



A Better Deal for Consumers

Review of the Regulation of Credit
and Store Cards: A Consultation

OCTOBER 2009

EXPLANATION OF THE WIDER CONTEXT FOR THE CONSULTATION AND WHAT IT SEEKS TO ACHIEVE

In July 2009, the Government published the White Paper *"A Better Deal for Consumers: Delivering Real Help Now and Change for the Future"*. One of the commitments we made in the White Paper was to review the regulations governing consumer credit and store cards. This consultation is the first step in taking forward that commitment.

We want to secure a better deal for consumers, giving them improved control of their credit and store card borrowing, whilst also ensuring that any intervention is proportionate, transparent and targeted. We believe that changes to the regulatory regime are likely to be necessary to achieve this.

We have set out options for change that cover four specific aspects of the way credit and store cards operate: minimum payments, unsolicited credit limit increases, the re-pricing of existing debt and the allocation of payments. We have also identified scope to improve the simplicity and transparency of credit and store cards more generally.

We have yet to take a final decision on any of the proposals set out in the consultation document. We are specifically interested in your views on the policy options we have set out.

Issued: 27 October 2009

Respond by: 19 January 2010

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London, SW1H 0ET, tel: 0207 215 1923
email: cscr@bis.gsi.gov.uk

This consultation is relevant to: all consumers and micro-enterprises (sole traders and partnerships) who own a credit or store card and to all credit and store card lenders who operate in the UK. It is also of wider interest to all consumers and businesses in the UK.

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Foreword



The past few decades have seen considerable growth in the use of credit cards. They are now the most popular form of unsecured borrowing in this country. In fact, there are now more credit cards in the UK than people.¹

Many consumers, however, feel that they are not getting a fair deal from their credit and store card providers. Certain features of the way cards work appear inherently balanced against the interests of consumers. Currently consumers have limited control over how their debts are repaid, over increases to their credit limits or over changes to the interest rates they are charged. Terms and conditions can be complex and confusing, leading consumers to incur unexpected costs. High levels of consumer dissatisfaction about credit and store cards reflect this lack of effective consumer choice.

Whilst many of us use our cards responsibly as a convenient way to pay and as a means of managing our short term borrowing needs, the Government is increasingly concerned that a growing number of consumers are using credit and store cards as a form of longer term borrowing and spiralling into increasing cycles of unsustainable debt as a result. We believe more can be done to protect consumers from the financial pressures and the anxiety caused by the burden of heavy debts they see little prospect of paying off in a reasonable time.

A robust and responsive regulatory system is key to ensuring sustainable financial markets and a fair deal for consumers. On 8 July, HM Treasury published “Reforming Financial Markets”, setting out the Government’s strategy for reform of the financial system.² This document announced measures to reform and strengthen financial regulation and to reinforce the institutional framework for safeguarding financial stability. The paper also set out measures to reduce the impact of the failure of financial firms and to improve competition in financial markets. Importantly, it also announced measures to protect, inform and empower consumers of financial services products, by raising financial capability, improving consumers’ access to simple and transparent products and giving consumers a collective right of redress in cases where there are widespread complaints about firms’ activities.

¹ Data from British Bankers Association: At July 2009, there were 63m credit cards in circulation in the UK compared with a population of approximately 61 million.

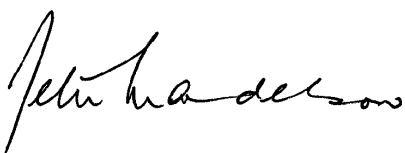
² http://www.hm-treasury.gov.uk/reforming_financial_markets.htm

Alongside this, our White Paper: “A Better Deal for Consumers: Delivering Real Help Now and Change for the Future” sets out the Government’s vision for a new approach to consumer credit, an approach that works not only during these difficult times, but which also sets us in a strong position for the future.³

This review of the credit and store card market is set in the context of a number of important Government initiatives outlined in the White Paper, including the implementation next year of the revised European Consumer Credit Directive⁴ and the work of the Office of Fair Trading to develop Guidance on Irresponsible Lending Practices.⁵ These initiatives will introduce important new protections for consumers. This review will build on these initiatives by looking at the specific challenges raised by credit and store cards.

As we examine how the rules on credit and store cards need to change, we will ensure that there is a clear and consistent regulatory picture for consumers and lenders alike. We must of course properly assess the risks that certain interventions could inadvertently increase the cost of credit and make it less readily available to consumers, but we will not hesitate to take action where there is evidence of consumers being exploited or disadvantaged.

Given the scale of credit and store card lending in the UK, this review could ultimately have far reaching consequences for levels of consumer credit in the economy. If there is less personal lending and borrowing overall as a result of the changes we are proposing, we want this reduction, and the way the market evolves, to be the result of consumers taking better decisions about their finances. This will be essential to rebuilding consumer confidence in these important financial products.



Rt Hon Lord Mandelson



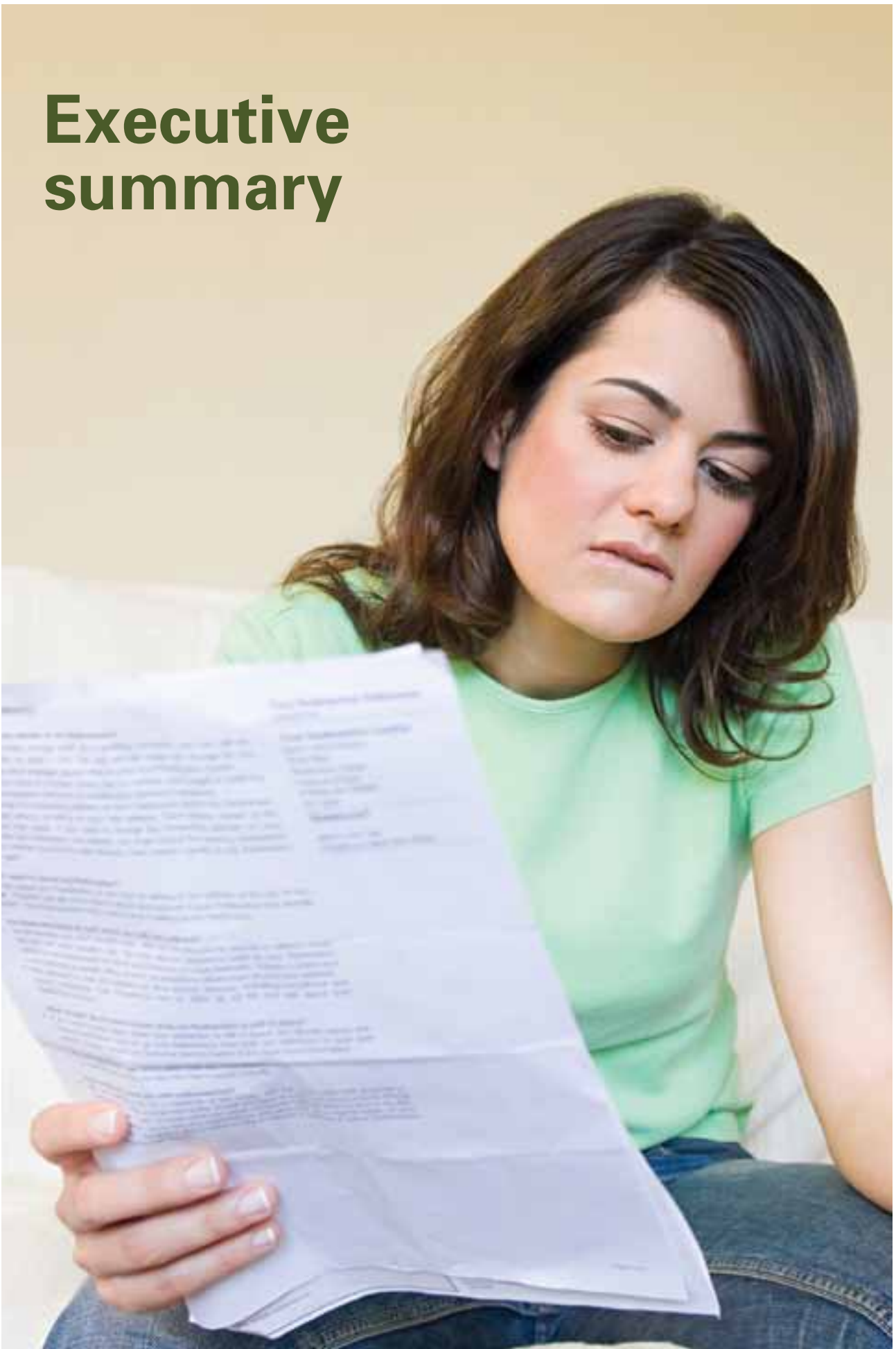
Kevin Brennan MP

³ <http://www.berr.gov.uk/whatwedo/consumers/consumer-white-paper/index.html>

⁴ Directive 2008/48/EC. Full text is available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF>

⁵ http://www.offt.gov.uk/advice_and_resources/resource_base/legal/cca/irresponsible

Executive summary



We want to secure a better deal for consumers, giving them improved control of their credit and store card borrowing, whilst also ensuring that any intervention is proportionate, transparent and targeted.

1. It is clear that some of the key features of credit and store cards are not in the best interests of consumers and can cause already indebted consumers to incur increased costs. This cannot continue. We are particularly concerned about this now because many consumers are facing financial pressures as a result of the downturn and are having to deal with unsustainable debts built up on their credit and store cards during the years of easy credit.
2. Consumers value the flexibility that credit and store cards offer and their use has risen dramatically in the past two decades. However, a growing number of consumers carry high levels of debt on their credit and store cards with no prospect of paying it off in a reasonable time, if at all. Store cards account for a much smaller proportion of unsecured borrowing than credit cards, but are of particular concern because of the high interest rates they charge.
3. Over the last few months, we have been evaluating the credit and store card market to look at how the regulation of credit and store cards should change. Through a series of workshops, we have also consulted informally with a number of stakeholders, representing both consumer and industry views. In the light of this work, and as we set out in the Consumer White Paper: *“A Better Deal for Consumers: Delivering Real Help Now and Change for the Future”*,⁶ we have identified four specific aspects of credit and store cards where we believe a review of existing market practices is necessary. We have also identified scope to improve the simplicity and transparency of credit and store cards more generally.
4. In considering the five areas set out below, the Government’s overall objective is to secure a better deal for consumers, giving them improved control of their credit and store card borrowing, whilst also ensuring that any intervention is proportionate, transparent and targeted.
5. The Government wants to see a better deal for consumers in each of the five areas covered by the review. We recognise the need to consider the impact of reform which favours one group of consumers over other types of consumers, in particular the potential impacts on the more vulnerable if access to credit were to be restricted.

⁶ <http://berr.gov.uk/whatwedo/consumer-white-paper/index.html>

ALLOCATION OF PAYMENTS

6. General industry practice is that when a consumer makes a payment against their credit or store card debt it is allocated to the cheapest debt first. However, many consumers do not understand that this is common practice, and may therefore not realise that balances accruing interest at a high rate will be paid off last. Consumers end up paying a lot more interest over a longer period as a result. This is a particular problem in relation to consumers who regularly withdraw cash on their card; typically charged at 25% or more. These consumers are often those most likely to be vulnerable to financial difficulties. Through this system of allocation of payments, most card lenders are profiting from the lack of understanding and limited choices of vulnerable consumers.
7. We want this to change. This consultation examines whether we should reverse the allocation of payments to ensure that expensive debts are paid off more quickly, as a very small number of lenders already do. An alternative, more targeted, measure would be to enable consumers always to pay off any expensive cash lending first, ensuring that vulnerable consumers who use their cards to withdraw cash are not doubly penalised.

MINIMUM PAYMENTS

8. Evidence suggests that last year around 14% of cardholders made only the minimum payment most months on active credit card accounts, equivalent to roughly one third of the people who regularly use their card for borrowing, rather than paying it off in full each month.⁷ Minimum payments are currently set at a level which just covers that month's interest charges, but does not make significant inroads into the capital borrowed (and may not cover fees and charges). This means that some consumers will be repaying their debts over decades and paying significant interest over the life of the debt.
9. A mandatory higher minimum payment to be paid by consumers would reduce their exposure to the burden of high cost lending lasting for decades. However, there is a possibility that this could expose consumers to greater risk of default at difficult times and could limit consumers' flexibility to adjust their repayments to help manage short term pressures. This consultation therefore also seeks views on alternative approaches such as the introduction of a recommended minimum payment that is higher than the contractual minimum. This amount would be set to pay off the card over a much shorter period of time (say three years) and could be the default level of payment for those who choose to pay the minimum by Direct Debit.

⁷ Data from UK Cards Association 2009

UNSOLICITED CREDIT LIMIT INCREASES

10. It is common practice for credit and store card lenders to increase consumers' credit limits without their active consent. Recent research from uSwitch shows that in the last year, 5.7 million consumers may have seen their credit limits changed in this way.⁸ The lack of consumer information and control over the timing and scale of limit increases, alongside low financial capability and in some cases the difficulty of rejecting an increase, undermines consumers' control over their borrowing.
11. In considering the options here we will take into account the interests of lower income consumers and those who are new to credit who often rely on being given low initial limits which then grow. This consultation calls for views on the impact of options for intervention including banning unsolicited increases altogether or requiring consumers to opt in to credit limit increases, either in general at the outset of the agreement, or to each specific increase.

