offset by falling interest rates and rising incomes. While the average household currently spends 7% of disposable income on debt repayments,[157] this average figure conceals significant problems for some households. The DTI Task Force on Over-indebtedness was set up in October 2000 to address concerns about consumer debt in the UK by considering ways of achieving more responsible lending and borrowing. The Task Force has published two reports, the first in July 2001 and the second in January 2003.[158] The Task Force suggested the following definitions for households that indicated a high risk of getting into financial difficulty, if not already in difficulty:[159]

- having four or more current credit commitments (7% of all households)
- spending more than 25% of gross income (excluding mortgages) on consumer credit (5% of all households)
- spending more than 50% of gross income (including mortgages) on consumer credit (6% of all households)

75. The FSA commissioned a survey which found that around 6.1 million families currently found it 'moderately difficult' or 'difficult' to meet debt repayments. These families were spending an average of 31% of their income on servicing the debt and also had "fewer liquid assets to fall back on if they experience an unexpected loss of income".[160] Citizens Advice reported an "alarming 46% increase in the number of new enquiries about consumer debt over the last five years".[161] Ms Perchard of Citizens Advice told us that this was puzzling at a time of benign economic conditions "with low interest rates and growing levels of employment".[162] Recent figures from the DTI indicated that personal bankruptcies are now at a ten year high, and this has been seen by the Bank of England as a sign "that

157 Cm 6040 para 1.5

158 http://www.dti.gov.uk/ccp/topics1/overindebtedness.htm

159 Second report of the Task Force on Tackling Over-indebtedness, pg 12

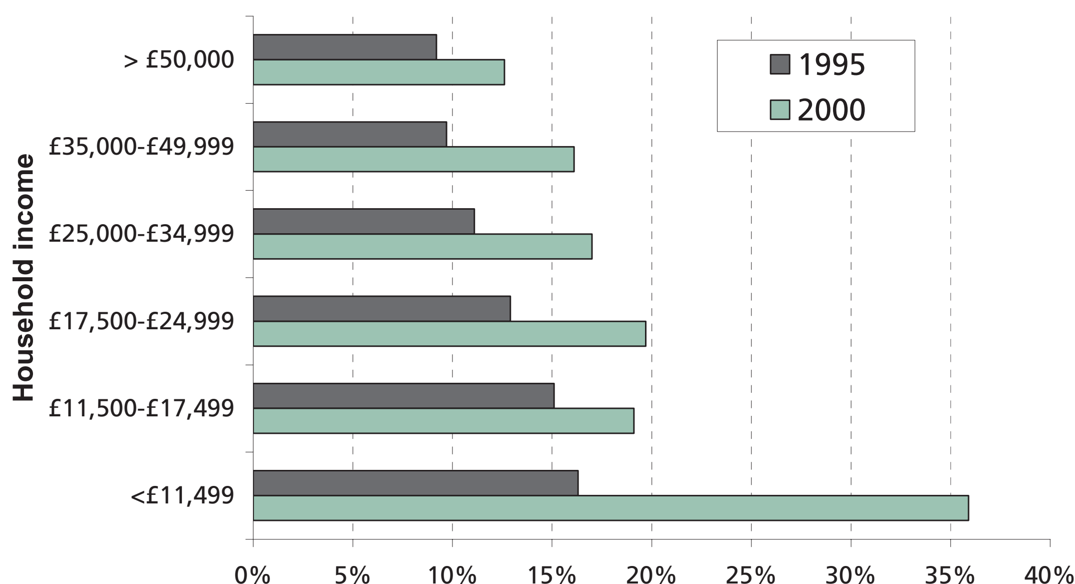
160 FSA, Financial risk outlook 2003, pp 32-41

161 Ev 232 (para 1.3)

162 Q 5

some households are finding it more difficult to repay unsecured debts”.[163] The Bank has been concerned to establish firmer data on how the overall levels of household debt are distributed amongst different kinds of households[164] and undertook a limited survey of the distribution of debt across households earlier this year, though its initial view is that there has not been any “trend increase in the number of households reporting that they face serious debt problems.”[165] This work will build on analysis of the British Household Panel Survey (BHPS), undertaken by the Bank in 2002.[166] This analysis found that “the youngest and lowest income households increased their debt to income ratios by most – and from the highest levels – between 1995 and 2000”.[167] The survey does not break down the unsecured debt by type. The following Charts give information from the 2002 analysis.

Chart 4 : Unsecured debt as a percentage of income



Source: Bank of England

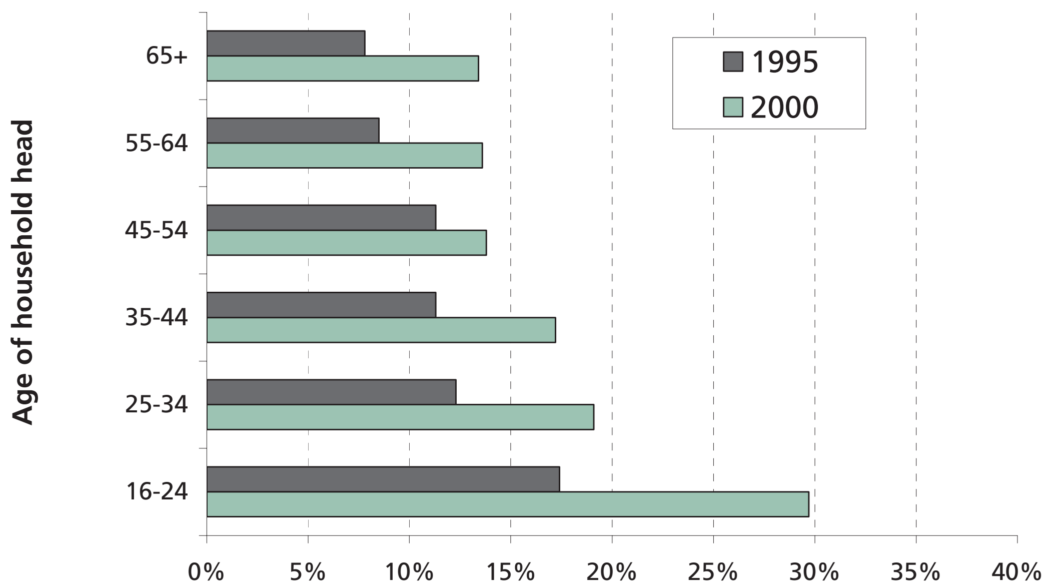
163 Financial Stability Review, Bank of England, Jun 2003, pg 61

164 See for example evidence from Mr Mervyn King, Governor of the Bank of England, before this Committee HC (2002-03) 1337 Q 44

165 *Ibid*. Q50

166 Financial pressures in the UK Household Sector: evidence from the household panel survey, Bank of England quarterly bulletin, Winter 2002

167 The study found there was “little evidence to suggest that these increases were due to the rise in the number of students and the introduction of University tuition fees between 1995 and 2000…Changes in unsecured debt as a percentage of income are…small across income and age groups when students are removed from the sample”



Source: Bank of England

76. Mr Sutcliffe, the Minister, told us that "the majority can handle credit well".[168] In a recent speech Professor Stephen Nickell, a member of the Bank of England's Monetary Policy Committee, said that, in aggregate, increases in household debt had been balanced by the acquisition of assets so that "overall household balance sheets are relatively healthy" but despite this there are "many households, particularly with low incomes which are in severe difficulty with unsecured debt".[169]

77. **In the past, consumers were in some sense bailed out from their unsecured debts, either through rising house prices in some parts of the country allowing them to secure loans on their property at a lower interest rate, or through inflation eroding the real value of a debt. In the current climate of low and stable inflation, and a cooling housing market, debt management can be more testing. The evidence indicates that the majority of households still deal with debt in a responsible manner and avoid becoming over-committed. However, there appear to be a small but significant minority for whom servicing debts, particularly large unsecured debts, has become a problem.**

78. This inquiry into the transparency of credit card charges arose in the context of concerns regarding over-indebtedness. APACS questioned whether there was "evidence to suggest a causal link between transparency of credit card charges and over-indebtedness",[170] believing that over-indebtedness was principally caused by "life-style changes" such as redundancy, divorce, marriage and illness. Citizens Advice told us that while "often it was a job loss or change of income that caused the [debt] problem to arise" in a significant proportion of cases the amount of change in income was relatively small, around 10% of annual income".[171] Ms Perchard told us that "many people have actually

168 Q 1186

169 Speech by Professor Stephen Nickell, *Two current monetary policy issues*, 16 September 2003

170 Ev 130 (para 2.1)

171 Ev 233

borrowed up to a limit where they have lost any sense of a buffer zone enabling them to cope with a small change in circumstances… Whilst credit cards are not the only product that our clients have arrears with, credit cards are the single largest debt by number in our research… [Citizens Advice] have identified in our evidence "a number of practices which may lead people to drift their commitment upwards, almost sleep-walking into a situation of over-commitment where, when they experience a small change [in circumstances], they find it totally impossible to cope with the level of commitment they have acquired".[172]

79. Many lenders stressed that it was not to their commercial advantage to lend to people who could not manage the repayments; RBS told us that it was "firmly against a lender's own interest to lend to a consumer who cannot afford to service the debt".[173] Mr Williamson of Nationwide told us that there was a "particular sector of the market that plays more of an aggressive role in encouraging people who can ill afford to take on debt to do so"; he believed that there was a need to be "sensible and responsible as lenders and that we have a duty of care to our customers" and that sometimes they had to step back and "forget about some short-termist growth patterns and think about the long-term responsibilities of the industry".[174]

80. The DTI Task Force identified a number of lending practices that were associated with households in financial difficulties. These were:

- the automatic raising of credit limits on credit and store cards and on overdraft facilities
- encouraging people to transfer balances on credit cards, by offering low initial interest rates and higher credit limits
- reducing the minimum payment on credit cards
- issuing cheques that can be used to draw on credit cards.

81. The Task Force report also said that "none of these practices affected large numbers of people and it would be wrong to claim that they caused financial difficulties or overborrowing. They do, however, disproportionately attract people who face these situations and have the potential to make a bad situation worse."[175] We examine the issues raised by these practices below.

82. **While it is not in the interests of industry to lend money to those who cannot afford to repay, certain sections of the industry are currently engaged in practices which can give rise to some consumers "sleep-walking into a situation of over-commitment" where a small change in circumstances can turn manageable debt problems into disasters. Over-indebtedness can have devastating consequences for those involved and all credit card issuers need to recognise their long-term responsibilities to prevent this from happening**.