RE-PRICING OF EXISTING DEBT

12. We are concerned about the continuing practice amongst credit and store card lenders of increasing interest rates on existing debt ("re-pricing") without properly explaining why they are doing so. Some lenders claim to be changing a consumer's interest rate because they pose a higher risk, but often there is not any obvious change in the consumer's circumstances and the reason for the increase is not properly explained. For consumers who have used their cards responsibly and never missed a payment over the years, there is understandable anger that they feel they may be paying the price for excessive risk-taking by financial institutions.
13. We want to ensure that consumers with limited choices are not subjected to unfair interest rate changes, that consumers are given clear information about how and when their rates might change, and that this is a genuine two-way street; rates should go down as well as up. We are therefore looking at a range of options, including banning all interest rate changes on existing debts or placing restrictions on the circumstances in which lenders can carry out risk-based re-pricing.

⁸ 12 month period from July 2008 to July 2009. The figures were extrapolated based on current UK credit card holders and sourced from the UK Cards Association report: UK Plastic Cards 2009.

SIMPLICITY AND TRANSPARENCY

14. The complexity of credit and store cards can lead consumers to make poor choices and to incur greater debts and charges; it also has a detrimental impact on levels of switching in the market. The need for greater transparency runs through each of the four specific practices that we examine as part of this review.
15. We are particularly attracted to the suggestion of an annual electronic statement setting out the total cost of running the card for the previous year along with information on specific fees and charges incurred. This could then be used by the consumer not only to enable them to change their own behaviour in the light of experience, but also as a basis for identifying cheaper alternatives in the market.

HOW TO RESPOND

16. Whilst this review highlights questions that interest us in the five areas of credit and store cards that we have set out above, we are interested in hearing any views that you want to share about the credit and store card market more generally, particularly in the light of ongoing consumer credit Government initiatives elsewhere.
17. The proposals set out in this paper will need to be considered both individually and in terms of their collective impact on consumers and businesses before we come to a final view on any package of measures. We have set out the evidence supporting our proposals in the Economic and Equality Impact Assessments that accompany this consultation.⁹ Further research by the Government and by others will be required during the period of this consultation and will inform our final decision alongside the responses we receive to this consultation.
18. Questions are included for each of the proposals in this consultation paper. The separate initial Equality Impact Assessment also includes a series of questions. A complete set of all the questions covered by this consultation document and the Equality Impact Assessment can be found at Annex A.
19. This review examines credit and store card policy as it applies to the UK. Consumer credit issues are reserved in Wales and Scotland. Consumer credit is a devolved (transferred) matter in Northern Ireland but the legislation (the Consumer Credit Acts 1974 and 2006 and associated regulations) apply to the whole of the UK. The Minister of Enterprise for Northern Ireland has asked that Northern Ireland be included in this consultation with a view to ensuring that people in Northern Ireland would benefit from the proposed reforms. Northern Ireland would only be included in any subsequent legislation passed at Westminster with the consent of the appropriate Northern Ireland authorities.

⁹ www.bis.gov.uk/creditconsultation

- 20.** The definition of a consumer credit agreement in the Consumer Credit Act 1974 encompasses business lending to sole traders and partnerships (i.e. not companies) up to a value of £25,000. The Act excludes such lending above £25,000 which is wholly or predominantly for business purposes. This review therefore covers the regulation of credit and store card provision to such micro-enterprises. For ease, we have referred simply to “consumers” throughout. However, we would welcome responses from small businesses and their representatives, in particular drawing out any areas where there may be a divergence of interests between consumers and small firms.
- 21.** This consultation on the review of the credit and store card market opened on 27 October 2009. Responses are sought by 19 January 2010.
- 22.** Responses to the consultation should be sent to: Christina Anderson, Bay 436, BIS, 1 Victoria Street, London, SW1H 0ET, Tel: 0207 215 1923, Email: cscr@bis.gsi.gov.uk.
- 23.** When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents, and where applicable, how the views of the members were assembled.
- 24.** A list of those organisations and individuals consulted is at Annex C. We would welcome any suggestions of others who may wish to be involved in this consultation process.
- 25.** If you have any policy queries on the consultation, these should also be addressed in the first instance to Christina Anderson.
- 26.** If you have concerns about the way in which this consultation is being managed or conducted, please refer to Annex D which details the Code of Practice for Consultations and provides contact details for complaints.

CONFIDENTIALITY AND DATA PROTECTION

- 27.** Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

- 28.** In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

ADDITIONAL COPIES

- 29.** This consultation on the review of credit and store cards is available electronically at www.bis.gov.uk/creditconsultation along with the accompanying Economic and Equality Impact Assessments. A Welsh language version of the executive summary is also available at www.bis.gov.uk/creditconsultation. A simpler, easy to read version of the consultation is also available on www.bis.gov.uk/creditconsultation. Additional hard copies can be ordered from:

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Chapter 1: Introduction



- 1.1** UK consumers currently owe around £1.4 trillion to banks and other financial institutions. The vast majority of this borrowing is for mortgages on houses. However, £230 billion is unsecured borrowing, which includes personal loans, overdrafts, credit cards, store cards and some other forms of specialist lending.
- 1.2** The UK credit card market is highly developed. Overall, there were around 1.6 billion credit card transactions in 2008, with a value of just over £100 billion. After the US, the UK has the highest number of credit cards per head of population with 63 million credit cards in circulation.¹⁰ Credit cards are accepted at more than 23 million retail outlets worldwide. They can be used to make purchases or to obtain cash and they are the predominant form of payment for purchases made on the internet. 0% balance transfer deals are standard throughout the industry, as are rewards such as cashback and points schemes, and other benefits (some of which incur a fee) such as rental car insurance and theft and fraud protection.
- 1.3** The use of credit cards has increased significantly over the past two decades in line with the pattern for unsecured borrowing more generally. In the last 10 years, the number of credit card transactions has increased by half, along with a doubling in the value of these transactions. This overall increase in credit card use masks an interesting pattern during this recent period of downturn. Unlike other forms of unsecured borrowing, such as personal loans and overdrafts, which continued to grow until late 2008, the level of debt held on credit cards has been falling since 2005 from a peak of almost £64 billion to £54 billion in July 2009.¹¹ Recent data from the Bank of England, however, shows that whilst all other types of unsecured consumer borrowing fell in July 2009 for the first time since records began in 1993, borrowing on credit cards actually increased by £92 million.¹² It would appear that consumers may be turning increasingly to their credit cards as access to other forms of borrowing dries up and as banks become more cautious in their lending and more constrained in terms of their capital and funding.
- 1.4** The picture for store cards is slightly different. The store cards market is much smaller than the credit card market, with approximately £1.9 billion of outstanding balances as of December 2008.¹³ Whilst there was a gradual increase in the use of store cards until about 2006, it has since decreased as store cards have suffered a decline in popularity in recent years and retailers have migrated customers onto credit card products. Whilst data on store cards is less readily available, latest figures indicate that quarterly growth was down by 17%.¹⁴

10 British Bankers Association (BBA)

11 Bank of England

12 Bank of England, reported in September 2009.

13 Finance and Leasing Association (FLA)

14 July 2009 from the Finance and Leasing Association (FLA)

- 1.5** Most consumers use their credit and store cards responsibly. Indeed, we know that around 69% of consumers pay off their outstanding balances on their credit cards in full every month or most months and that approximately 60% of consumers pay off their outstanding balances on their store cards in full every month.¹⁵ However, we are concerned that a significant number of consumers carry high levels of unsustainable debt on their credit cards, with little or no prospect of paying these debts off in a reasonable period and at a reasonable cost. Many consumers will be carrying such debts on a number of credit cards.¹⁶ Consumers who sought debt advice from the Consumer Credit Counselling Service (CCCS) in 2008 had average credit card debts of nearly £15,000 and store card debts of £1,700. Nine out of ten CCCS clients had an annual income of less than £30,000. For those clients with an income of less than £10,000 a year, the average credit card debt was nearly £8,000 and the average store card debt was almost £1,400.
- 1.6** Small businesses are also significant users of credit cards as a means of managing cashflow and a convenient payment mechanism. Organisations representing small firms and debt advice charities have expressed concerns that some business owners may be using credit cards taken out in a personal capacity to support their businesses through the downturn, incurring significant debts as a result.
- 1.7** In addition, the increasing complexity of credit and store cards means that many consumers are unaware of the true cost of using their card or understand how they can make the best use of it. Many consumers may not be choosing the card which is most suitable for their financial needs and in some cases lenders are benefiting from consumers incurring unexpected costs as a result of the lack of understanding about how their card works.
- 1.8** Finally, it is clear that many consumers feel they are not receiving a fair deal from credit and store card lenders. Just over a third of all banking and credit complaints received by the Financial Ombudsman Service in 2008 / 2009 were about consumer credit issues, and of these, just over 18,000 (75%) were specifically about credit cards. In addition, complaints to the Financial Ombudsman Service about store cards, whilst low in number (in the hundreds), more than doubled between 2008 and 2009.
- 1.9** It is in this context of rising levels of consumer indebtedness, increasing consumer complaints about credit and store cards, and concerns about the complexity and fairness of their key features that we made a commitment in the Consumer White Paper to review the regulation of the credit and store card market.

¹⁵ Competition Commission Enquiry 2005.

¹⁶ Figures from the UK Cards Association report, UK Plastic Cards 2009 show each credit or card charge holder in the UK had an average of 2.3 cards last year.

- 1.10** In examining the current state of the credit and store card market, our work has taken account of developments in financial markets over the last decades and particularly during this last year when we have seen unprecedented financial turbulence.
- 1.11** We have looked at the practical experience of consumers and lenders who operate in the credit and store card market. In particular, we have noted that lenders are relying increasingly on revenue from those borrowers who do not pay off their balance every month rather than on income from card transaction volumes. We have examined the impact this may have on their incentives to give consumers a fair deal.
- 1.12** We have looked carefully at the situation in the US following the recent introduction of measures relating to credit cards in the US Credit Card Accountability, Responsibility and Disclosure (CARD) Act¹⁷ whilst bearing in mind the fundamental differences between the US and the UK credit card markets, including in relation to the legal environment.
- 1.13** We are also mindful of the fact that this review is only a small part of a bigger picture of a range of initiatives and work taking place in this area.
- 1.14** A robust and responsive regulatory system is key to ensuring sustainable financial markets and a fair deal for consumers. On 8 July, HM Treasury published “Reforming Financial Markets”, setting out the Government’s strategy for reform of the financial system.¹⁸ This document announced measures to reform and strengthen financial regulation and to reinforce the institutional framework for safeguarding financial stability. The paper also set out measures to reduce the impact of the failure of financial firms and to improve competition in financial markets. Importantly, it also announced measures to protect, inform and empower consumers of financial services products, by raising financial capability, improving consumers’ access to simple and transparent products and giving consumers a collective right of redress in cases where there are widespread complaints about firms’ activities.
- 1.15** The Office of Fair Trading has launched its draft Guidance on Irresponsible Lending which aims to ensure that lenders do not engage in irresponsible lending practices and that they provide only affordable credit to consumers.¹⁹ The Guidance, which has recently been the subject of a public consultation, identifies types of behaviour that the OFT considers would constitute irresponsible lending.
- 1.16** In addition, following full public consultation, we are currently finalising the regulations that will implement the European Consumer Credit Directive by June of next year. Some of the provisions in these regulations, particularly the

17 <http://www.govtrack.us/congress/billtext.xpd?bill=h111-627>

18 http://www.hm-treasury.gov.uk/reforming_financial_markets.htm

19 http://www.offt.gov.uk/advice_and_resources/resource_base/legal/cca/irresponsible

requirement that lenders must give consumers “adequate explanations” about their products, are directly relevant to action on credit and store cards.

- 1.17** Furthermore, from 1 November 2009, the Lending Standards Board will supersede the Banking Code Standards Board which supervises the current Banking Code and the Business Banking Code.²⁰ These Banking Codes, which set standards of good banking practice for financial institutions, will be replaced by the Lending Code, and will include all the key provisions in the existing Banking Codes relating to credit.²¹
- 1.18** In considering the possibility of action in the five areas that are covered by this review, we will ensure that there is consistency and clarity on regulation in this area for consumers and lenders alike.
- 1.19** We want to secure a better deal for consumers, delivering a credit and store card market where:
- Consumers are better able to make decisions about credit and store card borrowing;
 - Levels of unsustainable credit and store card debt are reduced;
 - Sustainable credit and store card borrowing remains accessible to vulnerable consumers;
 - Credit and store card lending is based on a fair and transparent relationship between borrower and lender;
 - Card lending remains an innovative and viable sector.

²⁰ www.lendingstandardsboard.org.uk

²¹ Throughout this document, references to the Banking Code are to the personal (consumer) Banking Code. The Banking Codes will be replaced by the Lending Code from 1 November 2009. The FSA is taking over the regulation of banking conduct of business in relation to deposit-taking and payment services as of November 2009, although this will not affect those areas of regulation outside of the FSA's responsibility, such as consumer credit and overdrafts.

- 1. The Government calls on consultees to submit evidence about the current nature of the UK credit and store cards markets, including in particular:**
 - **The incidence of multiple credit card use, particularly among the most indebted consumers;**
 - **The use of personal credit cards for business purposes by the owners of small firms;**
 - **The consumer experience of using credit cards and dealing with their lenders; and**
 - **The profitability of credit card lending and the impact of the economic downturn on both consumers and lenders.**

Chapter 2: The allocation of payments



INTRODUCTION

- 2.1** General industry practice is for the most expensive debts held on a credit card to be paid off last. This is common practice across the credit card industry, with very few exceptions offering cards that reverse the standard allocation of payments on revolving balances.²²
- 2.2** For example, a consumer holding a card with i) £1000 balance transfer at 0%, ii) £500 new purchases at 15%, and iii) £250 cash advance at 25% would see payments reducing the £1000 balance transfer first. Only after the first £1000 has been paid off would the consumer's payments begin to reduce the £500 new purchases debt at 15% (and any subsequent new purchases which are made). The £250 cash advance at 25% will not begin to be paid off until any balances attracting a lower rate of interest have all been paid off in full, even if they are incurred after the cash withdrawal was made. This means that it would be possible to carry the £250 cash advance debt for a considerable time before it was repaid, during which time the debt would be attracting the highest interest rate of 25%.
- 2.3** The offer of 0% balance transfers is commonly used as a marketing tool to drive switching between card lenders and enable lenders to acquire more customers, who will in turn make purchases with their new card.²³ Even with the 3% one-off fee generally charged for balance transfers, consumers are usually better off transferring their balance rather than keeping it on another card charging standard rates on their balance, at least for the duration of the balance transfer offer.²⁴
- 2.4** Cash advances are charged at the highest rates of interest to reflect the level of risk they present to the lender. Consumers drawing multiple cash advances present a higher credit risk because withdrawing cash on a credit card is often correlated with financial difficulties. In addition, cash advances carry a significant risk of fraud, which increases the cost to the lender of providing this facility.
- 2.5** Store cards are slightly different from credit cards in this respect. Not all store card lenders offer the facility to withdraw cash on the card, although many will offer promotional rates. Typical industry practice appears to be that repayments are allocations to the cheapest debts first. However, the situation can be more complicated because some store cards are hybrid products offering instalment credit (often described as "buy now, pay to plan") and deferred credit ("buy

²² A revolving credit account (where the amount of money owed can fluctuate) typically has a variable interest rate, an open ended term and payments based on a percentage of the balance. Credit and store cards are examples of this type of account, as opposed to loans, which have fixed terms.

²³ Balance transfers do not in themselves generate profit for lenders. This comes from balances created by new spending on the card. It is arguably rational for card issuers to allocate payment to the cheapest debt first, so that balances attracting interest accumulate while interest free balances are reduced. Consumers benefit from 0% balance transfer deals because lenders can recoup costs from these growing interest-bearing balances.

²⁴ However, it should be noted that some 0% balance transfer offers require consumers to make a certain level of purchases within a certain number of months, or lose the 0%.

now, pay later”) alongside traditional revolving credit (where consumers decide how much or how little to pay off each month). In these circumstances, part of a repayment may be allocated to repaying an instalment loan before the rest is applied to other balances. We are advised that at least one store card lender provides customers with the option of allocating payments to specific plans.

WHAT IS THE PROBLEM?

- 2.6** There is evidence that the counter-intuitive way in which payments are allocated means that consumers do not realise that their repayments do not necessarily prevent them accruing interest at a high rate.²⁵ This is despite existing legal requirements to disclose information on the allocation of payments in credit agreements and periodic statements, reinforced by self-regulatory provisions in the Banking Code and guidelines from the UK Cards Association.²⁶
- 2.7** Recent research by the Office of Fair Trading (OFT) found that the terminology used by different lenders varied considerably, as did the way in which information was presented.²⁷ It is questionable whether this information is sufficient to enable consumers to understand how repayments are structured, and whether they are able to make rational decisions based on this information.
- 2.8** There are two groups of consumers who are particularly affected by the structuring of repayments in this way, and who may suffer different levels of detriment. The first group includes those consumers taking advantage of balance transfer deals and often heavily discounted promotions, who will find that, if they use their card for new purchases, the discounted balance is paid back first. The second group affected are those who use the card to make cash withdrawals and find that they are unable to pay back this borrowing (often at 1.5 to 2 times the rate for purchases) without paying back the entire outstanding balance first.
- 2.9** The concern the former group of consumers have is that they are unable to benefit from the discount as they would have liked or expected. Combined with promotional offers and lack of consumer understanding of different rates applied to different forms of borrowing, the current allocation of payments may result in consumers being unaware that the way they are using their card is increasing their indebtedness. This practice also potentially limits the ability of consumers to assess accurately the costs of entering into a deal, particularly where competition between lenders focused on 0% offers masks the true price to consumers. In fact, depending on subsequent usage of the card, the order of repayments can

²⁵ OFT Credit Card Survey, 2004.

²⁶ Consumer Credit (Agreements) Regulations 1983 (S.I. 1983/1553), Sch 1, para 14A and Consumer Credit (Information Requirements and Duration of Licences and Charges) Regulations 2007 (S.I. 2007/1167), Sch 2 paras 3-4.

²⁷ OFT Credit Card Comparisons Report February 2008

make some statements about 0% interest periods incorrect.²⁸ Recent research by Moneysupermarket.com found that almost two thirds of consumers surveyed did not know that if they made purchases on a card to which they had transferred a balance their repayments would continue to be allocated to the cheapest balance first.²⁹

- 2.10** For the second group who have used their cards to withdraw cash, these cash advances can remain on their balance for many years, attracting the highest rates of interest. This becomes a particularly serious concern if consumers are only making minimum payments, where it may take decades to pay off a relatively small cash advance at a high cost.
- 2.11** The problems associated with the allocation of payments are more acute for this second group of consumers. This group, while not necessarily a large proportion of credit card users, is likely to include a significant number of vulnerable consumers, who have limited choices of other borrowing vehicles. Withdrawing cash on a credit card is often a sign that consumers are in financial difficulties; they are borrowing on their card to fund essential cash expenditure.
- 2.12** There is also a question of fairness, in that a consumer does not have an option to correct a mistake. If, for example, a credit card was mistakenly used instead of a debit card to withdraw cash, it could take years to repay the cash component, as this could not be done without paying back the balance in full.
- 2.13** Given that the two different groups of consumers are affected in different ways, there may be a case for treating the allocation of payments against cash advances differently from other payments.
- 2.14** As the problem is, at least in part, an imbalance in information between card lenders and borrowers, an obvious approach would be to ensure that consumers understand the allocation of payments and are able to use their cards optimally as a result. However, this does not take into account the fact that consumers (particularly those lacking financial capability) may not understand the practice, even with increased information (in addition to existing legislative requirements). There is a case for arguing that consumers should not be disadvantaged by confusing complexity and that the Government should intervene to alter the allocation of payments in the consumer's favour.

²⁸To add to the confusion, introductory interest-free periods can expire on different dates. For example, a typical offer recently on the market is for 0% on both balance transfer and purchases, but this introductory offer lasts for 15 months for balance transfers, but only 3 months on purchases, which then attract a rate of 15.9%.

²⁹Moneysupermarket.com

Discussion of options

2.15 There are a number of possible options to achieve these outcomes:

1. Do nothing beyond current legislative and regulatory activity;
2. Improve information transparency;
3. Allocate repayments proportionally to debts attracting different interest rates;
4. Allocate repayments to the most expensive debt first;
5. Allow consumers to pay off cash advances first.

Option 1: Do nothing, beyond current legislative and regulatory activity

2.16 As stated in paragraph 1.15, the OFT has recently consulted on draft Irresponsible Lending Guidance. The current draft (which was subject to public consultation) lists “Allocating payments to the least expensive debt first (or otherwise than to the oldest or most expensive debt first) under circumstances in which it was not explained to the borrower, clearly and fully, in plain and intelligible language, in advance of him entering into the credit agreement, that this would be the case” as an irresponsible lending practice that would call into consideration the fitness of the creditor to be licensed by the OFT.³⁰ Legislation implementing the Consumer Credit Directive will also apply to this area, and among other things will require an adequate explanation of the cost of credit and any special or unusual features of the product.³¹

2.17 Under this option, and in the light of Consumer Credit Directive implementation and emerging OFT guidance, the Government would take no further action on the allocation of payments.

2.18 The information asymmetries described above would be reduced, but not completely removed under this option. Subject to the results of the recent consultation by the OFT on draft Irresponsible Lending Guidance, a lack of an adequate explanation of the payment allocation structure by a card lender could question that card lender’s fitness to be licensed by the OFT, and could also breach Consumer Credit Directive implementing legislation. This option would not necessarily address the detriment faced by consumers who use cash advances, for whom necessity, in addition to a lack of information, could be a problem.³²

³⁰ Paragraph 6.9 of the draft Guidance.

³¹ In addition to a requirement to include information on the allocation of payments in pre-contractual information and in agreements, Article 5.6 of the Directive requires adequate explanations to be given to consumers to help them decide whether or not credit products are suited to their needs. Our legislation implementing this requirement proposes to include an explanation of less obvious features of a credit product which could have a negative impact on the consumer and the cost of credit.

³² Although the implementation of the Consumer Credit Directive Article 5.6 will also require lenders to explain unusual/ risky features of products and the effect they might have on the borrower.

- 2. We would welcome evidence on the extent of consumer understanding of the order of payment allocation and its implications.**
- 3. Will the implementation of the Consumer Credit Directive, combined with OFT guidance, provide sufficient consumer protection in this area?**

Option 2: Improve information transparency

- 2.19** This option would involve making it more explicit to consumers, through a requirement for clearer information, that debt attracting the lowest rate of interest would be paid off first, and that this may increase indebtedness over time depending on their use of the card. Any additional legal requirements to provide information, over and above that which will be required under the measures described in option 1, would need to be consistent with the provisions of the Consumer Credit Directive, which restricts additional legal requirements for pre-contractual information, but allows flexibility in the provision of post-contractual information. An annual statement showing how payments have been allocated (with an accompanying explanation) could potentially be an effective illustration to consumers of the way in which repayment behaviour affects the costs of borrowing.
- 2.20** This would go some way to addressing the problem of information asymmetry set out above. However, it is questionable that increased information in this form would sufficiently increase consumers' understanding of the way payments are allocated and the impact this might have. There is a risk that consumers would not focus on this information and its implications for sensible use of their card, especially if it is not presented simply enough and given to them at a time when it can be most useful.
- 2.21** This leads into the question of what, if any, action consumers might take if they fully understood how the allocation of payments was structured. A better understanding of the consequences of paying off the cheapest debt first might lead to more consumers choosing cards that are marketed as having a different payment structure, and, in turn, could lead to more of these cards on the market, and a change in behaviour from lenders.
- 2.22** A more effective method of increasing transparency might be to provide information on what consumers could do to improve their card use, rather than explaining how the allocation of payments works. Understanding the principle behind the way payments are allocated may be more important than understanding how each individual payment is allocated. This could be supported by illustrative scenarios.

- 4. How could the allocation of payments be made more transparent for consumers?**
- 5. What effect is improved transparency likely to have on consumer behaviour? Would it sufficiently address consumer detriment?**
- 6. What might be the cost to lenders of implementing this change? What might be the longer term cost?**

Option 3: Allocate repayments proportionally to debts attracting different interest rates

2.23 This option would see the monthly payment being used to reduce each debt at different rates on a proportional basis.³³

2.24 This option would have the effect of reducing balances held at the highest interest rate (e.g. cash advances) to some degree. However, it might be likely to discourage some lenders from offering low rate promotional balances, and could have an impact on the availability of 0% balance transfer deals. Lenders have told us that any change to the current allocation of payments would involve significant systems change costs at the heart of their IT systems. It might also be confusing to consumers, particularly if they are unclear as to the make up of the current debt.

- 7. What effect might this option have on consumers?**
- 8. How might lenders react to a requirement to allocate repayments on a proportional basis?**
- 9. What might be the cost to lenders of implementing this change? What might be the longer term cost?**
- 10. Are there alternative ways of structuring repayments which would be preferable?**

Option 4: Allocate repayments to the most expensive debt first

2.25 This would follow the model set by the US CARD Act, which states that payments in excess of the minimum payment must be allocated to the highest interest of debt first, and would therefore reverse current practice in the UK. One of the few lenders to offer a card in the UK with this payment structure claims that consumers could save £224 a year as a result, based on certain assumptions about usage levels.³⁴

³³ So, for example, for a balance comprising £300 balance transfer at 0% interest, £600 purchases at 15% interest, and £300 cash advance at 20%, a payment of £120 would be allocated £30 to the balance transfer component, £60 to the purchases component and £30 to the cash advance component.