172 Q 5

173 Ev 258 (para 3)

174 Q 160

175 Second report of the Task Force on Tackling Over-indebtedness, page 16

Responsible lending

83. **Responsible lending is more than just meeting the minimum legal requirements. It is also about driving forward best practice and treating customers fairly. A credit card lender should be providing short-term debt as part of a convenience service rather than pushing a form of debt which sucks borrowers into a long-term cycle of indebtedness.**

Automatic raising of credit limits

84. A customer's credit limit—the maximum amount they may borrow on the credit card—is initially set during the application process for the card. The limit may be raised gradually as the individual consumer becomes better known to the issuer. However, the Consumers' Association told us that "it appears a common practice for card issuers to raise credit limits without first consulting the consumer or even in some cases consulting credit histories."[176] Barclays told us that they "always carries out a sophisticated credit score when credit limits are increased" and that if "a restriction on increased credit limits became a new banking code requirement, this may act as artificial restraint on a competitive market. It would also reduce the flexibility of the credit card for consumers who would have to apply for credit limit increases. It may also lead to many going over limit and/or being embarrassed at the checkout or till".[177] Mr Goodwin argued that RBS on occasion increases customers' limits because "it stops them incurring [penalty] fees…If we see [a customer] coming up towards the limit and we see behaviour patterns justifying it – then the limit is increased selectively".[178] General Krulak told us that MBNA "increase limits either on request, and sometimes automatically" but only after carrying out "both an external and an internal check to ensure that [the customer] is capable of handling that increase limit".[179]

85. **Issuers should never raise credit limits without carrying out appropriate internal and external credit checks. Lenders also need to recognise that in many cases, for over-indebted consumers, increases in credit limits are wholly inappropriate. Despite all the sophisticated scoring techniques used, it must be recognised that the borrowers themselves have an important contribution to make in the decision.**

86. One possible approach would be for issuers to be subject to a set maximum in the amount of any unsolicited increase they may grant. This would allow credit card issuers to provide short-term flexibility and avoid customers being embarrassed at the till, while still addressing concerns regarding responsible lending. Once a limit had been increased in this way, the issuer could be required to contact the borrower to check on any changes of circumstances and gain their positive acceptance before any further unsolicited increase is made. **We recommend that the industry consider establishing a system whereby a limit is placed on unsolicited increases in credit limits.**

176 Ev 164 (para 24)

177 Ev 153 (para 18)

178 Q 1029

179 Qq 1026–1029

Increasing overall credit availability on transfer/conversion of balances

87. While the Task Force on Over-indebtedness classified borrowing to pay off other commitments as irresponsible borrowing, this practice is increasingly condoned in the credit card market. Many lenders advertise offers to transfer an existing balance from a different card while extending the credit limit on the new card to accommodate the extra balance. **Balance transfers at a lower interest rate provide benefits to millions of card-holders, but should not be used as a device to lock consumers into additional debt.**

88. Mr Barrett confirmed that Barclays were currently doing some tests to examine whether customers with large balances could be persuaded to move to personal loans, but there were issues of "trying to control the overall level of credit", since shifting the customer to a personal loan would create room on the credit card and the outstanding balance may then increase.[180] **If lenders are encouraging consumers to consolidate credit card borrowing into a personal loan, the industry should consider making it their practice to reduce the credit card limit accordingly to take account of the consumer's loan commitments. It is also important to note that, although the interest rate on the loan may be lower, a personal loan will often involve a longer repayment period so the total cost of the credit to the borrower could be greater. Furthermore, if secured against property, the borrower's home is at risk.**[181]

Inadequate credit checking

89. Before offering a customer a credit card, lenders will typically undertake a check of data held by external credit reference agencies. This could include data such as whether the customer is on the electoral role at their current address, the extent of some of their credit agreements including mortgages and the repayment behaviour of the household. Ms Hanson told us that the Consumers' Association had found that "it does not always include all the types of transaction".[182] Ms Perchard told us that it was unusual for lenders to "look at the consumer's income and all of their other commitments including commitments that are not necessarily held by the credit reference agency". She believed lenders should be "looking in more detail at the individual's circumstances in order to check that they are not becoming over-committed".[183] Ms Edwards pointed out that consumers "can get a good credit rating just by paying the minimum payment each month".[184]

90. Lenders supported calls for credit reference agencies to be given more information. Barclays told us that lending responsibly included "examining ways to increase data sharing…enabling better informed decisions"; they also called on the Government to "do more on sharing its data on consumers to improve lenders' knowledge of a consumer's overall commitments".[185] Households are increasingly obtaining debt from a wider set of sources—for example 21% of households now possess two or more credit cards. This will

180 Q 865

181 There are also possible issues about both the practices of and fees charged by debt management firms to restructure debt. We may wish to examine this in any future work on financial inclusion.

182 Q 78

183 Q 8

184 Q 7

185 Ev 149 (paras 11.2, 11.4)

increase the importance of the credit reference agencies in providing a fuller picture of the consumer's credit commitments. The Minister told us that "there needs to be an updating of the information that is given by lenders to the credit reference bodies and I personally am going to look at that as an issue alongside the White Paper".[186] **It is important that lenders assess a consumer's ability to repay based on as complete as possible a picture of their current income and credit commitments and not just on their payment history. We welcome the Minister's intention to review the information given by lenders to credit reference bodies.**

Credit card cheques

91. Many firms now issue cheque books which can be used to draw on credit card accounts. These credit card cheques allow customers to write out the cheque to a retailer to pay for goods or even to fill in their own name on the cheque and pay it into their bank account. The amount of the cheque is then debited from the credit card account together with a handling fee (normally around 2% of the amount). Such credit card cheques have been sent to 16% of households with credit cards—almost all unsolicited; research also found that credit card cheques had been sent to above average proportions of card holders in financial difficulties.[187] Ms Harrison of NCC said that these cheques had been causing enormous confusion for consumers, noting also that "normally with a credit card, of course you get rights against the credit card issuer in accordance with those that you have against the supplier of the goods and services. This neatly circumvents that obligation in law by issuing you with a cheque book to make your payments, but drawn on the same account."[188] Research showed that only a third of cheque users knew that they paid interest on the amount straightaway and did not benefit from any interest free period.[189]

92. We requested marketing literature for credit card cheques from a number of issuers and examples were also submitted to us by members of the public. These were clearly inadequate in a number of respects. Many key conditions such as the handling fee were in the small print and in one case were not stated. The interest rate applying to payments made by cheque was not stated clearly in all cases. The fact that using these cheques to make payments meant that card-holders did not have any redress against the credit card company was not indicated. Information from one company merely stated that "Purchases made using credit card cheques are not covered by section 75 of the Consumer Credit Act". We doubt many consumers are familiar with the terms of section 75 of the Act, or what practical difference flows from the fact that it not applicable. Marketing material from certain issuers encouraged consumers to use credit card cheques to pay for utility bills, such as gas, electricity and telephone, or for council tax. We do not believe encouraging consumers to get into debt to pay household bills constitutes responsible lending.

93. The previous consumer Minister, Melanie Johnson MP, had called for an industry code of practice which guaranteed that "credit card cheques should not be sent out unsolicited

186 Q 1189

187 Second report of the Task Force on Tackling Over-indebtedness, paras 6.6-6.7

188 Q 19

189 Second report of the Task Force on Tackling Over-indebtedness, paras 6.6-6.7

and should be accompanied by clear guidance to consumers on how they work".[190] APACS told us that "improved information to accompany credit card cheques" would be in place by March 2004 at the latest.[191] HBOS told us that they believed "there was a role for convenience cheques as long as they are delivered to the customer in a very transparent way", but that, as a result of this Committee's focus on credit card cheques, they had "stopped sending…cheques to both new and existing customers under the age of 25. Customers under 25 are clearly feeling their way in the world either shortly after university or a few years into the world of work. We, therefore, think it is appropriate that they should not receive the offer of the convenience cheque from us."[192]

94. **Credit card cheques are being issued irresponsibly by some lenders. Regulatory changes are necessary to prevent this behaviour. Credit card cheques should be accompanied by clear information regarding terms and conditions including the applicable APR and fees, clear notice that interest will be calculated from the date of the transaction with no interest free period, and a clear warning that using credit card cheques means that consumers have a lesser degree of protection under the Consumer Credit Act. This should be displayed prominently in minimum 12 point type. Appropriate credit checking should be carried out before cheques are sent. The sending out of unsolicited credit card cheques should be banned.**

Minimum repayments

95. Although credit cards are a flexible form of borrowing, terms and conditions specify a minimum monthly payment that the consumer needs to make. This is typically 2% - 5% of the outstanding balance. The Task Force on Over-indebtedness expressed concern that "a number of lenders have in recent times reduced the minimum repayments that are required for credit card debts, sometimes to as little as 2%. At this level borrowers will be paying little, if any, of the principal outstanding."[193] For example, with an interest rate of 13.9% a customer with a debt of £1,000 making a minimum repayment of 3% will take approximately 11 years to clear the outstanding balance, costing a total of £1,518. If this is reduced to 2% then it will take around 19 years, costing a total of £2,013. Around 11% of credit card holders make the minimum payment each month although, as lenders told us, it is not the same 11% of individuals each month.[194] In a recent survey by MORI 10% of respondents reported that they "usually" pay the minimum repayment on their store or credit card balances.

96. There have been calls to set a statutory level of minimum repayment that would ensure the debt is paid off in a reasonable time. However, Mr Pearson of APACS told us that offering different levels of minimum repayment might be a competitive part of the product.[195] Mr Barrett told us that Barclays' policy was "to make sure that the minimum

190 Ev 184 (Ministerial Response to 2nd report of the Task Force on Tackling Over-indebtedness, para 10)

191 Ev 142

192 Ev 211

193 Second report of the Task Force on Tackling Over-indebtedness, page 19

194 Q 217

195 Qq 284–288

payment is at least high enough…so at least it covers the interest”.[196] Ms Perchard told us the need was for repayment levels to be such that they were “clearing the interest and the contract is not functioning to increase overall indebtedness”.[197]

97. Ms Quinn from APACS told us that the minimum payment was not “a repayment schedule. A lot of customers use minimum repayments for one month…and the following month they do another type of payment.”[198] Mr Williamson, of Nationwide, told us that “unfortunately people do not know how long it will take them to repay their debt”.[199] Nationwide also told us that “Many in the industry argue that the minimum monthly payment is not a recommended repayment pattern. This may be true, but as the industry does nothing to dissuade the cardholder from doing this, it is not transparent to the cardholder what alternative repayment pattern they should adopt, or the financial implications of their actions.”[200]

98. California has recently introduced legislation requiring credit card issuers to show on statements how long it would take customers to re-pay the outstanding debt if only the minimum payment were made. Consumer groups, Nationwide and some other lenders have supported the inclusion of scenarios in the Summary Box demonstrating the length of time that making the minimum repayment would take to pay back an example balance, as well as the cost of this. Mr Crosby of HBOS told us that they “would be happy to put on a statement saying that we do not recommend that our customers sustain the minimum payment for prolonged periods” .[201]

99. **We believe that some consumers are unaware that only paying the minimum payment can lead to a situation in which it can take a very long time to pay off the debt. Consumers need to be provided with clear information on statements showing that this will maximise the length of time needed to clear the debt and the amount of interest paid. Statements should show how long it would take for the debt to be paid off if only the minimum payments are made. Whatever else may be included in the Summary Box there should be a clear statement of the consequences in time and cost of repaying only the minimum amount each month.**

100. **The minimum payment should always cover the interest on the outstanding balance (and any payment protection insurance premium), so that by making the minimum payment households should never be increasing the size of their debts. The industry should publish data on the proportion of customers that have been making the minimum payment for six straight months. This would provide a useful measure and may provide an early indication of households in financial difficulty. These households could also be targeted with specific information that paying the minimum will take a long time.**

196 Q 857

197 Q 102

198 Q 281

199 Q 270

200 Ev 244 (para 3.5)

201 Q 845

Other marketing practices

101. Marketing material and procedures provide consumers with information they will use before applying for a credit card. Citizens Advice flagged seven key practices of credit card marketing which did not appear to them to be consistent with responsible lending practices or the promotion of transparency. These were:[202]

(a) speed and ease of application
(b) prominence given to very high credit limits
(c) prominence given to very low interest rates for cards where the interest rate paid by the consumer is determined by risk
(d) inducements to use the card
(e) unsolicited mailshots for credit card cheques
(f) important information in small print
(g) indiscriminate targeting of direct mailshots.

102. We have discussed above a number of the issues arising, in the context of transparency and responsible lending, from these practices. But there are also issues to do with the marketing methods themselves. Ms Perchard of Citizens Advice told us that irresponsible marketing "can give an impression to consumers that it is quick, it is easy, it is painless, you can borrow a huge amount of money very quickly, only a matter of seconds, So I think the whole package, really, in some cases needs reining in, and I think more focus on informed consumers entering into agreements with their eyes open knowing what they are getting would be a much better way forward for the future."[203]

103. **Marketing of credit cards by some companies has developed in a way which can be characterised as highly misleading and highly damaging to the interests of the consumer. We expect the industry to improve its practices significantly. It is essential that credit cards are marketed with clear information and in a responsible way. Lenders should take particular care when marketing credit cards to young people, vulnerable consumers and those on low incomes. OFT should develop best practice guidelines and these need to be incorporated into the Banking Code or directly enforced by the OFT. People should be encouraged to complain to the OFT regarding misleading marketing.**

104. Direct mail is the dominant medium for the promotion of credit cards and now accounts for more than three-quarters of the total spent on credit card promotion. In 2002, credit card issuers spent around £250 million on direct mail[204] and around half a billion pieces of marketing material are sent each year. The National Consumer Council told us that they "had been concerned for some time about the proliferation of marketing material for credit cards. It is often aimed indiscriminately and drops through the letter-boxes of students and those already in debt, as well as those who may have an interest and the financial capability to take out an agreement".[205] The Royal Bank of Scotland recently sent a credit card application for a Gold card with a £10,000 limit to a Shih Tzu dog. Mr Goodwin

202 Ev 234–235

203 Q 90

204 Argent, the journal of the Financial Services Forum

205 Ev 240 (para1)

admitted that the incident was one that he "would rather not have happened" but that the dog's name was on a mailing list that RBS had purchased.[206]

105. Citizens Advice told us that there appeared to "be little or no attempt on the part of credit card companies to stop sending marketing to people who are already in debt".[207] They reported a disturbing example of a client on income support who had "run up a £10,000 credit card debt in order to pay for his drug addiction. He had been resident in a rehabilitation clinic to treat his drug addiction for six months when he received an unsolicited credit card application form at the clinic. The client completed it and the credit card company issued him a card. The client told Citizens Advice that it was fortunate that the card was intercepted by a member of the clinic staff otherwise he would have been tempted to use it to buy more drugs."[208] **If targeted indiscriminately marketing material could encourage consumers with existing debt problems to increase their commitments and thus contribute to over-indebtedness. We recommend that the OFT should set down clear guidance on credit marketing, laying down the standards of conduct that consumer credit licence-holders need to demonstrate. Credit card issuers need to fulfil their social responsibilities and should not blindly use lists of names purchased from third parties without appropriate checks.**

106. Increasingly credit card issuers have also begun to market credit cards using sales representatives in shopping centres, railway stations and other public places. Mr Hoffman confirmed that Barclaycard had been doing some "tests on a small scale" in these locations.[209] However, when staff from the Committee approached sales representatives of Barclaycard in a shopping centre, the representatives refused to allow copies of the application form to be taken away for further consideration. Mr Hoffman told us that he "did not condone this practice" and that Barclaycard had "clear standards by which we operate" and "clearly something had gone wrong".[210] Ms Harrison of the NCC told us that "where consumers simply do not feel that they can read through all of the documentation at the point of sale, then it is absolutely right that they should be able to take it away, and it is very poor practice indeed not to allow that".[211] **It is essential that where credit cards are marketed by sales representatives consumers are given sufficient information to make an informed choice in what can be a pressurised environment. A clear version of the Summary Box should help in this respect, but if customers wish they should always be able to take away details of the product along with the application form to make a considered decision. Issuers should monitor their procedures closely to ensure there are no abuses of the process.**

Payment protection insurance

107. Although it is not strictly an issue of irresponsible lending, concerns have also been raised about inappropriate selling of insurance linked to card payments, and it is

206 Q 821

207 Ev 235 para 4.2.7

208 Ev 235 para 4.2.7

209 Q 260

210 Qq 260–269

211 Q 91

convenient to deal with them at this point. Payment protection insurance is often sold by lenders alongside credit cards. This insurance meets some of the costs of repayment should the customer be unable to work due to illness, redundancy or accident. The balance would also be cleared in the event of the cardholders death. The exact terms and exclusions vary between providers. The household survey on the causes, extents and effects of over-indebtedness commissioned by the DTI found that "In fact very few payment protection policy-holders (4 per cent) had tried to claim on them in the past 12 months, and 3 per cent said that they had done so successfully."[212] **Payment protection insurance can play a role in meeting customers' repayments should they be unable to work through illness or redundancy. The terms and exclusions need to be explained clearly to customers. Insurance should not be sold to customers who would not benefit from it due to their age or current employment situation. The OFT should investigate the selling practices of payment protection insurance, how it is priced and whether the market may benefit from increasing competition.**

Responsible borrowing

108. It must be remembered, however, that not all the fault in the creation of excessive personal debt lies with the lenders. It is important that consumers borrow responsibly. Again, the DTI Task Force on Over-indebtedness found some evidence of a small proportion of consumers borrowing irresponsibly; this had a strong link both with financial difficulties and with high spending on credit repayments.[213] These included unplanned purchases and credit use; borrowing to re-finance other credit commitments or to pay off arrears on bills; and taking on credit agreements despite knowing that they will struggle to repay the money. The Minister for Competition, Mr Sutcliffe, told us that consumers should ask themselves three questions when deciding whether to borrow—these were "how much will it cost me, can I afford it and what happens if it goes wrong?".[214]

109. The best method consumers should use to meet their credit needs will depend on their own personal circumstances. Credit cards are an extremely flexible method of short-term borrowing, but charge higher interest rates than other longer term forms of borrowing such as personal loans, overdrafts and secured lending. Consumers have also begun to borrow longer on credit cards, with the average duration customers take to clear their balance increasing from 3 months in 1997 to 5 months in 2002.[215] Mr Barrett told us that there is "no question that credit card borrowing is an expensive way to do chronic borrowing" and that certainly "he would not recommend to anyone that they chronically borrow on a credit card".[216] **While credit cards are a flexible and convenient method of short-term borrowing, there is no doubt that they are an expensive way of borrowing for the long-term. Borrowers must recognise this.**

212 Household survey on the cause, extent and effects of over-indebtedness, DTI, November 2002

213 Second report of Task Force on Tackling Over-indebtedness, page10

214 Q 1117

215 Bank of England Nov 2002 inflation report

216 Q 864

4 Store Cards

Background

110. Following concern expressed by consumer organisations, and further research, we decided that our inquiry—initially confined to credit cards—should be widened to examine the transparency of store card charges. We took evidence from the leading provider of store cards (GE Consumer Finance), some individual stores involved and the Finance and Leasing Association (FLA, the relevant trade association).

111. Store cards are payment cards issued by certain chains of shops or department stores. Unlike credit cards, store cards can typically only be used in the store or chain of stores by which they have been issued, although some store cards allow customers to obtain cash advances. The FLA told us that there are around 21.6 million store cards in issue in the UK and around £4.8 billion was spent on them in 2002.[217] Mintel estimate that around 14 million people (around 30% of the adult population) in the UK own at least one store card.[218] Most store cards typically charge far higher rates of interest than do credit cards. The average interest rate on a store card is in the region of 27% APR, with many charging between 28% APR and 32.5% APR. This compares with an average credit card interest rate from the major banks of 15% APR. Many store card issuers partner external finance companies to provide their card. GE Consumer Finance is the largest of these, with around 50% of the store card market; other major players include Creation Financial Services, IKANO Financial Services and HFC Bank (part of HSBC).