³⁴ Nationwide Building Society marketing material.

- 2.26** This option works in the consumer's favour, giving them a better deal and allowing them to pay their debt off faster. It is the simplest and most transparent option for consumers and it would also address the issue of cash advances being held for long periods of time on balances attracting the highest rates of interest.
- 2.27** The credit card industry has argued that this option is likely to restrict the availability of 0% balance transfer deals, as the income lenders receive from charging interest at high rates for longer would no longer cross-subsidise lower rate deals. However, providers who apply a high-to-low allocation of payments do still provide discounted offers.
- 2.28** As mentioned above, some store cards are hybrid products offering different forms of credit. In the case of these cards, a straightforward flipping of payment structure may not be possible. This is a matter we will look at further.
- 2.29** A study in the US looked at the effects of a range of options on payment allocation, and found that on an annualised basis the interest income lost on credit card portfolios due to the reversal of the allocation of payments would be at least \$835m.³⁵ Lenders have also told us that any change to the current allocation of payments would involve significant and costly systems changes at the heart of their IT systems. Finally, lenders have said that if the cash facility is made proportionately more expensive to provide because of the way payments are allocated, costs to consumers who use this facility will rise, and some lenders could withdraw the cash advance facility altogether. The Government calls upon industry to provide evidence in support of these arguments.

- 11. What effect might this option have on consumers?**
- 12. How might lenders react to a requirement to allocate repayments to the most expensive debt first?**
- 13. What might be the cost to lenders of implementing this change? What might be the longer term cost?**

Option 5: Allow consumers to pay off cash advances first

- 2.30** A less wide ranging option would be to allocate payments first to cash advances. Once all cash balances are repaid, any additional payments could then be allocated according to lender preference.
- 2.31** This would directly address the concerns set out above that the most significant consumer detriment in this area is suffered by the minority of card users who use

³⁵ Oliver Ireland, Morrison & Foerster LLP, August 2008. The US market is, however, considerably larger than that in the UK. If we were to assume that the allocation of payments accounts for the same proportion of yield in the UK as in the US, a comparable figure for the UK might be likely to be somewhere in the region of £50-60m. However, the Government is working with the UK credit card industry to deliver a more accurate impact analysis based on UK circumstances.

the cash advance facility either because of financial need or because they do not understand the implications. It would also ensure that there is minimal impact on the availability of 0% balance transfers, which many consumers appear to value.

2.32 As cash advance users are a relatively small group, the impact on lender revenue should not be as significant as a total reversal of the current pricing structure. However, as for option 4, lenders have suggested it is possible that costs of cash withdrawal for consumers could rise and that some lenders might cease to offer cash withdrawal facilities.

2.33 However, this approach would not address the concern that some consumers may be entering 0% balance deals without a proper understanding of what that entails and with the allocation of payments weighted against them.

14. What effect might this option have on consumers?

15. How might lenders react to a requirement to allow consumers to pay off cash advances first?

**16. What might be the cost to lenders of implementing this change?
What might be the longer term cost?**

17. Of the 5 options for reform of the allocation of payments, which do you prefer?

Chapter 3: Minimum payments



Introduction

- 3.1** The minimum payment is the minimum amount that consumers must pay each month against their outstanding balance without incurring default charges from the credit or store card lender. The minimum payment varies across different lenders, but must be set at a level that at least covers new interest payments on the balance of the debt to ensure that consumers do not enter a negative spiral of debt (known as negative amortisation). This is set out in paragraph 10.13 of the Banking Code, which states: “we will make sure that your minimum payment covers more than that month’s interest”. It may not, however, cover fees and charges, such as those for cash advances or balance transfers.
- 3.2** Currently, the average minimum payment is around 2-3% of the outstanding balance for credit cards and around 4% of the outstanding balance for store cards, subject to a minimum amount (usually £5 or £10). Between 2002 and 2008, the number of consumers who only made the minimum payment on their credit card increased by a third. In 2008, the minimum payment was regularly made on around 14% of all credit card accounts (estimates show that between 11% and 20% of store card holders make the minimum payment in an average month). Around 69% of consumers paid off their outstanding balances on their credit cards in full every month or most months (for store card holders, approximately 60% of consumers paid off their balances). This means that of the 31% of consumers who borrowed on their credit card, over a third of these made only the minimum payment. Of this 31%, a proportion will make only one or two minimum payments over the year, while some consumers will make the minimum payment over a period of many months or even years. Some consumers will be consistently making minimum payments on more than one card.

WHAT IS THE PROBLEM?

- 3.3** We know that the percentage of consumers making minimum payments has increased; indeed nearly a third more consumers make only minimum payments on their credit cards now than was the case in 2002. This rise may be attributable to a number of factors, including the impact of recent economic conditions on many consumers’ personal finances. It may also reflect the larger percentage of 0% deals available over the period since 2002. These make it economically rational to make only a minimum payment and then pay the total outstanding balance immediately prior to the end of the promotional period, assuming that the consumer is not incurring any further expenditure on their card.
- 3.4** However, consumers who make only the minimum payment can end up paying off debt very slowly, in some cases over decades, and paying significant amounts of interest. The Government is particularly concerned about those consumers who regularly make the minimum payment; they will be most at risk from longer repayment periods and higher interest payments.

- 3.5** Lenders have put in place some mechanisms to alert consumers to the impact of making only the minimum payment. In 2004, the credit card industry agreed the text of a health warning which appears on all credit card statements. This reads: “If you make only the minimum payment each month, it will take you longer and cost you more to clear your balance”. The Banking Code also requires that credit card statements include an estimate of the amount of interest payable next month if the consumer makes only the minimum payment. Credit card lenders also agreed that additional information should be included within pre- or post-contract information to make clear that the minimum repayment amount does not constitute a repayment schedule. These voluntary measures by industry were replaced by regulations made under the Consumer Credit Act 1974, and amended following the Consumer Credit Act 2006. These regulations, which came into force in October 2008, incorporate the above health warning into all credit and store card statements; although they do not prescribe how prominently it should appear relative to other prescribed information. In addition, the Store Cards Market Investigation Order 2006 requires store card lenders to include the minimum payment warning in direct debit mandates and requires an interest estimate on monthly statements.
- 3.6** Despite the mechanisms developed so far by industry and regulatory authorities in the UK, a significant minority of consumers make only the minimum payment even after a 0% period has ended, and therefore continue to pay off debt very slowly and at a high cost.
- 3.7** In recent years, the average minimum payment on credit cards has declined from around 5% to its current average of 2–3%. Whilst this may partly be a reflection of a global decline in interest rates, it leaves consumers who only make minimum payments paying back their balance over much longer periods than a few years ago.
- 3.8** As set out in Chapter 2, it is also general industry practice for the most expensive debt on credit and store cards to be paid off last. When making only the minimum payment, consumers will be paying off their debt at the lowest interest rate first; a practice that further increases the costs to those consumers who make the minimum payment.³⁶
- 3.9** Recent research from the University of Warwick shows that the level of the minimum payment has an indirect effect on those consumers who borrow on their card, but who repay more than the minimum payment.³⁷ For this group of consumers, the minimum payment acts as an “anchor” upon which they base their own levels of repayment. The research suggests that setting a low minimum

³⁶This also reduces the utility of the APR as a cost comparator for such consumers, as the APR under the Consumer Credit Directive assumes that the balance is paid off at the highest interest rate and charges applicable to the most common drawdown mechanism (typically purchases).

³⁷http://www2.warwick.ac.uk/newsandevents/pressreleases/research_finds_customers146/

payment encourages these people to pay less than they would do otherwise. Any policy intervention in this area is therefore likely to influence most consumers who borrow on their cards and not just those who make the minimum payment.

3.10 The Government is concerned that minimum payments are set at a level that means a significant number of consumers who borrow on their cards repay their debt over long periods of time with high levels of interest, and that lenders have not done enough to explain to consumers the implications of making only the minimum payment. Even if they read the statutory health warning, consumers may not fully appreciate that regularly paying only the minimum payment is not a sustainable approach to card borrowing and that if they wish to pay off the full amount over a reasonable period they should be repaying significantly more each month. These issues are compounded by recent declines in the levels of minimum payment, industry practice on the allocation of payments and evidence that low minimum payments indirectly affect all borrowers.

DISCUSSION OF POLICY OPTIONS

3.11 In the light of these concerns, the Government believes that further action is necessary in this area so that consumers not only have a clearer idea of the implications of making the minimum payment, but are also encouraged to make higher payments where they can so that credit and store card debts are repaid over a reasonable period.

3.12 In considering options for action, we recognise that for some consumers who borrow on their cards, particularly those who only infrequently make a minimum payment or who benefit from a 0% deal, paying small amounts may be a rational choice. The flexibility offered by the minimum payments regime on credit and store cards enables consumers to manage their finances as their personal circumstances alter over a period of time. For others, however, it is clear that the current information provided is not sufficiently focused for consumers to make informed decisions on their borrowing. This is particularly true of those consumers who could pay more than the minimum payment on a regular basis, but choose not to. We will also consider how action in this area might affect the credit and store card market more generally and might impact on the range of products and offers available to consumers.

3.13 There are a number of possible options.

1. Do nothing beyond current legislative and regulatory activity;
2. Improve information transparency;
3. Set a recommended minimum payment;
4. Increase the minimum payment.

Option 1: Do nothing beyond current legislative and regulatory activity

- 3.14** Under this option, we would take no further action beyond that which emerges as a result of the implementation of the Consumer Credit Directive and the OFT's Irresponsible Lending Guidance.
- 3.15** The Consumer Credit Directive requires Member States to ensure that consumers receive adequate explanations before entering into a credit agreement.³⁸ These must be sufficient to enable consumers to assess whether the proposed agreement is adapted to their needs and financial situation. Among other matters, the draft regulations implementing the Directive will require an explanation of "the cost to the debtor of the credit to be provided under the agreement". The regulations implementing the Consumer Credit Directive are expected to be finalised by the end of the year, coming into force in June 2010.
- 3.16** The draft OFT Irresponsible Lending Guidance states that the OFT would expect adequate explanations to include an indication of how much is payable each month, and the risk to the borrower "if only minimum repayments are made that do not pay off part of the capital".³⁹ In addition, the draft Guidance includes as an example of an unfair business practice: "Setting the minimum repayment on a running account credit agreement at a level that would not repay capital, as well as interest, within a reasonable period".⁴⁰ The Guidance was recently subject to consultation in draft form. The OFT will issue final Guidance, taking account of consultation responses, in early 2010.

18. Will the implementation of the Consumer Credit Directive, combined with OFT Guidance, provide sufficient consumer protection in this area?

Option 2: Improve information transparency

- 3.17** This option would involve making the consequences of the minimum payment more explicit to consumers at the start of a credit or store card relationship and during the life of the agreement. Any action in this area would need to be consistent with the regulations implementing the Consumer Credit Directive. Whilst the Directive restricts additional requirements for pre-contractual information, it provides Member States with considerable freedom regarding the adequate explanations that must be given. It also allows for more flexibility on post-contractual information, imposing no constraints, except with regards to information on overdrafts and changes to borrowing rates.

³⁸ Article 5.6 of the Consumer Credit Directive

³⁹ Paragraph 3.15 of the draft OFT Guidance

⁴⁰ Paragraph 6.2 of the draft OFT Guidance

- 3.18** The draft regulations implementing the Consumer Credit Directive include proposals in relation to adequate explanations. There are also a range of post-contractual information options that we should consider. These should help to illustrate to borrowers the way in which their payment levels affect the costs of their borrowing. The intention would be to really bring to life for consumers how little of the debt they are repaying by making only the minimum payment.
- 3.19** Periodic statements could include simple illustrative scenarios indicating how much it will cost and how long it will take to repay the outstanding balance if only the minimum payment is made. An alternative scenario could show the implications if a larger amount is repaid each month (for example, 25% or 50% of the outstanding balance) or if the consumer repays the same proportion of the debt as he has done in, say, the previous six months. The statement could also require an estimate of the interest payable the following month if only the minimum payment is made, embedding in statute the current voluntary provisions under the Banking Code.
- 3.20** The provision of this additional kind of information is very similar to that which will be required in the US under the CARD Act of 2009. Lenders will need to display on periodic statements how long it will take to pay off the existing balance and the total interest cost if the consumer pays only the minimum payment. They will also need to display the payment amount and total interest cost to pay off the existing balance in a reasonable period, deemed to be 36 months in the US.
- 3.21** Requiring lenders to improve the information they provide to consumers on minimum payments should put consumers in a better position to make more informed choices on their borrowing. However, there is no guarantee that consumers would read or follow advice to make more than the minimum payment, especially where this is routinely included on monthly statements, which many consumers will not study in detail. On its own, therefore, this option is unlikely to change the behaviour of those consumers who are most susceptible to high levels of unsustainable debt.