Transparency

112. The FLA told us that "our members provide transparent and open consumer information in respect of APRs".[219] GE told us that APRs "are stated in bold on the front of each application form and included in the second copy of Terms and Conditions which accompany the welcome pack and the card".[220]

113. We examined marketing material for several store cards, and also the provisions for informing the customer of the interest rate. On the GE Consumer Finance application form, the APR was shown in bold text 2mm high towards the bottom of the application form. The application form was typically filled in by the store member of staff with the customer only being asked to sign the form. The customer received the store card through the post, attached to a 'card-carrier' together with a glossy leaflet and a booklet of terms and conditions in small print. The APR was not stated on the letter to which the card was attached, with the glossy booklet stating that "interest would be charged at the current rate". The customer would need to delve into the depths of the small print booklet to discover the interest rate they were being charged. A leaflet was available in House of Fraser advertising details of the store card, but this did not mention the interest rate

217 Ev 188

218 Mintel, Store Cards - UK - October 2002, see www.mintel.co.uk

219 Ev 190 (para 38)

220 Ev 201 (para 4.6)

applicable. Mr Seamus Smith, for GE, defended the leaflet, telling us that it "classed as a simple form of credit advertisement" and GE were "not permitted under the [Consumer Credit] Act currently to put the APR details on that"; the in-store leaflet from Arcadia, on the other hand, included details of the APR; Mr Smith described this as "an intermediate form of credit advertisement and it is permissible to put the APR on".[221]

114. We asked the DTI how stores were able to get away with only issuing a leaflet to advertise their store card without showing the APR. Mr Rees, for the DTI, told us that the "rules which govern advertising at the moment were pretty poor" and that part of the forthcoming White Paper would aim to "simplify" the regulations and make them "easier to enforce".[222] We also examined a statement sent by one of the stores in the Arcadia group. This did not make any reference anywhere to the interest rate that would be charged on the debt outstanding or the amount of interest that would be charged if the customer only made the minimum repayment. **To date there has been in some cases a cosy arrangement between the store card providers and the stores involved to prevent customers from gaining the full facts about their cards. The fact that this has been legal serves only to underline the urgency of reforming existing consumer credit legislation.**

115. At the hearing on 14 July, we asked GE if they would consider introducing a Summary Box into the marketing material. Mr Smith subsequently wrote to us saying that GE were "fully supportive of the adoption of a [Summary] box to improve clarity for customers".[223] The proposals were discussed by the FLA and they wrote to us in September outlining proposals for a Summary Box that would be included "in any advertising or promotional material advertising store cards"; FLA members agreed to comply "as soon as possible and no later than 31 March 2004".[224] Mr Brad Cooper, the CEO for GE Consumer Finance UK, wrote to us in September saying that the Summary Box was "already in place in some of our retailers and will be rolled out to the others commencing November 2003".[225] In a further letter in November he confirmed that GE had reinforced their staff training programme, placed the Summary Box in point of sale literature in every store and introduced a 'no-quibble' guarantee under which customers could cancel their agreement at any time within 60 days at no cost.[226] **While store cards may offer some benefits to consumers in terms of discounts, customers need to be aware of the extremely high interest rates charged. Some progress has now been made in improving transparency, but further work remains to be done, in particular concerning the size of the print giving the APR (which should be minimum 18pt in all literature) and the provision of further information on monthly statements, especially the interest rate that applies.**

Interest rates

116. We sought to examine why store cards typically charge much higher interest rates than credit cards—up to eight times the Bank of England base rate. GE Consumer Finance

221 Q 545

222 Q 786

223 Ev 205

224 Ev 192

225 Ev 206

226 Ev 207

told us that "funding costs"—the costs to GE of financing the money lent on to customers—were only 15% of their total costs, with marketing and other operating costs, bad debt provisions and payments to the retailer accounting for the other 85%. They also explained that "the amount of debt a customer has on one of our cards is significantly less than they have on a credit card";[227] the typical balance of a customer who paid interest was £328.[228]

117. GE Consumer Finance charge interest rates between 28% APR and 32.5% APR. Store cards marketed by Creation Financial Services charge 30.7% APR. Some store cards do have lower rates, with the Marks and Spencer card having a rate of 18.9% APR and John Lewis a rate of 13.0% APR. When asked when they last reduced the rate on their store card, GE told us that this was in April 1999. Since then, the base rate has reduced overall by 1.5 percentage points and the average interest rate on credit cards has fallen by 5 percentage points (from 20% APR to 15% APR), but the store card rate not at all. The difference between the rate on which a typical customer could borrow using a store card is now significantly higher than that on a credit card. GE told us that "they serve a very competitive market" and that "the competition sits in the consumer's wallet" implying that consumers decide whether to borrow money on the store card or on their credit card.[229]

118. Available information suggests that GE might be making almost twice the level of profit as a proportion of transactions compared with the market-leading credit card supplier. This could be for one of a variety of possible reasons:

- GE are an extremely efficient and well-run company;
- the store card market as a whole is significantly less competitive than the credit card market;
- GE is able to exploit consumers' lack of understanding of the real price of its products.

Only when sufficient transparency exists so that customers are properly aware of the interest rates charged will it be clear that GE makes its profits from being an efficient and well run firm. Mr Cooper wrote to us saying that GE's store card products represented "good value for our customers when the whole program, *cost* and *benefit,* is taken into account. The customer weighs the substantial benefit (discounts, invitations etc.) with the cost (typically 2.2% monthly interest) to determine *if* they use our products and how quickly they pay it off."[230] We note that 2.2% monthly interest is equivalent to around 29% APR.

119. GE Consumer Finance has around 45% to 50% of the store card market and we were concerned that its large presence in the market may have restricted competition. When asked what proportion of a market a firm would have to have before the OFT had concerns about a dominant position, Mr Vickers told us that this involved "defining the relevant market, looking at market shares, but there is not a market share that determines the

227 Q 485

228 Ev 201 (para 4.3)

229 Q 451, Q 537

230 Ev 207

question of dominance".[231] Defining the relevant market involves considering which products are the "competing alternatives". For example, the OFT would need to come to a judgement as to whether the store card market was separate from the credit card market. Following our hearing on 9 September, the OFT formally announced that it was launching a preliminary examination of the store card market.[232]

120. **Store cards charge much higher rates of interest even than credit cards. Although in part this may flow from a pricing model which places all the costs of the operation on the minority who pay interest, there is also evidence to suggest that competition is not working properly. For competition to function effectively, consumers need to have reliable and clear information about both the benefits and costs of the product. We therefore strongly welcome the OFT's decision to undertake a preliminary examination of the store card market, and will follow developments with a close interest.**

Retailers' responsibility

121. We took evidence from the individual retailers to ascertain what responsibility they accepted for the price of their store cards, their operation and how they deal with their customers who may get into debt. Mr Wayment told us that House of Fraser's policy on this was managed "through our specialist provider, GE".[233] Arcadia indicated that they did not provide any information to their typically younger consumers concerning the consequences of getting into debt, with Mr Budge telling us that they "work with GE on it" but "pass over matters in terms of financial services".[234] Following the meeting Arcadia wrote to us to say that "through GE we do take cases of financial difficulty very seriously…we monitor their policies and procedures…to ensure they operate appropriately".[235]

122. We also questioned retailers as to what input they have into the running of the store card operation and how much control they exercise over the interest rates charged. We thought that as retailers they would ensure that the merchandise and services supplied in their stores was of sufficient quality and represented a good deal for their customers. Arcadia told us that "the quality of the store card programme hinges on the benefits we are able to offer to our customers. Arcadia works with GE to ensure quality in the same way as it would deal with any other major supplier"; they also told us that they "monitor the level of interest rates in the context of the overall store card product on a regular basis" but that "GE have ultimate control over interest rates charged".[236] House of Fraser told us that "GE earns money from the charges levied upon the customer for the various financial services it provides, including all interest charges. House of Fraser benefits from the increased trade from those loyal customers due to affinity with the brand". They also told us that "House of Fraser does not control the APR".[237]

231 Q 771

232 OFT press release 120/03 *OFT launches store cards study*, 17 September 2003

233 Q 565

234 Q 558

235 Ev 128

236 Ev 129

237 Ev 213

123. **We find it astonishing that stores should allow a product—i.e. store cards— to be supplied in their shops where they claim they have no control over the price (in this case, the interest rate). Retailers generally claim that the goods they supply are of high quality, representing good value for their customers. In not applying these principles to financial services offered in their name they are being inconsistent and letting their customers down.**

Point of sale practices

124. We sent researchers to stores to examine point of sale practices. At stores operated by both Arcadia and House of Fraser staff refused to allow a copy of the application form to be taken away, saying that this was not standard practice. We questioned representatives from House of Fraser and Arcadia about this. Mr Wayment, for House of Fraser, and Mr Budge, for Arcadia, both claimed that the reason customers were unable to take the form away from the store was to do with the Consumer Credit Act.[238] However, later on at the same hearing Mr Smith, for GE, confirmed that there was nothing in law that prevented GE from changing its practice to allow a customer to take away the application form.[239] Mr Rees of the DTI also confirmed that "the law is quite clear: [consumers] can take away the material".[240]

125. GE wrote to us following the session saying that they currently had "a comprehensive training programme in place to ensure that store staff are properly trained in our point of sale processes and are fully briefed on the key features of our store cards". GE were also "updating their training processes to ensure that all store staff are fully aware of the applicable APR, and…ensuring that store staff will, if requested, allow customers to take copies of the application forms out of the stores".[241] **It is extraordinary and indefensible that stores should have stated that it was against the provisions of the Consumer Credit Act to let customers take details of the terms and conditions of their store card out of the shops so that they were able to make an informed choice in a less pressurised environment. We welcome confirmation from GE and the stores involved that they will no longer seek to prevent customers exercising their legal right to take away copies of the application form.**

Conversion of store cards to credit cards

126. The market for store cards has been static in recent years, despite the large overall growth in consumer credit. Marks & Spencer (one of the most popular store cards) has been in the process of transferring the majority of its customers to a credit card. As part of this process the APR has been reduced from 18.9% to 14.9%. GE Consumer Finance have also been writing to some holders of the Debenhams store card, offering to convert them to a credit card charging 16.9% APR, compared to the rate on the store card of 28% APR. These cards offer similar benefits to store cards, such as loyalty points and discounts but charge much lower rates of interest.

238 Q 498, Q 519

239 Q 526

240 Q 784

241 Ev 205

127. In respect of the Marks & Spencer transfer operation, the OFT intervened on the grounds that the operation involved issuing unsolicited credit. Marks and Spencer complied with the request by only activating the new cards when a phone call has been received from the customer. They told us that "they had always intended to send out the majority of cards" in this way and they "agreed with the OFT that they would require all of the cards to have this telephone activation sticker and would add a sentence to the letter accompanying the card confirming that it is the customer's choice to accept the new card".[242] We also had some concerns regarding responsible lending in the light of reports that credit limits were being increased by large amounts. One trading standards officer reported to us that his credit limit had been increased from £1,000 to £10,000, with the new figure representing a quarter of his gross income. Marks and Spencer told us that they used "credit scoring technology and experienced people to set prudent and appropriate credit limits for each individual customer". They also told us that "the average credit limit on our store card account is around £800. On the credit card the average limit will be £3,600. This figure compares to an industry average of £4,400".[243]

128. **While lower prices for consumers can be a welcome result of the conversion of a store card to a credit card, it is essential that any transition process is carried out responsibly and transparently. The cards should not be activated without the explicit consent of the customer. The terms and conditions of the new product should be clearly stated. Consumers should not be offered increases in credit limits without the appropriate checks, and firms should limit the size of any increase initially with the consumer left to request any future increases.**

242 Ev 229

243 Ev 228

5 Financial literacy

129. The measures we have discussed in this report are aimed at greatly increasing the knowledge available to consumers in choosing a card and in managing its use. But, even if clear information is provided, consumers need to be able to understand it if they are to make effective use of it when comparing products and if competition is to be enhanced. Limitations in consumers' ability to understand financial products have been recognised in earlier studies and reports,[244] and society in general—and the financial sector in particular—faces a significant challenge in establishing how to improve this understanding.

Raising standards

130. Recognising the Government's role in addressing this challenge, the Financial Secretary, Ruth Kelly MP, recently stated that:

> "Raising standards of financial literacy is an important part of the Government's wider strategy to reduce social and financial exclusion, … and promote saving. Financially literate, confident, and independent consumers also spur firms to offer high quality, value for money products and services, and promotes effective competition."[245]

131. Particular measures under way are the inclusion of financial education in the school curriculum and the work being launched by the Financial Services Authority. The FSA recently announced the establishment of a national *Strategy for Financial Capability*, backed by a Financial Stability Steering Group.[246] This Group includes representatives from both financial institutions and consumer groups among others. The banks in their evidence to this inquiry expressed their support for these efforts. Consumer groups in their evidence emphasised how such education had to be more than just a matter of preparing and making widely available explanatory leaflets about products and about financial issues or provision of courses specifically directed at financial literacy, but about reaching out in wider ways.[247]

132. **We welcome the steps being taken by the Government, the Financial Services Authority and the financial sector towards developing greater financial understanding and awareness among consumers, though we consider that the financial sector in particular has more to do if it is to live up to its responsibilities.** But we note also the reality that there is a limit to what such measures can achieve and that, as the Consumers' Association has noted elsewhere, even to the extent they are successful it will be a generation before any benefits will work through. The Consumers' Association has suggested the establishment of a publicly funded 'National Financial Advice Network',[248]

244 For example, the Report of a Working group on Improving literacy and numeracy, chaired by Sir Claus Moser in 1999 suggested that 1 in 5 adults had literacy standards expected of an 11-year old and that very nearly half of all adults had poor or very poor numeracy skills; see also the Report of the Adult Financial Literacy Advisory Group chaired by Derek Wanless in December 2000

245 HC Debates, 17 November 2003, Col 523W

246 *Towards a national strategy for financial capability*, FSA November 2003

247 Q 101

248 See Consumers' Association website www.which.net for further information

which could complement existing private sector sources of advice. This proposal raises wider questions than we have addressed in this inquiry. Nevertheless, we note the importance of maintaining an open approach to this issue and it is an area which we expect witnesses to our inquiry into *Restoring confidence in long-term savings*,[249] and to any future work relating to financial exclusion, may wish to discuss with us.

133. If the information needed by consumers is properly and clearly set out in the proposed Summary Box, then consumers will be increasingly used to seeing it in a standardised form. This might in itself act as an educational tool.[250] Nevertheless, **it will continue to be important for issuers to test their products with groups of consumers to determine the extent to which they understand it**.

Education in relation to debt

134. This inquiry has shown to us, however, that there is a specific and particularly serious issue in relation to consumers' understanding of debt. We have discussed above how lack of clarity in the way in which credit products operate not only hurts consumers financially and impedes competition, but also that in some cases it can lead to the build up of debt, sometimes unmanageable debt.

135. For households in debt, advice is available from a number of organisations including the Citizens Advice Bureaux, National Debtline, the Consumer Credit Counselling Service, and the Money Advice Trust. These bodies can prevent people from going to debt management firms that can charge unreasonable fees. Many financial institutions support this work.[251] **When households become over-indebted, it is essential that clear advice is available for them to manage their commitments. We commend the work of the Citizens Advice Bureaux and other free money advice services. We welcome financial support from the industry for these organisations and, given the rising prevalence of credit card debts, we expect this support to increase. Issues relating to consumer debt need to be a specific part of the FSA's strategy of consumer education**.

136. We have referred above to the work of the Task Force on Over-indebtedness set up by the Government in 2000. This has produced reports in 2001 and 2003 and has been a useful forum for discussion between industry, consumer groups and regulators. We note that for its 2003 report the Task Force had only one member specifically representing consumers. **We welcome the Government's decision to put the Task Force on Over-indebtedness on a more permanent footing.**[252] **Consideration should be given to enhancing the voice of consumer groups on the Task Force.**

249 Announced in a Press Notice of 14 November 2003 (see Committee website)

250 See memorandum by Mr Barry Gardiner MP Ev 194

251 See for example memoranda from HBOS Ev 209 (para 4), HSBC Ev 216, Lloyds TSB Ev 223 (para 2.6)

252 Q 1225

6 Conclusion

137. This inquiry arose out of concerns about unfair treatment of consumers and fears that industry practices—in both the credit card and store card sectors—were raising levels of unmanageable personal debt. As we noted at the beginning of this report, many of our concerns appear to have been fully justified.

138. We have made a number of recommendations to address the problem. Some of these are primarily directed at the industry, and some at the regulatory authorities in the form of the Department of Trade and Industry and the Office of Fair Trading. **In practice, it is both industry and the regulators who need to act, working together. We hope that the coming months will provide evidence of effective action and cooperation between all those involved. We will be monitoring developments and will if necessary return to the subject with further hearings if we are not satisfied.**

139. This is not to say that nothing has been done already by the industry, supported by the regulators, and—in recent months—prompted by this Committee, to improve the situation. In particular, agreement has been reached on the principle of the introduction of a Summary Box providing key information, and further improvements—for example in the establishment of a single way of calculating the APR—should result from the consumer credit White Paper published at the beginning of December. In addition, the OFT is examining the state of competition in the store card sector of the industry. But we have gained the strong impression that it has largely been pressure from this Committee which has brought about these developments.

140. **The deliberate obscurity of information vital to comparing credit cards and to competition in the industry has been a most disturbing aspect of the Committee's inquiry. It is also a matter of concern that the statutory regulator, the Office of Fair Trading, did not appear to be aware of the unsatisfactory state of affairs in the industry or if aware did nothing to remedy the situation until it was publicly revealed by the Committee. The Department of Trade and Industry was aware of the situation but showed little sense of urgency to remedy the position. Instead it appeared to believe that the leisurely publication of consultation papers and the use of the European Commission as an alibi for inaction justified its pedestrian approach.**

141. **The passivity of the statutory regulator, the Office of Fair Trading, in the face of blatant unfairness to consumers is unacceptable. We call for a far more active approach in future and deliberate attempts to broker a voluntary agreement where statutory powers are considered inadequate. We will be looking for evidence of this in the coming months. We are pleased to see that the DTI are now treating the matter as urgent and intend to bring forward a new Consumer Credit Act which we hope will deal with the issues raised in this report.**

Conclusions and recommendations

Level of interest rates charged

1. The high interest rates charged by some credit and store cards are excessive, as the banks have conceded, and are a considerable cause for concern. There is an impression that they result in part from a lack of transparency in pricing which obstructs effective competition. Excessive rates would not exist in a genuinely transparent and competitive market. Consumers cannot shop around if they lack the mechanisms to compare products. It is not for Government, or this Committee, to state what rates are acceptable, but *it* is for Government to ensure that competitive forces can work. We hope that the steps laid out in this report will help consumers to make informed choices, and we would expect lower prices to result. If this does not happen, credit card issuers will still be obstructing competition. (Paragraph 12)

Regulatory environment

2. The Government should consider (perhaps within the current review of the Financial Services and Markets Act 2000) examining the boundary between the respective responsibilities of the DTI/OFT and the FSA for consumer credit regulation. (Paragraph 13)

3. The consumer credit regime is from a previous age in terms of the developments which have taken place in the market. It is essential that a regulatory regime is in place that keeps pace with developments and protects consumers. The DTI has issued many consultation documents but consumers have seen little practical gain. We expect improvements to be brought forward with urgency. We hope the White Paper is the start of a period of action by the DTI, rather than just the start of a new round of consultations, and that consumers will soon see real benefits alongside increased protection. The Office of Fair Trading has been too passive in safeguarding the rights of consumers in the face of endemic obscurity in the industry on issues the customer had a right to know about and where competition depends on clarity. In future whether the regulator is the OFT or FSA a much more active approach is needed with remedies following the identification of bad practice much more quickly. (Paragraph 15)

4. Self-regulation through industry codes, if accompanied by monitoring and enforcement, can play an important role in supplementing statutory requirements. We note and welcome the commitment of Capital One and American Express to join the Banking Code in the very near future. (Paragraph 16)

5. We welcome the DTI's commitment that delays in European legislation will not be used as an excuse for UK consumers to wait longer than necessary for vital improvements. The EU draft consumer credit directive needs to be redrafted (and the FSA should be involved at an early stage in the discussions). (Paragraph 17)

Transparency in credit card charges

6. Whilst the UK credit card industry considers itself competitive, we feel that while consumers cannot properly compare products the level of competition is inadequate. We want to make it more competitive, by giving consumers clear information to choose between cards. The industry and regulatory frameworks need to provide consumers with clear and understandable information. This is clearly not happening currently. Important information is buried in small print of often miniscule proportions, written in technical jargon. The APR figure used by consumers to compare cards is calculated in more than one way. The true cost of cards to the consumer is concealed behind complex interest calculation methods not taken account of in the APR. Seemingly unreasonable charges are levied of which the consumer is unaware. While some of these failings reflect a regulatory framework that is comprehensively out of date, there have been no significant initiatives from much of the industry aimed at improving matters. Our inquiry has been a wake-up call to the industry—as some in the industry have already conceded—and we hope that providing customers with clear and transparent information about what are necessarily complex products will now become a priority. (Paragraph 19)