- 19. What information on minimum payments would be the most useful to consumers and how often could it be provided?**
- 20. What effect is improved transparency likely to have on consumer behaviour? Would it sufficiently address consumer detriment?**
- 21. What might be the costs to lenders of implementing this change? What might be the longer term cost?**

Option 3: Set a recommended minimum payment

- 3.22** Under this option, a recommended minimum payment would be set at a level that is higher than the contractual minimum payment and allows consumers to pay off the card over a much shorter period of time. Consumers could be encouraged to make the recommended minimum payment rather than the contractual minimum payment. Lenders could explain the advantages of a recommended minimum payment at the start of a new agreement. Consumers could opt in to always making at least the recommended minimum payment. Alternatively, Direct Debit mandates for those who do not intend to repay in full could be set at the higher recommended minimum payment rather than at the contractual minimum.
- 3.23** The recommended minimum payment could be set voluntarily by industry or could be made a regulatory requirement, but we would expect it to be based on a repayment over a reasonable period of time, probably around 36 months. This is the same period that has been set in the US for the provision of information on minimum payments, and anecdotal evidence shows that this period is a reasonable estimate of the average life of a credit card agreement issued in the current UK market. The information transparency measures set out in option 2 could include information on how much money and time could be saved if the recommended minimum payment is made each month instead of the contractual minimum payment.
- 3.24** Consumers who borrow on their card and who can afford to pay more than the contractual minimum payment will benefit from this option as it should allow them to clear their debt faster over a much shorter repayment period and at a corresponding lower cost. In addition, depending on how the recommended minimum payment is presented, consumers should have a degree of control over their borrowing and should be able to make a more informed decision as to how they want to repay their debt.
- 3.25** The impact of this option on both consumers and lenders will, however, depend on how it is implemented. If consumers are asked to opt in to the recommended minimum payment, it is not clear whether many would choose to do so, particularly more vulnerable consumers who may be in more precarious financial situations and particularly if the benefits of doing so are not clearly articulated. If the recommended minimum payment becomes the default payment option for Direct Debit mandates, then some more vulnerable consumers may struggle in the short term to make a higher recommended minimum payment on their outstanding balance. We would anticipate, however, that some mechanisms could be built in to allow more vulnerable consumers to default to the contractual minimum payment if necessary. The new recommended minimum payment could also be phased in order to allow those consumers, who cannot currently afford to pay, more time to adjust their finances.

- 3.26** Paradoxically, it is possible that setting a recommended minimum payment may actually discourage some consumers from making payments above the recommended minimum level as they may see it to be a “desirable” repayment level. So some consumers might end up repaying less of their debt than they otherwise would because they mistakenly believe that the recommended minimum payment is the payment they should ideally make.
- 3.27** Finally, we would need to consider the effect that having both a contractual and recommended minimum payment would have on the “anchoring” effect. It is not clear whether consumers would anchor against the higher recommended minimum payment or the lower contractual minimum payment and whether having two different types of minimum payments might actually be too complicated and confusing for both lenders and consumers.

- 22. Should there be a recommended minimum payment?**
- 23. How could the recommended minimum payment be set?**
- 24. What might be the unintended consequences of a recommended minimum payment? How might it impact on consumer repayment behaviour?**
- 25. What might be the costs to lenders of implementing this change? What might be the longer term cost?**

Option 4: Increase the minimum payment

- 3.28** Under this option, the minimum payment for all consumers (or for a defined subset of consumers who borrow on their cards) would increase, thereby ensuring earlier repayments of the existing balance over a shorter period of time with a lower level of interest over the lifetime of the debt.
- 3.29** There are a number of important issues we will need to consider in analysing this option.
- 3.30** Firstly, we will need to consider how the minimum payment should be increased. One option might be to increase the percentage minimum payment from, say, 2% to 5%, based on the outstanding balance on the card. This is the model we have used in the illustrative examples below. An alternative could be to base the level of the minimum payment on a maximum period over which the debt can be repaid. The two approaches may achieve broadly the same effect. However, presenting the minimum payment in terms of how long it will take to pay off a debt may be more meaningful to consumers than a percentage figure.
- 3.31** Setting minimum payments with reference to the time it would take to pay off the debt could also allow for more flexibility in the way it is implemented. For example, the repayment period could be set in legislation, or by the credit or

store card lender with a consumer opt-in or opt-out, or it could be agreed in direct consultation with the consumer at the point at which they open their card. The repayment period could be based on the overall credit limit of the card, or apply to the actual spend on the card, and could be capped at a maximum monthly figure agreed with the consumer.

- 3.32** Whilst the concept of making a minimum payment based on a repayment period may be easier for consumers to understand than an arbitrary percentage figure, there are risks to this approach. Consumers may assume that their debt will be cleared at the end of the repayment period, whereas if they continue to spend on their card over that period, it will not. This option may therefore require the provision of additional information to consumers to enable them to make an informed decision as to how long their ideal repayment period should be, and the impact of making minimum payments based on a given repayment period. There is a risk that this could lead to information overload for some consumers.

Illustrative Examples:

1. James holds an outstanding balance of £1,856 with an interest rate of 17.6%. If James pays the minimum payment at a level of 2%, to pay off this balance would cost him £4,620 in total interest charges over **38 years and 10 months** with a monthly repayment starting at **£37** (and progressively declining, reaching around **£11** halfway through). If, however, the minimum payment was increased to 5%, James would pay off his debt over **8 years and 10 months**, with only £748 in total interest charges and a monthly repayment starting at **£93** (and progressively declining, reaching around **£14** halfway through).

2. Amy holds an outstanding balance of £500 with an interest rate of 30%. If Amy pays the minimum payment at a level of 3%, it would take her **24 years and 4 months** and cost her £1,863 in total interest charges with a monthly repayment starting at **£15** (and progressively declining, reaching around **£7** halfway through). If, however, the minimum payment was increased to 5%, Amy would pay off her debt over **7 years and 8 months** and would pay only £440 in total interest charges with a monthly repayment starting at **£25** (and progressively declining, reaching around **£8** halfway through).

[These examples are based on BIS calculations. They assume no additional spend on the card and a minimum payment of the % figure or £5, whichever is greatest.]

- 3.33** The illustrative examples above show that there is a clear long term benefit in raising the minimum payment for the 14% of consumers who make the minimum payment; they will clear their debt much faster and at a significantly lower overall cost. As mentioned above, research by the University of Warwick also shows that a universal increase will provide a knock-on indirect benefit for those consumers who borrow on their card but who repay more than the minimum payment each

month. Increasing the minimum payment “anchor” will encourage this group to pay off more of their debt each month.

- 3.34** Whilst there are some obvious long term benefits to increasing the minimum payment, we will need to carefully consider the short term impact of an increase. Relatively low minimum payment levels provide consumers with some flexibility in the way in which they manage their finances, and may help to ease the pressures on more vulnerable consumers at times of strain. This is particularly an issue at the moment given the current economic downturn.
- 3.35** An increase in a minimum payment which is too high and not properly phased-in could lead to more people experiencing short term repayment difficulties as they struggle initially to pay the higher minimum payment. It could also draw them to other less appropriate short term lending options. Whilst this may only be a short term issue (the higher the minimum payment, the smaller the outstanding balance at the next statement date and the lower the risk of repayment difficulties), we would need to ensure that we weigh up these short term impacts.
- 3.36** Finally, we will also want to consider whether we should limit an increase in the minimum payment to a defined sub-set of consumers who may be particularly affected by repaying only the minimum each month. The second illustrative example above shows that those consumers who hold small amounts of debt on higher cost credit cards will particularly benefit from an increase in minimum payments. For these consumers, even a small increase in the minimum payment of only a few pounds a month can lead to the repayment of their debt over significantly shorter periods of time.
- 3.37** However, we will need to consider the difficulties in identifying and defining such groups of consumers and whether any discrimination issues might arise. We will also need to evaluate whether differentiating consumers in this way may impact on the range of lenders and products available to specific groups of consumers. In addition, we will need to take into account the potential cost to the credit and store card lenders in having to provide separate minimum payment calculations for different types of consumers.
- 3.38** Given these kinds of consequences, any proposed increase in the minimum payment, either to all consumers, or to a defined sub-set of consumers, would have to be carefully analysed and its implementation carefully managed.

- 26. Should the minimum payment increase?**
 - 27. On what basis should an increase in minimum payment be set?**
 - 28. How many consumers would be affected by an increase in the minimum payment, for example, if it were raised to 5%? How many of these consumers would be unable to meet these higher repayment levels? How many consumers holding balances on more than one credit card are likely to be affected?**
 - 29. Should an increase in the minimum payment apply to all consumers or to a sub-set of consumers?**
 - 30. What might be the costs to lenders of implementing this change? What might be the longer term cost?**
 - 31. What evidence do you have about the impact of previous reductions or increases in the level of minimum payments on cardholders?**
-
- 32. Of the 4 options for the reform of minimum payments, which do you prefer?**

Chapter 4: Unsolicited limit increases

Loan and Credit Planner

Provides an overview of the financial planning process for a business. It includes a checklist of items to consider, a list of questions to ask, and a list of resources to consult.

1. Determine the business's financial goals and objectives.

2. Analyze the business's current financial position.

3. Develop a financial plan.

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Introduction

- 4.1** It is standard practice for credit and store card companies to grant their customers higher credit limits on an unsolicited basis; that is, without the customer having requested an increase. Consumers will generally be informed on their statement that they now have a higher limit and will not normally be given an explanation of why their limit has been increased. Recent research from uSwitch shows that in the last year an estimated 5.7 million consumers had their credit limits changed without their consent.⁴¹
- 4.2** Under the Banking Code, credit card issuers are committed to conducting a credit check before they grant a customer a higher limit and when they raise someone's limit they must notify consumers that they can refuse the new limit if they want to and how to do so. However, there is no requirement for a consumer to have asked for, or actively consented to, a higher limit.
- 4.3** Card companies raise limits in this way for all types of customers, but they argue that this practice is a key feature of "low and grow" lending to higher risk customers. The risk of such customers defaulting is higher so lenders can only justify very low initial limits. Low and grow starting balances can be as low as £250 on credit cards; for store cards initial limits can be much lower starting at around £150. The lender will monitor the accounts during the first months of operation, and select out poor credit risk customers by leaving their limits very low, whilst successively increasing the limits of those who manage their accounts effectively.

What is the problem?

- 4.4** The Government is concerned that consumers do not have enough control over increases in their credit and store card limits. Borrowers should be better able to make their own decisions about increases in the amount of credit they can responsibly access. It should be noted that the Government does not propose to constrain lenders' ability to unilaterally decrease a consumer's credit limit, subject to rules on unfair terms and the provisions of the Consumer Credit Directive. The right to reduce a customer's limit without their consent, as long as this is done fairly and reasonably, within the bounds of consumer protection and equality rules, is critical to lenders' ability to protect borrowers and themselves from problem debt.
- 4.5** Whilst lenders argue that they only offer higher limits to customers who appear to be able to afford it and to be a good credit risk, their information is imperfect and they may not be aware of, or able to respond rapidly to, a sudden change in a borrower's circumstances. The second report of the Over-Indebtedness Taskforce

⁴¹ 12 month period from July 2008 to July 2009 figures extrapolated based on current UK credit card holders and sourced from APACs report: UK Plastic Cards 2009.

in 2002 found the automatic raising of credit limits on credit and store cards to be associated with financial difficulties and high levels of expenditure on debt servicing.⁴² The report showed the practice to be quite prevalent with 28% of credit card holders and 10% of store card holders having received a limit increase in the previous 12 months, of which more than 90% were unsolicited. More recent data from uSwitch found that 19% of credit card holders surveyed had had their limit increased on an unsolicited basis in the previous year, with an average increase of £1,538.⁴³

4.6 Although there may not be a direct link between an individual limit increase and increased likelihood of default, the practice of increasing limits through the life of an agreement has clearly contributed to the significant growth we have seen in personal debt on cards. A recent study in the US found that increases in credit limits generated an immediate and significant rise in debt; on average, 10–14% of any increase in the credit limit.⁴⁴ This figure was larger for cardholders starting near their credit limit. People seeking debt advice from the Consumer Credit Counselling Service (CCCS) in 2008 had average credit card debts of £14,839 and store card debts of £1,687. The average credit card debt for clients with an income of less than £10,000 was £7,871.

4.7 Lenders argue that in addition to being able to contact their bank and refuse the new limit, consumers can also simply choose not to use the new limit. They believe that this provides sufficient protection for those who want to control their access to credit whilst leaving other consumers with the flexibility to deal with unforeseen emergencies or benefit from additional protection when buying one-off items without the hassle of applying to their bank for more credit.

4.8 However, consumer groups complain that it is often not easy for borrowers to contact their lender to ask for their limit to be changed. With an unsolicited increase there is a greater risk that a consumer will spend on their card without giving proper consideration to what it will cost them, how they intend to repay it or what they will do if they experience a loss of earnings further down the line. Responsible borrowing considerations are much less likely to be at the forefront of a consumer's mind when they incur spending against a higher limit at the checkout or when shopping online. There is some support for this view from attitudinal survey evidence:⁴⁵

- 30% of survey respondents agreed with the statement, 'Buying things on credit does not feel like spending';

42 <http://www.berr.gov.uk/files/file38667.pdf>

43 <https://www.uswitch.com/press-room/?downloadfile=CREDIT-CARD-PROVIDERS-THROW-8.8-BILLION%5B1%5D-OF-UNREQUESTED-CREDIT-AT-CONSUMERS>

44 http://idei.fr/CORE/articles/gross_souleles.pdf

45 YouGov Debt Tracker

- 15% agreed with the statement, 'I am impulsive and tend to buy things even when I can't really afford them';
- 11% agreed with the statement, 'If I want something, I am prepared to buy it on credit and think about how I will repay the money afterwards', and
- 6% agreed with the statement 'If lenders offer me money I will take it'.

4.9 Some consumers may be concerned about unsolicited limit increases because a fixed limit on their credit or store card would help protect themselves against reckless spending. This is particularly true for vulnerable consumers, for example people suffering from certain forms of mental illness such as bipolar disorder. Studies have linked such mental health disorders with exuberant spending sprees and compulsive spending behaviour.⁴⁶ Consumer representatives have also queried whether lenders are genuinely making responsible lending decisions when offering higher limits. They argue that lenders frequently grant such increases even though there does not appear to have been a material improvement in a borrower's circumstances and that the purpose of an increase can be merely to encourage consumers to use the card in preference to other credit and store cards.

4.10 The Government believes that consumers should be in control over their personal finances, especially where it comes to taking on potentially long term borrowing commitments which may carry considerable cost implications. Our starting point, therefore, is that current industry practice is unsatisfactory. We welcome stakeholder views on measures to give consumers an active role in deciding whether they should have a higher credit limit, including a ban on granting limit increases on an unsolicited basis.

Options for Reform

4.11 We want to see consumers encouraged to take responsibility for actively managing their credit limits and that they are able to do so easily, in line with responsible borrowing and lending principles. We also want to ensure that measures to promote greater consumer control of their credit limits do not unduly constrain access to credit and store cards for consumers who might otherwise be forced into more expensive and less suitable forms of credit. There are a number of possible options to achieve our desired outcome in this area.

1. Do nothing beyond current legislative and regulatory activity;
2. Improve information transparency on unsolicited limit increases;
3. Limit the size and/or frequency of individual limit increases;

⁴⁶ "In the Red: Debt and Mental Health" Mind 2008 http://www.mind.org.uk/assets/0000/0102/In_the_red.pdf

4. Ban all unsolicited limit increases – increases only to be given in response to a specific consumer request;
5. Allow consumers to opt in to receive unsolicited limit increases.

Option 1: Do nothing beyond current legislative and regulatory activity

- 4.12** The Consumer Credit Directive, which needs to be implemented by June 2010, will cement existing industry practice by placing a requirement on lenders to conduct creditworthiness checks (including consulting any relevant database where necessary) before offering a significant limit increase. In addition, lenders will be required to give adequate explanations to consumers before they enter into a credit agreement.
- 4.13** The statutory requirements flowing from the Consumer Credit Directive will be supplemented by new Irresponsible Lending Guidance produced by the OFT. The OFT's draft Guidance, published in July this year, identified the following practices in relation to limit increases as likely to call into consideration a firm's fitness to hold a consumer credit licence:
- Raising a borrower's credit limit without notifying the borrower and/or without the borrower's consent;
 - Failing to lower a borrower's credit limit following receipt of a specific request from the borrower to do so;
 - Providing a borrower with a new or additional credit facility following receipt of a specific request from the borrower not to do so;
 - Failing to remove any such credit facility following receipt of a specific request from the borrower to do so.
- 4.14** The OFT has recently consulted on this draft Guidance. Subject to consultation responses, the OFT's final Guidance, which will come into force early next year, may go some way to address public concerns regarding unsolicited limit increases, in particular concerns around consumers being able to decline a new credit facility if they don't want it. For the vast majority of lenders, this is unlikely to create any significant additional compliance burden.
- 4.15** However, in the Government's view, as they are currently framed these measures may not go far enough. Crucially, a requirement only to notify consumers of a credit limit increase rather than requiring consumers to engage in a positive decision, would mean that consumers would continue to have limited control over the amount of credit they can access on their cards and would still be at risk of taking on too much debt.

- 33. What evidence do you have that unsolicited credit limit increases are not associated with financial difficulties?**
- 34. Will the implementation of the Consumer Credit Directive, combined with OFT Guidance, provide sufficient consumer protection in this area?**

Option 2: Improve information transparency on unsolicited credit limit increases

- 4.16** Improving transparency for consumers about the reasons for a credit limit increase and their option to decline it could potentially encourage more consumers to actively manage their credit limits. A separate specific communication when a new limit is granted could help ensure that consumers are aware of what is happening: they may be more likely to focus on this information if it comes as a separate letter rather than alongside other information on their statement.
- 4.17** The Government believes there is more that can be done to ensure consumers are given clear, timely and accessible information so that they can make fully informed decisions about their personal finances. However, transparency measures alone are unlikely to be sufficient. There is a risk that consumers will not read the information provided. Moreover, even if they are aware of their right to decline a credit limit increase they may fail to do so because they are concerned that it may affect their ability to apply for a larger limit in future or because they are put off by the “hassle factor” of contacting their lender.

- 35. How could information about credit limits be made clearer and more accessible to consumers?**
- 36. What particular information do you think would be most effective in encouraging cardholders to be more proactive in managing their credit limit?**
- 37. What might be the cost to lenders of implementing this change? What might be the longer term cost?**

Option 3: Limit the size and/or frequency of individual limit increases

- 4.18** The credit card industry has proposed new best practice standards on unsolicited limit increases, which will be enforced by the Lending Standards Board. These standards would commit lenders to:
- Provide customers with clear and transparent written notification of an unsolicited limit increase by means of a specific communication;
 - Make clear that consumers have the option to decline a new limit;

- Make clear that consumers have the option to notify their lender that they would actually prefer the credit limit to be reduced;
- Make it as convenient as possible for customers to advise their card lender of their preference;
- Fully assess whether a customer is likely to be able to manage a higher credit limit, with reference to all the information available to them;
- Not increase a borrower's limit more than once every 6 months;
- Ensure that staff are able to explain to customers, on request, why they have had their limit increased and the options available to them.

4.19 The Government welcomes the submission of these proposals by the UK Cards Association on behalf of the credit card industry. However, in their current form these proposals do not go far enough. The commitment not to increase a customer's limit more than once every six months is unlikely to benefit many consumers; few consumers currently have their limits increased more frequently than this. To be meaningful this proposal would have to contain a commitment to genuinely reduce the frequency of limit increases. If a longer time period were adopted, it would be desirable to also limit the size of any single limit increase to a maximum proportion of the existing credit facility to mitigate any risk of lenders offering larger increases to compensate for the fact that they could offer them less frequently.

4.20 The Government has significant concerns that this approach taken alone would not give borrowers any greater direct control over the decision to take on a larger credit limit. Consumer groups have also expressed concern that in order to have simpler systems, lenders might apply these limitations to consumer requests for higher limits as well as lender-initiated increases, which could limit consumers' ability to request a higher limit if, say, they were going on holiday or wanted to make a one-off large purchase. The Government calls on the credit and store card industry to explain what they believe the benefits of this option are over other possible approaches.

38. Would limits on the frequency and/ or size of credit limit increases be sufficient to address the issues in this area?

39. What would be appropriate limits? Who should set them?

40. Under this approach, how could consumers' ability to request a new increase be preserved?

41. What might be the cost to lenders of implementing this change? What might be the longer term cost?

Option 4: Ban all unsolicited limit increases – increases only to be given in response to a specific consumer request

- 4.21** Under this proposal, consumers would only be granted access to additional credit if they make a positive request for a higher limit (and of course subject to a proper affordability assessment by the lender). Lenders would be precluded from giving or offering customers pre-approved limit increases, but could promote the fact that customers can request a higher limit. The requirement to make such a request would mean that limits would only be increased where consumers had actively made a decision that they wished to be able to borrow more, away from the sales environment. Consumers could also stipulate the amount of additional credit that they would like, consistent with their ability to repay.
- 4.22** Lenders argue that this approach would undermine lending to higher risk consumers, for whom a “low and grow” strategy would be much harder to successfully operate because of the problem of “adverse selection”.⁴⁷ Card lenders argue that if not enough “good” low and grow customers were to ask for a higher limit, this form of lending could become unprofitable. This is because they rely on the ability to increase the limits of the overwhelming majority of low and grow customers; starting balances on these products are typically too low to make a profit (even at quite high interest rates) because of the fixed and other costs of running a credit card account. Lenders therefore argue that there is a risk under this option that they would no longer lend to high risk consumers, who might then take out other less appropriate forms of credit.
- 4.23** In addition to the consequences for low and grow lenders, this option could lead to lenders offering higher limits at the outset to mainstream customers (assuming that it would be consistent with statutory requirements and the OFT’s Irresponsible Lending Guidance to do so). Although consumer groups support a ban on unsolicited limit increases, some have expressed concern that this might prevent lenders from temporarily extending a consumer’s limit in response to a consumer briefly going over their limit by a small amount by accident or where they have had to use their card in an emergency. In this circumstance the consumer would be likely to incur a default charge or could have their transaction declined. Consideration would have to be given, therefore, to whether a ban could be implemented in a way that would protect consumers from incurring default charges if they accidentally go over their limit by a few pounds.
- 4.24** Lenders have also stated that if a ban were applied to existing as well as new customers, profitability would decline. This is because lenders will have set the price and terms of their contracts with existing customers in the expectation that

⁴⁷ Statistically, consumers who actively request more credit on their cards are currently more likely to default than others. This is because, in a world where limits are generally increased unilaterally, when a customer actively asks for more credit, this can be a sign of financial difficulties which is not evident to the card company. This means that lenders are more likely to refuse increased limits to consumers who proactively request them.

they would be able to increase their limits over time if they were creditworthy and appeared likely to use a higher limit. If those customers do not actively seek and take advantage of higher limits they will be unable to recover the expected value for that customer and will have effectively under-priced the card. They believe that they would make losses and would be forced to recoup this lost revenue, and revenue lost through an overall reduction in new lending, from other sources such as higher interest rates or fees and charges. Some lenders whose business model relies heavily on low and grow have said that they might see their profitability so compromised that they may choose to exit the market altogether.

4.25 The Government recognises the importance of ensuring that access to credit on reasonable terms is maintained for those who want to borrow and can afford to do so. However, it is important that when they borrow consumers are placed in the best possible position to make responsible choices and to manage their finances effectively. Where there is evidence that industry practice is balanced against the interests of consumers, particularly the most vulnerable, we cannot fail to take strong action. The Government therefore calls on card companies to submit evidence in support of their arguments.

- 42. Do you have evidence that consumers who apply for a credit limit increase are a significantly worse credit risk than consumers that do not?**
- 43. Should lenders be banned from offering unsolicited limit increases? Should a ban apply to all consumers?**
- 44. What do you believe would be the benefits and risks to consumers? How severe are any risks?**
- 45. What might be the cost to lenders of implementing this change? What might be the longer term cost?**
- 46. How could a ban be implemented in a way which minimises unintended impacts on both consumers and lenders?**

Option 5: Allow consumers to opt in to receiving unsolicited limit increases

4.26 An alternative response would be to allow consumers to opt in to receiving unsolicited limit increases. An opt-in could work in two ways. Consumers could be required to opt in to each individual offer of a higher limit by lenders or there could be a provision for consumers to opt in to unsolicited limit increases at the time they enter into their agreement.

- 4.27** Under the first approach, lenders could still offer limit increases on an unsolicited basis but could only apply the new limit if and when the customer positively consents to it. This approach would give consumers control over individual limit increases and would help them to make a responsible borrowing decision before taking on a bigger card facility, whilst preserving lenders' ability to market credit and make new offers to existing customers.
- 4.28** Lenders argue that even on this option the risk of adverse selection would be significant enough to undermine low and grow lending, leading to some of the consequences spelled out above. However, others have argued that this approach may be viable for low and grow products where there is a strong incentive for consumers to respond; so take up rates from "good" as well as "bad" customers might be expected to be higher.
- 4.29** Lenders have also stated that they may need to offer higher limits at the outset because of concerns that consumers would not opt in to higher limits through inertia. However, the Government would not expect any lender to offer more credit than a consumer could afford; indeed, to do so would be in breach of legal requirements. Furthermore, measures could be taken to ensure that it is convenient for consumers who want a higher limit to exercise their right to opt in, for example by providing a freephone telephone number, a tear-off slip and pre-paid envelope, or by making it possible to opt in to a higher limit online.
- 4.30** The second approach would be to give consumers the ability to opt in to receiving unsolicited limit increases at the outset of the agreement. Under this option, consumers who choose not to opt in at the outset should be able to do so at a later stage should their preferences change, and likewise those who have opted in to unsolicited limit increases should be able to inform their lender that they no longer wish to receive them at a later date. Some consumer representatives have gone further, calling for a more flexible approach, whereby consumers would be granted a wider range of choices about how their limits will be managed and changed at the outset of their contract. For example, consumers could be granted the right to set their own limit at the outset (within the bounds of what lenders were prepared to lend). If they chose to receive unsolicited limit increases, they could also decide their frequency. Consumers could also, if desired, set a maximum amount beyond which they did not wish their credit limit to ever be raised. These decisions would be taken at the time an agreement is entered into, but customers would be able to change the way their limits were determined during the life of the agreement if they chose.
- 4.31** An opt-in at the outset would reduce the number of individual decision points for consumers. Consumers would be required to make a decision at the point at which they entered into an agreement so the risk that they did not receive desired limit increases because of inertia or difficulties in contacting their lender would

be minimised. This option would also be considerably less costly to introduce. However, opting in at the outset would mean that consumers did not make decisions about each individual limit increase in light of their circumstances at the time, which could have changed significantly. Consumers might not be in a position to predict at the outset how their personal circumstances may change in future. They may also not focus sufficiently on this aspect when entering into the agreement, given the mass of other information presented to them.