Transparency: a 'Summary Box'

7. Over the past two years there has been little or no progress in improving transparency for consumers. Key terms and conditions have been buried in the small print, making it difficult for consumers to compare cards. Many lenders, consumer groups and regulators responding to our inquiry had expressed support for the introduction of a Summary Box, but no firm timescale had been agreed. We now welcome the positive response of the industry to our challenge to bring forward firm proposals. As a start to improving transparency, the Summary Box must now be implemented by April 2004, and in a way which emphasises the provision of information in a clear and simple manner. (Paragraph 26)

8. The Summary Box needs to develop in response to consumers' needs. To this end, the regulators and the industry should commission consumer research to determine how the box may be made better and clearer for consumers. The DTI's review of the regulations should place the principle of the Summary Box on a statutory footing, and it should be enshrined in the Banking Code in the current review. (Paragraph 27)

9. While credit cards are complex products used by consumers in a variety of ways, there exists the potential for improved transparency by the inclusion of examples in the Summary Box giving the cost of different borrowing scenarios. This will not increase confusion if implemented in a simple and standard way. The industry should work with consumer groups to develop scenarios for consideration for inclusion in the Box at the time of the review of the Summary Box in September 2004. This process should be informed by the consumer research which we recommended above. (Paragraph 31)

10. The large number of different interest rates in the Summary Box could serve to confuse consumers. We would expect to have seen progress towards establishing an

effective balance in the amount of information included in the Summary Box by the time of the review in September 2004. (Paragraph 32)

11. Banks have a duty to implement the Summary Box in the spirit of its purpose—to present information to consumers in a clear and transparent way. Its purpose, after all, is to allow easy and genuine comparison of the costs of credit offered by the various providers. The format of the Summary Box must be fully standard and consistent, and the placement clear and prominent. We expect the banks to cooperate constructively in achieving this. The consumer research we have recommended above should include consideration of format and placement. (Paragraph 35)

12. The Summary Box must not be allowed to become part of the small print. A minimum font size of 18pt should be specified for the APRs. All other text in the summary box should be minimum 12pt. (Paragraph 36)

Transparency: monthly statements

13. To improve competition, consumers need to be kept informed of the charges and interest rates applicable to their credit card. This will enable them to compare products and determine whether they could get a better deal elsewhere. The Summary Box should be extended so that it appears on monthly statements. APACS should develop these proposals by the time of the proposed review of the Summary Box in September 2004. (Paragraph 38)

14. We welcome the DTI's intention to explore with industry and consumer groups the scope for using the monthly statement to educate consumers about the implications of the debt they are taking on. This could include examples of how long the debt would take to repay for a given monthly payment. Statements should also make consumers aware of the financial implications of only making the minimum repayment each month. (Paragraph 39)

Transparency: the APR figure

15. We were astonished to discover that the APR figure most commonly used by consumers to compare credit cards is allowed to be calculated in more than one way. This is clearly unacceptable, impedes competition and damages consumers' ability to compare products. The fact that such a situation has been able to persist for several years reflects badly on all participants. (Paragraph 42)

16. Despite continued efforts, it is unlikely that the industry can change to a single method of calculating the APR before the regulations are amended. The DTI plans the new regulations to come into force in October 2004. It is regrettable that the potential for consumers to be misled and confused will continue to that date. The DTI, OFT and the industry should continue dialogue in an attempt to establish a commonly and legally acceptable working interpretation in advance of October 2004. This should be implemented as soon as possible. We welcome the Minister's commitment that the October 2004 deadline will not be missed, and that the work will be seen as a priority. We will be monitoring developments closely. Until the

industry converges on a single method consumers will not gain full benefit from the Summary Box. (Paragraph 45)

17. The final decision to be taken on which method of APR calculation to use should be based on the objective of clarity for consumers rather than complex legal and technical judgements. We believe the proposals in the White Paper to calculate the APR using the "go-to" or standard rate for purchases after any introductory period will provide a clearer and more understandable basis for consumers on which to compare cards than any blended rate. (Paragraph 46)

Transparency: interest calculation methods

18. For card issuers to compete on price, consumers need to have reliable information to compare the costs of different products. The different methods that card issuers currently use to calculate the total interest charged are technical and opaque. Many consumers are unaware that such differences exist and lack the means to calculate what impact they have on the total cost of using their credit card. As a result, many are being misled. There is a clear need for greater transparency and if the differences and their effects cannot be explained to the consumer then some degree of standardisation will be required. We welcome the DTI's intention to discuss with the industry ways in which interest calculation methods can be standardised and made more transparent without inhibiting competition. The DTI aims to conclude discussions by February 2004 and we will be looking for prompt action after that date has passed. The onus will be on the industry to prove that a measure of standardisation will not be beneficial. (Paragraph 52)

Transparency: risk-based pricing

19. Risk-based pricing is a practice which raises serious transparency issues, as consumers are often unaware of the rate they will be charged until after the card has been received. This is an unacceptable practice. We are also concerned that the very act of shopping around by applying for several different cards can damage a consumer's credit rating. The OFT should monitor the proportion of customers who obtain the favourable rates advertised and those who end up on the higher rates. It should ensure that a system is put in place to prevent consumers being misled. (Paragraph 57)

20. Where a range of products is offered, consumers should not be offered a more expensive product without clear written reasons. We believe the issuer should also be required to obtain a positive acceptance from the consumer before issuing the card. Exclusions that apply to cards, such as minimum ages or annual incomes, should be clearly advertised in the marketing literature. (Paragraph 58)

21. With the increasing use of risk-based pricing, errors on credit references could end up costing consumers money. Previously a consumer would have been turned down, whereas now they may instead be offered a higher price, which could in the longer run end up costing them hundreds, even thousands of pounds. On the other hand, provided lenders act responsibly, in particular in relation to credit limits, it may offer an opportunity to secure a credit card in circumstances where it would not otherwise

be available. Consumers offered less favourable terms than the typical APR should be provided with a free copy of their credit reference by the lender. The regulators and the industry should develop a strategy for promoting awareness and a sense of ownership amongst consumers of credit references and the factors that affect their credit score. Consumers should be actively encouraged to provide the firm with positive information to reduce the rate charged. Firms should also share both positive and negative data with the credit reference agencies. (Paragraph 59)

Transparency: order of payments

22. The order in which payments are applied should become clearer with the adoption of the Summary Box. In the past this information was not clear, and was normally buried in the small print in impenetrable language. It is possible that many consumers were actively misled by cards not making it clear that payments would first be used to clear the balance at the promotional interest rate. The industry should continue to develop methods of clear communication on this point. It may be that wherever payments do not go towards paying off the highest interest elements first there should be a clear indication of this preceded by the word 'Warning:…' (Paragraph 60)

Transaction and penalty charges

23. We agree that there should be no such thing as hidden charges. Stating that in certain circumstances "charges will apply" without giving further details is not acceptable. Consumers need to be aware of the extent and the exact amount of any possible transaction charge or penalty fee. All relevant charges should be expressed in the Summary Box, allowing consumers clearly to compare levels between products. (Paragraph 62)

24. Flat fees impact particularly badly on poorer customers. While many lenders claimed that their charges represented a fair recovery of the costs involved on any breach of contract, none supplied any figures to support this assertion. Barclaycard refused to provide us with data concerning the amount of revenue raised from penalty fees. We are therefore not convinced that these charges are reasonable. To reassure us and the general public we call on all lenders to place information on the amounts raised from penalty fees and the costs involved in the public domain. The DTI should investigate this issue. We encourage consumers to question the application of penalty fees and to switch providers if they believe they are unreasonable. (Paragraph 67)

25. While it is true to say that penalty fees will be incurred by those customers who manage their accounts imprudently, they are also likely to be incurred by people in financial difficulty. It is unacceptable that the application of unreasonable penalty fees can make debts spiral out of control. Card issuers should charge lower fees for customers with low credit limits or low outstanding balances when payments are received late, as is the case in the US. In levying penalty fees, the industry should adopt the principle that the fee should not exceed the cost to the lender of the relevant breach of the contract. (Paragraph 69)

Special promotions

26. Special offers are a legitimate part of marketing. But misleading promotional material is not. This applies to both the terms and the consequences of the offer. Describing the cost in the leaflet for Barclays' "0% forever" offer as £0 was highly misleading and Barclays should review its practices. We welcome the action of the OFT in taking action over this leaflet and Barclays' decision to withdraw it. But a product still exists that potentially encourages consumers to get into more debt in order to take advantage of special offers. This amounts to sharp practice. Both the OFT and the DTI, in its review, need to address the regulatory aspects governing such products and their promotion. We would also like to alert the Advertising Standards Authority to the issues raised by this inquiry. (Paragraph 72)

Over-indebtedness and responsible lending

27. In the past, consumers were in some sense bailed out from their unsecured debts, either through rising house prices in some parts of the country allowing them to secure loans on their property at a lower interest rate, or through inflation eroding the real value of a debt. In the current climate of low and stable inflation, and a cooling housing market, debt management can be more testing. The evidence indicates that the majority of households still deal with debt in a responsible manner and avoid becoming over-committed. However, there appear to be a small but significant minority for whom servicing debts, particularly large unsecured debts, has become a problem. (Paragraph 77)

28. While it is not in the interests of industry to lend money to those who cannot afford to repay, certain sections of the industry are currently engaged in practices which can give rise to some consumers "sleep-walking into a situation of over-commitment" where a small change in circumstances can turn manageable debt problems into disasters. Over-indebtedness can have devastating consequences for those involved and all credit card issuers need to recognise their long-term responsibilities to prevent this from happening (Paragraph 82)

29. Responsible lending is more than just meeting the minimum legal requirements. It is also about driving forward best practice and treating customers fairly. A credit card lender should be providing short-term debt as part of a convenience service rather than pushing a form of debt which sucks borrowers into a long-term cycle of indebtedness. (Paragraph 83)