- 4.32** Moreover, consumers might be concerned that expressing a reluctance to accept unsolicited limit increases at the application stage could limit their chances of being approved. Indeed, consumers who are unwilling to accept limit increases on an unsolicited basis may well be less profitable for lenders and therefore more likely to be declined a card as a result. It might, however, be possible to introduce appropriate safeguards to ensure that lenders could not discriminate against borrowers who choose not to opt in, for example, making clear that a decision to opt in could only be taken when a consumer is activating their card after they have been accepted.
- 4.33** Whilst the fully flexible approach would give consumers total control over how their limits should be changed, there are risks that this would lead to excessive complexity for both consumers and lenders, who would have to develop IT systems which could accommodate a wide range of possible permutations. For store cards, the fully flexible approach could lead to additional complications as the application will be handled by the staff of the relevant retailer who may lack the expertise to fully explain to prospective borrowers what their options are. Some consumers may find it difficult to understand these at the outset, particularly if there are a number of different options.
- 4.34** The Government calls on stakeholders to submit further evidence on the likely impact of this approach, in particular its implications for low and grow lending and access to credit.

- 47. To what extent do you think that an 'opt-in' model for credit limit increases would rectify the problems identified in relation to unsolicited credit limit increases?**
 - 48. What might be the unintended consequences of this option, including the implications for low and grow lending?**
 - 49. Should consumers be required to opt in to each individual increase or to all increases?**
 - 50. How could an opt-in be implemented so that consumers would not harm their chances of getting the card they want?**
 - 51. Could a fully flexible approach be made to work?**
 - 52. What might be the cost to lenders of implementing this change? What might be the longer term cost?**
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- 53. Of the 5 options for the reform of unsolicited credit limit increases, which do you prefer?**

Chapter 5: Re-pricing of existing debt

INTRODUCTION

- 5.1** Interest rates on credit and store cards can change over time, reflecting the fact that they are open-ended products. This applies both to rates for future spending and to rates charged on existing balances. Broadly, lenders change interest rates in two ways. First, rates are altered as a result of changes in the cost to the lender of providing credit to all consumers, such as increases in the cost of funds for the lender. Generally, these rate changes are applied across a whole portfolio. Some lenders only do this form of “re-pricing”. Most of the largest credit and store card companies also alter interest rates in response to changes in the “risk cost” of serving a particular consumer or group of consumers because of changes in the perceived risk that those consumers will default (“risk-based re-pricing”).⁴⁸ Risk-based re-pricing can result in consumers’ interest rates falling, as well as rising, where the perceived risk of default for a consumer or group of consumers falls.
- 5.2** The risk that someone will default is significantly influenced by individual consumer behaviour, for example, previous defaults, how a credit limit is utilised, number of cash advances, information from the credit reference agencies (including information about the consumer’s borrowing commitments with other lenders) and how other products by the same lender are used. Where behaviours are statistically associated with consumers not meeting their payments, lenders may assign a higher risk score to all customers who behave in a similar way. The lender cannot know why a consumer has behaved in a particular way and whether they genuinely do pose a higher risk; their decision is based on the fact that customers who have behaved this way in the past have been more likely to default.
- 5.3** Some lenders will periodically review a consumer’s risk of default and decide whether an account should be re-priced (up or down). Other lenders will use a recognisable event as a trigger for an automatic increase, such as two late payments in the last 12 months.

WHAT IS THE PROBLEM?

- 5.4** A year ago, the Government became increasingly concerned that consumers were having their interest rates dramatically increased on existing balances without adequate explanation. In some cases consumers’ interest rates were doubled with little prior warning, ostensibly due to risk-based re-pricing.
- 5.5** The Government took swift action to address these concerns and called a Credit Card Summit in November 2008. Following the summit, credit card and store card lenders produced a Statement of Fair Principles which stated that they will:

⁴⁸ Some credit and store card providers do not operate risk-based re-pricing.

- Give consumers at least 30 days' notice of any increase in the interest rate paid on a credit or store card if it is being changed as a result of risk-based re-pricing;
- Give consumers the option to close their account and repay the balance at the existing interest rate, within a reasonable period;
- Not increase a borrower's interest rate for the first 12 months that a card is held; or more often than once every 6 months after that;
- Explain why an interest rate has been increased, if consumers ask; and
- Offer an alternative product (if there is one available) at an equivalent or lower rate of interest.

5.6 The Statement of Fair Principles also undertakes that credit and store card lenders will not increase a borrower's rate where:

- Consumers have failed to make the last two consecutive minimum monthly payments;
- Consumers have already agreed a repayment plan for the account; or
- The credit or store card company has been told by a not-for-profit debt advice agency that consumers are discussing a repayment plan with them.

5.7 All credit card and store card lenders signed up to this Statement of Principles, which they applied from 1 January 2009.⁴⁹

5.8 Reports from the Financial Ombudsman Service have indicated that the Government's swift intervention and industry's response in establishing the Statement of Principles has led to a marked decrease in the very worst examples of re-pricing, with the volume of complaints received by the Financial Ombudsman Service falling. It would appear that rate rises have been more limited in scale and at least one lender has instituted a freeze on risk-based increases, which would suggest that the Statement of Principles put a ceiling on the very worst behaviour.

5.9 However, the Government is concerned that industry self-regulation may be failing to protect some consumers from unjustifiable interest rate rises on existing debt, and that risk-based re-pricing is still not sufficiently transparent.

5.10 There is limited evidence of take up of the option introduced in the Fair Principles to close credit card accounts and repay balances at existing rates. Initial evidence from the industry suggests that the majority of consumers who are subject to a re-price are choosing (albeit passively) to remain with their current lender and have their existing debt re-priced at a higher rate of interest. This could be due to the desire of consumers to maintain their relationship with their credit card lender. The fact that consumers have to make a positive choice to close their account

⁴⁹http://www.theukcardsassociation.org.uk/best_practices/-/page/681/

may also have an impact on the low levels of take up, either because of inertia or because consumers may not find it easy to contact their lender. Other consumers may be choosing not to opt out of their relationship with their existing lender, but rather to pay off their balance (even at a higher rate) and maintain their card without any further spending. Some consumers may have limited scope to switch to other products.

- 5.11** There is more that could be done to improve the way risk-based re-pricing is explained to consumers. Price increases are seen by consumers in the context of falling base rates and falling rates on other products. Whereas consumers can generally understand how a change in the interest rate on their savings account or their mortgage relates to changes in the base rate, interest rate increases on credit cards can be unpredictable and poorly explained. Consumers do not always understand the reason why they have been subject to a re-price and what they can do to improve their price. It is vital that consumers who have their rate increased understand their options and what a decision to accept the new price or reject it and pay off their debts will mean for them.
- 5.12** We need to look at whether the Fair Principles give consumers sufficient information, meaningful options and time to make the right choices. But we also need to make sure that risk-based re-pricing happens for the right reasons and is fair to consumers. We are concerned that lenders may be using risk-based re-pricing in order to shore up their profitability following the financial crisis, rather than in response to genuine changes in consumer risk. This would mean that some borrowers (usually those who can least afford it) are unfairly shouldering a greater share of lenders' increased costs. Consumer groups report incidences of re-pricing in the absence of an obvious increase in risk. Inadequate explanations of why a consumer's interest rate has been increased only exacerbate this perception. For consumers who have used their cards responsibly and never missed a payment over the years, there is understandable anger that they feel they may be paying the price for excessive risk-taking by financial institutions. It may be necessary therefore to define more clearly what factors can be considered legitimate justifications for risk-based re-pricing.
- 5.13** Finally, there is a question of whether any re-pricing of existing debt is unfair in principle and whether consumers should have greater certainty that debt they incur at a particular interest rate should not become significantly more expensive later on. The US CARD Act prohibits the re-pricing of existing debt, except in certain circumstances.⁵⁰ While default re-pricing (where an interest rate is increased if a consumer defaults on a repayment) is permitted in the US, risk-based re-pricing for other reasons (such as repeated use of cash advance facilities)

⁵⁰ These include the expiration of promotional rates, an increase in index for variable rate accounts, and default re-pricing (where an interest rate is increased if a consumer defaults on a payment).

is prohibited. In contrast, the Fair Principles in the UK commit lenders not to raise rates where the customer has missed two consecutive payments or is in financial difficulty.

Discussion of options

- 5.14** Any re-pricing of existing debt must be justified, proportionate and transparent. There are a number of possible options to achieve this outcome:
1. Maintain the Statement of Principles, if sufficient evidence shows that this has removed consumer detriment in this area;
 2. Further measures to provide consumers with better information about risk-based re-pricing decisions;
 3. Define the factors that it would be fair for lenders to take into account when changing an individual's price on grounds of risk;
 4. Limit the size and/or frequency of existing debt re-pricing;
 5. Prohibit re-pricing of existing debt.

Option 1: Maintain the Statement of Principles

- 5.15** This option would maintain the status quo, with lenders continuing voluntarily to follow the Statement of Principles. If we are to accept that current industry self-regulation has been sufficiently effective, we will need to see evidence of how consumer detriment has been reduced as a result of its first year of operation. A key element of the current consultation is to collect and assess this evidence.
- 5.16** This option would have the least impact on lenders, but would not address concerns that consumers are still suffering detriment from risk-based re-pricing. It may be that the Statement of Principles could be enhanced by placing them on a statutory footing to ensure that tougher enforcement action could be taken against any lenders who fail to apply the rules properly, or by extending some of the principles to provide additional protection, for example requiring a longer notification period.

- 54. The Government would welcome further evidence of whether or not the Statement of Principles has been effective. In particular, we would welcome evidence since November 2008 of:**
- **Trends in re-pricing activity by lenders and the impact of the Statement of Principles on the scale and nature of re-pricing activity;**
 - **Whether consumers are aware of their choices under the Statement of Principles and able to exercise them effectively;**
 - **How consumers have chosen to exercise their choice following a re-price (e.g. take up of the option to pay down their balance at the existing price, take up of alternative products, switching);**
 - **The extent to which consumers understand risk-based re-pricing and the explanations provided to them by lenders;**
 - **Volume of complaints on re-pricing (received by lenders, consumer groups or FOS) and the nature of those complaints;**
- 55. Should the Statement of Principles be placed on a statutory footing? Should the Statement of Principles be extended, for example, by requiring a longer notification period?**

Option 2: Further measures to provide consumers with better information about risk-based re-pricing decisions

- 5.17** The Statement of Principles currently provides that credit card lenders will explain why an interest rate has been increased on the basis of individual risk if a consumer requests this. As a minimum, lenders could increase transparency by proactively providing an explanation to consumers alongside any notification of a rate increase or decrease.
- 5.18** One way of achieving this might be to provide a detailed explanation of how a re-priced consumer's cost of credit is calculated, perhaps breaking down the cost of credit into components relating to wholesale re-pricing and re-pricing linked to consumer risk and setting out the sort of factors which contribute to a lender's assessment of individual risk. This could help consumers to understand why their price had gone up or down.
- 5.19** Transparency measures that could also help might include a standardisation (along best practice lines) of how re-pricing is communicated to consumers, setting out

information to help consumers behave in ways that would improve their future price.

5.20 An important aspect of this type of measure would be that consumers would have more information, and in turn be able to exert more pressure on lenders, to reduce price when they clearly have demonstrated improved credit behaviour or personal circumstances.⁵¹ The concern that risk-based pricing is only a one-way street would therefore be tackled. This approach might also have the consequence that lenders would come under pressure to re-price only as a result of clearly identifiable changes in the individual consumer's risk, as risk-based approaches which cannot make that clear link would be harder to explain.

5.21 This could be supported by measures implementing the Consumer Credit Directive. These will require lenders to provide adequate explanations about the cost of credit and how the agreement will operate. Such explanations could include details of how risk pricing operates and why rates may change.