Responsible lending: credit limits

30. Issuers should never raise credit limits without carrying out appropriate internal and external credit checks. Lenders also need to recognise that in many cases, for over-indebted consumers, increases in credit limits are wholly inappropriate. Despite all the sophisticated scoring techniques used, it must be recognised that the borrowers themselves have an important contribution to make in the decision. (Paragraph 85)

31. We recommend that the industry consider establishing a system whereby a limit is placed on unsolicited increases in credit limits. (Paragraph 86)

32. Balance transfers at a lower interest rate provide benefits to millions of card-holders, but should not be used as a device to lock consumers into additional debt. (Paragraph 87)

33. If lenders are encouraging consumers to consolidate credit card borrowing into a personal loan, the industry should consider making it their practice to reduce the credit card limit accordingly to take account of the consumer's loan commitments. It is also important to note that, although the interest rate on the loan may be lower, a personal loan will often involve a longer repayment period so the total cost of the credit to the borrower could be greater. Furthermore, if secured against property, the borrower's home is at risk (Paragraph 88)

34. It is important that lenders assess a consumer's ability to repay based on as complete as possible a picture of their current income and credit commitments and not just on their payment history. We welcome the Minister's intention to review the information given by lenders to credit reference bodies. (Paragraph 90)

Responsible lending: credit card cheques

35. Credit card cheques are being issued irresponsibly by some lenders. Regulatory changes are necessary to prevent this behaviour. Credit card cheques should be accompanied by clear information regarding terms and conditions including the applicable APR and fees, clear notice that interest will be calculated from the date of the transaction with no interest free period, and a clear warning that using credit card cheques means that consumers have a lesser degree of protection under the Consumer Credit Act. This should be displayed prominently in minimum 12 point type. Appropriate credit checking should be carried out before cheques are sent. The sending out of unsolicited credit card cheques should be banned. (Paragraph 94)

Responsible lending: minimum payments

36. We believe that some consumers are unaware that only paying the minimum payment can lead to a situation in which it can take a very long time to pay off the debt. Consumers need to be provided with clear information on statements showing that this will maximise the length of time needed to clear the debt and the amount of interest paid. Statements should show how long it would take for the debt to be paid off if only the minimum payments are made. Whatever else may be included in the Summary Box there should be a clear statement of the consequences in time and cost of repaying only the minimum amount each month. (Paragraph 99)

37. The minimum payment should always cover the interest on the outstanding balance (and any payment protection insurance premium), so that by making the minimum payment households should never be increasing the size of their debts. The industry should publish data on the proportion of customers that have been making the minimum payment for six straight months. This would provide a useful measure and may provide an early indication of households in financial difficulty. These households could also be targeted with specific information that paying the minimum will take a long time. (Paragraph 100)

Responsible lending: marketing of credit cards and products

38. Marketing of credit cards by some companies has developed in a way which can be characterised as highly misleading and highly damaging to the interests of the consumer. We expect the industry to improve its practices significantly. It is essential that credit cards are marketed with clear information and in a responsible way. Lenders should take particular care when marketing credit cards to young people, vulnerable consumers and those on low incomes. OFT should develop best practice guidelines and these need to be incorporated into the Banking Code or directly enforced by the OFT. People should be encouraged to complain to the OFT regarding misleading marketing. (Paragraph 103)

39. If targeted indiscriminately marketing material could encourage consumers with existing debt problems to increase their commitments and thus contribute to over-indebtedness. We recommend that the OFT should set down clear guidance on credit marketing, laying down the standards of conduct that consumer credit licence-holders need to demonstrate. Credit card issuers need to fulfil their social responsibilities and should not blindly use lists of names purchased from third parties without appropriate checks. (Paragraph 105)

40. It is essential that where credit cards are marketed by sales representatives consumers are given sufficient information to make an informed choice in what can be a pressurised environment. A clear version of the Summary Box should help in this respect, but if customers wish they should always be able to take away details of the product along with the application form to make a considered decision. Issuers should monitor their procedures closely to ensure there are no abuses of the process. (Paragraph 106)

41. Payment protection insurance can play a role in meeting customers' repayments should they be unable to work through illness or redundancy. The terms and exclusions need to be explained clearly to customers. Insurance should not be sold to customers who would not benefit from it due to their age or current employment situation. The OFT should investigate the selling practices of payment protection insurance, how it is priced and whether the market may benefit from increasing competition. (Paragraph 107)

Responsible borrowing

42. While credit cards are a flexible and convenient method of short-term borrowing, there is no doubt that they are an expensive way of borrowing for the long-term. Borrowers must recognise this. (Paragraph 109)

Store cards: rates and transparency

43. To date there has been in some cases a cosy arrangement between the store card providers and the stores involved to prevent customers from gaining the full facts about their cards. The fact that this has been legal serves only to underline the urgency of reforming existing consumer credit legislation. (Paragraph 114)

44. While store cards may offer some benefits to consumers in terms of discounts, customers need to be aware of the extremely high interest rates charged. Some progress has now been made in improving transparency, but further work remains to be done, in particular concerning the size of the print giving the APR (which should be minimum 18pt in all literature) and the provision of further information on monthly statements, especially the interest rate that applies. (Paragraph 115)

45. Store cards charge much higher rates of interest even than credit cards. Although in part this may flow from a pricing model which places all the costs of the operation on the minority who pay interest, there is also evidence to suggest that competition is not working properly. For competition to function effectively, consumers need to have reliable and clear information about both the benefits and costs of the product. We therefore strongly welcome the OFT's decision to undertake a preliminary examination of the store card market, and will follow developments with a close interest. (Paragraph 120)

Store cards: role of retailers and marketing

46. We find it astonishing that stores should allow a product—i.e. store cards— to be supplied in their shops where they claim they have no control over the price (in this case, the interest rate). Retailers generally claim that the goods they supply are of high quality, representing good value for their customers. In not applying these principles to financial services offered in their name they are being inconsistent and letting their customers down. (Paragraph 123)

47. It is extraordinary and indefensible that stores should have stated that it was against the provisions of the Consumer Credit Act to let customers take details of the terms and conditions of their store card out of the shops so that they were able to make an informed choice in a less pressurised environment. We welcome confirmation from GE and the stores involved that they will no longer seek to prevent customers exercising their legal right to take away copies of the application form. (Paragraph 125)

48. While lower prices for consumers can be a welcome result of the conversion of a store card to a credit card, it is essential that any transition process is carried out responsibly and transparently. The cards should not be activated without the explicit consent of the customer. The terms and conditions of the new product should be clearly stated. Consumers should not be offered increases in credit limits without the appropriate checks, and firms should limit the size of any increase initially with the consumer left to request any future increases. (Paragraph 128)

Financial literacy

49. We welcome the steps being taken by the Government, the Financial Services Authority and the financial sector towards developing greater financial understanding and awareness among consumers, though we consider that the financial sector in particular has more to do if it is to live up to its responsibilities. (Paragraph 132)

50. It will continue to be important for issuers to test their products with groups of consumers to determine the extent to which they understand it (Paragraph 133)

51. When households become over-indebted, it is essential that clear advice is available for them to manage their commitments. We commend the work of the Citizens Advice Bureaux and other free money advice services. We welcome financial support from the industry for these organisations and, given the rising prevalence of credit card debts, we expect this support to increase. Issues relating to consumer debt need to be a specific part of the FSA's strategy of consumer education (Paragraph 135)

52. We welcome the Government's decision to put the Task Force on Over-indebtedness on a more permanent footing. Consideration should be given to enhancing the voice of consumer groups on the Task Force. (Paragraph 136)

Conclusions

53. In practice, it is both industry and the regulators who need to act, working together. We hope that the coming months will provide evidence of effective action and cooperation between all those involved. We will be monitoring developments and will if necessary return to the subject with further hearings if we are not satisfied. (Paragraph 138)

54. The deliberate obscurity of information vital to comparing credit cards and to competition in the industry has been a most disturbing aspect of the Committee's inquiry. It is also a matter of concern that the statutory regulator, the Office of Fair Trading, did not appear to be aware of the unsatisfactory state of affairs in the industry or if aware did nothing to remedy the situation until it was publicly revealed by the Committee. The Department of Trade and Industry was aware of the situation but showed little sense of urgency to remedy the position. Instead it appeared to believe that the leisurely publication of consultation papers and the use of the European Commission as an alibi for inaction justified its pedestrian approach. (Paragraph 140)

55. The passivity of the statutory regulator, the Office of Fair Trading, in the face of blatant unfairness to consumers is unacceptable. We call for a far more active approach in future and deliberate attempts to broker a voluntary agreement where statutory powers are considered inadequate. We will be looking for evidence of this in the coming months. We are pleased to see that the DTI are now treating the matter as urgent and intend to bring forward a new Consumer Credit Act which we hope will deal with the issues raised in this report. (Paragraph 141)

Formal minutes of the Committee relating to the Report

Wednesday 10 December 2003

Members present:

Mr John McFall, in the Chair

Mr Nigel Beard
Angela Eagle
Mr Michael Fallon
Norman Lamb
John Mann
Mr George Mudie
Mr James Plaskitt

The Committee deliberated.

Draft Report (Transparency of credit card changes), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 and 2 read, amended and agreed to.

Paragraph 3 read and agreed to.

Paragraphs 4 to 7 read, amended and agreed to.

Paragraphs 8 to 10 read and agreed to.

Paragraphs 11 to 15 read, amended and agreed to.

Paragraphs 16 and 17 read and agreed to.

Paragraphs 18 and 19 read, amended and agreed to.

Paragraphs 20 and 21 read and agreed to.

Paragraph 22 read, amended and agreed to.

Paragraphs 23 and 24 read and agreed to.

Paragraphs 25 to 27 read, amended and agreed to.

Paragraphs 28 to 30 read and agreed to.

Paragraph 31 read, amended and agreed to.

Paragraphs 32 to 34 read and agreed to.

Paragraph 35 read, amended and agreed to.

Paragraphs 36 to 38 read and agreed to.

Paragraph 39 read, amended and agreed to.

Paragraph 40 read and agreed to.

Paragraph 41 read, amended and agreed to.

Paragraphs 42 and 43 read and agreed to.

Paragraph 44 read, amended and agreed to.

Paragraph 45 read and agreed to.

Paragraph 46 read, amended and agreed to.

Paragraphs 47 to 50 read and agreed to.

Paragraphs 51 and 52 read, amended and agreed to.

Paragraph 53 read and agreed to.

Paragraph 54 read, amended and agreed to.

Paragraph 55 read and agreed to.

Paragraphs 56 and 57 read, amended and agreed to.

Paragraph 58 read and agreed to.

Paragraph 59 read, amended and agreed to.

Paragraphs 60 to 64 read and agreed to.

Paragraphs 65 to 67 read, amended and agreed to.

Paragraph 68 read and agreed to.

Paragraph 69 read, amended and agreed to.

Paragraph 70 read and agreed to.

Paragraphs 71 and 72 read, amended and agreed to.

Paragraph 73 read and agreed to.

Paragraphs 74 and 75 read, amended and agreed to.

Paragraph 76 read and agreed to.

Paragraph 77 read, amended and agreed to.

Paragraphs 78 to 81 read and agreed to.

Paragraphs 82 and 83 read, amended and agreed to.

Paragraph 84 read and agreed to.

Paragraph 85 read, amended and agreed to.

Paragraph 86 read and agreed to.

Paragraphs 87 and 88 read, amended and agreed to.

Paragraphs 89 and 90 read and agreed to.

Paragraph 91 read, amended and agreed to.

Paragraphs 92 and 93 read and agreed to.

Paragraphs 94 and 95 read, amended and agreed to.

Paragraphs 96 to 98 read and agreed to.

Paragraphs 99 and 100 read, amended and agreed to.

Paragraphs 101 and 102 read and agreed to.

Paragraph 103 read, amended and agreed to.

Paragraph 104 read and agreed to.

Paragraph 105 read, amended and agreed to.

Paragraphs 106 to 110 read and agreed to.

Paragraph 111 read, amended and agreed to.

Paragraph 112 read and agreed to.

Paragraph 113 read, amended, divided and agreed to (now paragraphs 113 and 114).

Paragraphs 114 to 116 read, amended and agreed to (now paragraphs 115 to 117).

Paragraphs 117 and 118 read and agreed to (now paragraphs 118 and 119).

Paragraph 119 read, amended and agreed to (now paragraph 120).

Paragraphs 120 and 121 read and agreed to (now paragraphs 121 and 122).

Paragraph 122 read, amended and agreed to (now paragraph 123).

Paragraph 123 read and agreed to (now paragraph 124).

Paragraph 124 read, amended and agreed to (now paragraph 125).

Paragraphs 125 and 126 read and agreed to (now paragraphs 126 and 127).

Paragraph 127 read, amended and agreed to (now paragraph 128).

Paragraphs 128 to 131 read and agreed to (now paragraphs 129 to 132).

Paragraph 132 read, amended and agreed to (now paragraph 133).

Paragraphs 133 to 137 read and agreed to (now paragraphs 134 to 138).

Paragraph 138 read, amended and agreed to (now paragraphs 139).

A paragraph—(*Mr Nigel Beard*)—brought up, read the first and second time, and inserted (now paragraph 140).

A paragraph—(*Mr Nigel Beard*)—brought up, read the first and second time, amended and inserted (now paragraph 141).

Summary, as amended, agreed to.

Resolved, That the Report be the First Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select committees (reports)) be applied to the Report.

Several papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

Several Memoranda were ordered to be reported to the House.

[Adjourned till this day at the conclusion of the meeting of the Sub-committee

Witnesses

(See Volume II)

Tuesday 1 July 2003 *Page*

Ms Ashleye Sharpe, Head of Money Research, *Which?* Magazine and **Ms Louise Hanson,** Senior Public Affairs Officer, Consumers' Association, **Ms Teresa Perchard,** Head of Social Policy and **Ms Sue Edwards,** Social Policy Officer, National Association of Citizens Advice Bureaux, and **Ms Frances Harrison,** Head of Policy, Research and Development, the National Consumer Council — Ev 1

Wednesday 9 July 2003

Mr Philip Williamson, Chief Executive, **Mr Paul Feldman,** Director of Banking and Savings, Nationwide, **Mr Gary Hoffman,** Chief Executive, Barclaycard, **Mr Chris Pearson,** Chief Executive, **Ms Sandra Quinn,** Director, Corporate Communications, the Association for Payment Clearing Services — Ev 19

Monday 14 July 2003

Mr Seamus Smith, Director, Client Management, **Mr Steven Nicholson,** Credit Policy Manager, GE Consumer Finance, **Mr Richard Wayment,** Director of Retail Sales, House of Fraser, **Mr Paul Budge, and Ms Gillian Hague,** Arcadia Group — Ev 42

Tuesday 9 September 2003

Mr Jonathan Rees, Consumer and Competition Policy, **Ms Fiona Price,** Director of Cross-market Interventions, Department of Trade and Industry, **Mr John Vickers,** Chairman, and **Ms Christine Wade**, Director of Consumer Regulation Enforcement Division, Office of Fair Trading — Ev 62

Thursday 16 September 2003

Mr Matthew Barrett, Chief Executive Officer, Barclays Bank, **Mr Gary Hoffman,** Chief Executive, Barclaycard, **Mr James Crosby**, Halifax Bank of Scotland, **Mr Eric Daniels**, Chief Executive, Lloyds TSB, **Mr Fred Goodwin**, Chief Executive, The Royal Bank of Scotland, and **General Charles C Krulak**, Chief Executive Officer, MBNA Europe — Ev 82

Tuesday 4 November 2003

Mr John Vickers, Chairman, **Ms Penny Boys,** Executive Director, **Mr Ray Hall,** Director of Consumer Credit and Estate Agency, **Ms Christine Wade**, Director, Consumer Regulation Enforcement, Office of Fair Trading — Ev 103

Mr Gerry Sutcliffe MP, Parliamentary Under-Secretary of State for Employment Relations, Competition and Consumers, **Mr Jonathan Rees,** Director, Consumer and Competition Policy Directorate — Ev 112

List of written evidence

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American Express	Ev 127; 128
Arcadia Group	Ev 128
Association for Payment Clearance Services	Ev 129; 135; 141
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Barclays Plc	Ev 144; 159
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House of Fraser	Ev 213
HSBC	Ev 214
Dr Robert Hunt, University of Cambridge	Ev 216
John Lewis Partnership	Ev 219
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MBNA Europe	Ev 229; 230; 231
National Association of Citizens Advice Bureaux	Ev 232
National Consumer Council	Ev 240
Nationwide Building Society	Ev 242; 248
Office of Fair Trading	Ev 250; 252; 255
Royal Bank of Scotland Group	Ev 257; 259; 261

List of unprinted written evidence

Additional papers have been received from the following and have been reported to the House but to save printing costs they have not been printed and copies have been placed in the House of Commons library where they may be inspected by members. Other copies are in the Record Office, House of Lords and are available to the public for inspection. Requests for inspection should be addressed to the Record Office, House of Lords, London SW1. (Tel 020 7219 3074) hours of inspection are from 9:30am to 5:00pm on Mondays to Fridays.

P Baker
C Barry
J Burstow
S Cypher
P Dacombe
R Dickson
D Edward
R Elmes
C Fawcett
H Forman
M Gale
D Holman
N Irvine
R Johnson
D Knowles
S Kumar
Lewis Citizens Advice Bureau
M Lewis
B Lobodozinski
R Macer
J Mason
D Millis
T Perkins
S Playle
M Proom
Mr & Mrs Purnell
R Rowland
P Skinner
R Smith
J Smurthwaite
R Spencer
A Stinchcombe
C Stocks
A Torch
W Toulman
O Williams
L Wilson

List of Reports from the Treasury Committee since 2001

Session 2003–04

First Report	The Transparency of Credit Card Charges	HC (2003–04) 125
Second Report	Child Trust Funds	HC (2003–04) 86

Session 2002–03

First Report	National Statistics: The Classification of Network Rail *Response: Second Special Report*	HC (2002–03) 154 *HC (2002–03) 550*
Second Report	The 2002 Pre-Budget Report *Response: Third Special Report*	HC (2002–03) 159 *HC (2002–03) 528*
Third Report	Split Capital Investment Trusts *Response: Fourth Special Report*	HC (2002–03) 418 *HC (2002–03) 651*
Fourth Report	The Handling of the Joint Inland Revenue/Customs and Excise PFI Project *Response: Fifth Special Report*	HC (2002–03) 184 *HC (2002–03) 706*
Fifth Report	Annual Report for 2002	HC (2002–03) 491
Sixth Report	The UK and the Euro *Response: Sixth Special Report*	HC (2002–03) 187 *HC (2002–03) 1004*
Seventh Report	The 2003 Budget *Response: Seventh Special Report*	HC (2002–03) 652 *HC (2002–03) 1028*
Eighth Report	Appointment to the Monetary Policy Committee of the Bank of England of Mr Richard Lambert	HC (2002–03) 811
Ninth Report	Appointment of Ms Rachel Lomax as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee	HC (2002–03) 1011
Tenth Report	Inland Revenue Matters *Response: Eighth Special Report*	HC (2002–03) 834 *HC(2002–03) 1181*

Session 2001–02

First Report	The 2001 Census in England and Wales *Response: Ninth Special Report*	HC (2001–02) 310 *HC (2001–02) 852*
Second Report	Budget 2002 *Response: Tenth Special Report*	HC (2001–02) 780 *HC (2001–02) 1075*
Third Report	The Office of Government Commerce *Response: Eleventh Special Report*	HC (2001–02) 851 *HC (2001–02) 1217*
Fourth Report	Appointment to the Monetary Policy Committee of the Bank of England of Mr Paul Tucker and Ms Marian Bell	HC (2001–02) 880
Fifth Report	Banking, the Consumer and Small Businesses *Response: Twelfth Special Report*	HC (2001–02) 818 *HC (2001–02) 1218*
Sixth Report	The Financial Regulation of Public Limited Companies *Response: Thirteenth Special Report*	HC (2001–02) 758 *HC (2001–02) 1219*

Seventh Report	Parliamentary Accountability of Departments *Response: First Special Report [Session 2002–03]*	HC (2001–02) 340 *HC (2002–03) 149*
Eighth Report	Inland Revenue: Self Assessment Systems *Response: Fourteenth Special Report*	HC (2001–02) 681 *HC (2001–02) 1220*
Ninth Report	Appointment of Sir Andrew Large as a Deputy Governor of the Bank of England and Member of the Monetary Policy Committee	HC (2001–02) 1189