- 56. How could transparency on risk-based re-pricing be improved? At what stage would it be most appropriate to provide additional information (e.g. pre-contract, monthly statements, when customer requests)?**
- 57. How could measures to improve transparency be balanced against the risk of information overload?**
- 58. What might be the cost to lenders of implementing this change? What might be the longer term cost?**
- 59. Do you think that increased transparency around changes to interest rates would be sufficient to address problems reported by consumers?**

Option 3: Define the factors that it would be fair for lenders to take into account when changing an individual's price on grounds of risk

5.22 Improved transparency may help to ensure that lenders only apply individual risk-based interest rate increases in circumstances where they can explain to consumers that they have legitimate reasons for doing so. However, this approach leaves the onus on individual consumers to switch lenders or seek redress if they feel that they have been subjected to an unfair increase. In practice, this might leave those consumers with low levels of financial capability or limited alternatives unprotected from unjustified re-pricing. Greater transparency would also not directly resolve the debate about what constitutes unfair re-pricing, leaving this

⁵¹ Providing consumers are able and willing to switch if the lender does not re-price.

down to the Financial Ombudsman Service or the courts to consider on a case by case basis.

5.23 An alternative approach may be to define the circumstances in which it would be considered fair to change an individual's price on grounds of risk. This approach could provide greater clarity and certainty for both consumers and lenders. A definition of the factors that lenders can legitimately take into account when changing a consumer's price on the basis of risk would provide a clear benchmark against which the Financial Ombudsman Service (FOS) and consumer groups could assess complaints from individual consumers. It would need to be developed in consultation with both lenders and consumers and be flexible enough to respond to developments in credit scoring and modelling techniques.

5.24 The OFT's current draft Irresponsible Lending Guidance includes, as an example of an unfair lending practice:

"Varying interest rates where there is no objective basis for doing so. For example, variable rates should not be misused to take advantage of a borrower's lack of ability to end the agreement or the restrictions on him doing so such as redemption charges. Objective reasons would include:

- *the recovery of genuine increased costs in lender funding or*
- *a quantifiable change in the risk presented by a borrower such as to justify a change in the interest rate.*

*In the OFT's view, it would be disproportionate to increase the interest rate applied to a borrower solely on the basis that the borrower had missed a single repayment or had failed to pay in full on more than one occasion."*⁵²

60. Should there be a list of the factors that lenders can take into account when changing an individual's price on grounds of risk?

61. Who should decide what those factors are?

62. How could such a definition be made flexible enough to adapt to future changes?

63. What are the possible unintended consequences of this approach?

Option 4: Limit the size and/or frequency of existing debt re-pricing

5.25 There are already voluntary limits on the frequency of risk-based re-pricing contained in the Statement of Principles. This could be expanded (and possibly placed on a statutory basis) with a commitment that any rate increases (both risk-based and wholesale) would be no more than a certain amount and/or by setting a maximum frequency for interest rate increases. The maximum size of an increase

⁵² Paragraph 6.13 of the draft OFT Guidance

could be a set proportion of the existing rate (e.g. any individual increase should add no more than a third of the current rate) or a set absolute amount (e.g. 5 percentage points)

- 5.26** This would improve transparency and make rate rises more predictable for consumers, helping them to better manage their borrowing. However, it may be more appropriate to ensure that any rate increases are objectively justifiable rather than potentially artificially capped at a specified percentage ceiling, which could unduly constrain pricing decisions.
- 5.27** Any restriction on a lender's ability to re-price existing debts will reduce the lender's ability to respond to changing economic circumstances or changes in consumers' risk profiles. Lenders might respond by charging a higher price for all consumers at the outset. This could result in the supply of credit to vulnerable consumers becoming prohibitively costly. In addition, restrictions on re-pricing could limit the potential benefits to consumers who might otherwise have seen their interest rates lowered as a result of risk-based re-pricing.

- 64. Should there be limitations on the size of any interest rate increase on existing debt? What should these be?**
- 65. Should there be further limitations on the frequency of interest rate increases? What should these be?**
- 66. What effects might these limitations have on consumers?**
- 67. How might lenders react to these limitations?**
- 68. What might be the cost to lenders of implementing this change? What might be the longer term cost?**

Option 5: Prohibit re-pricing of existing debt

- 5.28** Prohibiting the re-pricing of existing debt would follow the model set by the US CARD Act.⁵³ This option could either be a complete ban on any re-pricing of existing debt, or a more specific prohibition on risk-based re-pricing. A complete ban would mean that consumers would have certainty when they borrowed money on a credit card that their interest rate on that debt would not change at all, while a targeted prohibition on risk-based re-pricing would give greater transparency and predictability to any change. This would not prevent lenders charging different rates for new debt.

⁵³ Although see above for differences in the UK and US systems.

- 5.29** A targeted ban could be achieved by limiting the circumstances in which lenders could re-price existing debt to general movements in the cost of funds or base rates. It would remove the risk of lenders making arbitrary changes to the price of debt that had already been incurred.
- 5.30** Either form of ban on re-pricing could lead to confusion for consumers: as different elements of the debt (incurred at different times) may become subject to several different rates, and the starting rate across the board would be very likely to increase. Lenders would face a variable risk profile, but would be constrained by a fixed income stream, so would be likely to charge more for initial borrowing. If this were combined with measures to reverse the way payments are currently allocated (see Chapter 2), the availability of cheap introductory offers may be severely curtailed. As in the previous option, the availability of credit to high risk consumers is likely to be severely curtailed, leading them to seek alternative, possibly more detrimental, forms of borrowing. This option also presents major systems implications for lenders.

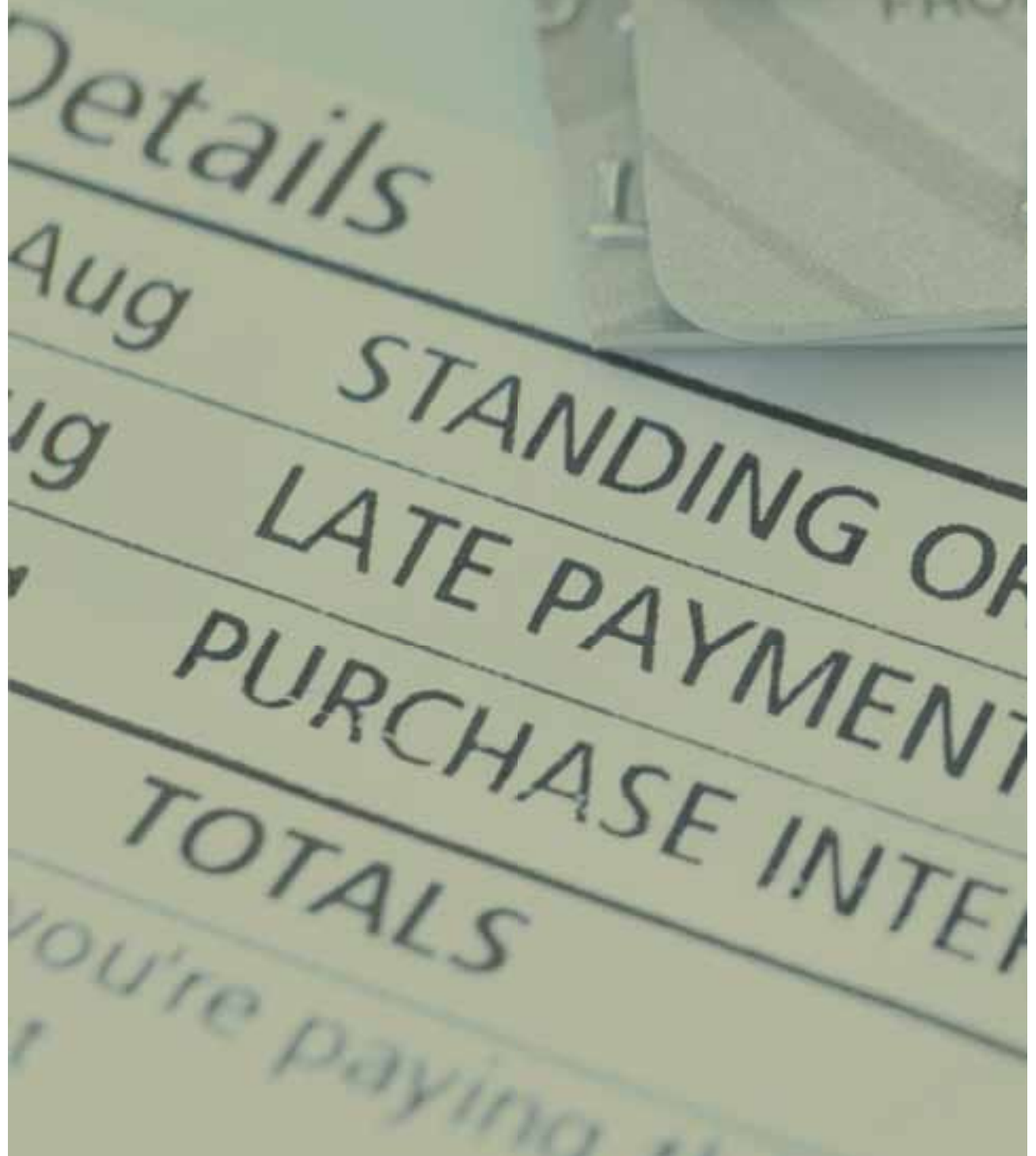
69. What effect might a ban on re-pricing of existing debt have on consumers?

70. How might lenders react to such a ban?

71. What might be the cost to lenders of implementing this change? What might be the longer term cost?

72. Of the 5 options for tackling the re-pricing of debt which do you prefer?

Chapter 6: Simplicity and Transparency



INTRODUCTION

- 6.1** The complexity of credit and store cards and the difficulty consumers face in understanding precisely how they work and how to make best use of their card is a theme that runs through all of the four issues we have explored so far. This complexity and opacity not only risks consumers making poor choices and incurring greater debts and interest charges; it also has a detrimental effect on competition in the market, making it harder for consumers to compare different cards effectively.
- 6.2** This chapter examines whether, in addition to the options outlined in chapters two to five, measures to provide consumers with better information or the provision of a simple “stakeholder” product could help to restore consumer confidence and trust in credit and store cards and promote competition.

GIVING CONSUMERS BETTER INFORMATION

- 6.3** There have been significant improvements in regulation requiring greater transparency for credit and store cards in recent years. Treasury Select Committee investigations into credit cards in 2003 and 2004 led to the enhancement of summary boxes on pre-contractual material and their introduction in periodic statements, bringing together key terms and conditions of the card in one place.⁵⁴ The Consumer Credit Act 2006 led to new requirements on monthly statements for credit and store cards, including a warning about the consequences of making only the minimum payment. The Competition Commission Store Cards Order 2007 also required store card lenders charging an APR (annual percentage rate of charge) of 25% or more to include in statements a warning that customers could access cheaper forms of credit through other means.
- 6.4** The Consumer Credit Directive builds on these measures by introducing the Standard European Consumer Credit Information (SECCI) form, which will provide a single consistent summary of the key features of unsecured lending products, including credit and store cards and personal loans, to be given to consumers before they enter into an agreement. In addition, the regulations implementing the Consumer Credit Directive, which are expected to be finalised by the end of the year and will come into force in June 2010, will require lenders to provide customers with an adequate explanation (including an oral explanation where appropriate) of the key features of the product and the risks associated with it before an agreement is entered into.
- 6.5** These provisions amount to a considerable strengthening of pre-contractual transparency requirements, ensuring that customers have the information they

⁵⁴ Summary boxes were recently updated to ensure that consistent terminology is used by all lenders and information is presented in ways consumers find easier to understand. This followed the OFT Credit Card Comparisons Report in February 2008: http://www.of.gov.uk/shared_of/reports/financial_products/oft978.pdf

need to make a responsible decision about taking on a new credit product and to assess whether the product is appropriate for their needs at the time they enter into a new agreement. However, they do not help consumers to understand how they could use an existing card more responsibly or save money on their card borrowing by changing the way they use it or moving to another provider. Monthly statements provide some key information, but there are limits to how much information can be meaningfully provided in a printed form on statements; it is likely that the inclusion of additional information could lead to overload and could be simply ignored by consumers.

- 6.6** The Government believes more can be done to provide consumers with the information they need, in ways they find easy to understand, at a time they can make best use of it. More can also be done to take advantage of the opportunities offered by technology to present information in ways that are tailored to the needs and preferences of individual consumers.
- 6.7** In addition to improving the information given to consumers by individual banks and lenders about their products and the accounts they hold with that institution, the Government believes it is important to give consumers impartial information and guidance they need to choose products and manage products effectively throughout their lifetime. In the paper “Reforming Financial Markets”, HM Treasury recently announced its intention to roll out a national Money Guidance service, currently being piloted in the North West and North East of England under the Moneymadeclear brand, from spring 2010. The service will offer impartial, sales-free information and guidance on all kinds of money issues online, over the phone and face to face; guidance will be tailored to an individual’s needs and circumstances.
- 6.8** The Consumer White Paper “A Better Deal for Consumers” published in July announced that, subject to consultation and feasibility, an online credit card comparison tool will be added to the Moneymadeclear website, the online strand of the Money Guidance service. This comparison tool will help consumers to make informed decisions about which credit card would suit their needs depending on the way they expect to use their card.
- 6.9** Better information from their current lender about how they have used their existing card would enable consumers to get the most out of the tailored individual advice provided to them by the impartial Money Guidance service. This information would also be useful for those who wish to seek independent financial advice from reputable commercial providers. The Government therefore considers that there may be benefits in providing consumers with an annual statement about their credit and store card usage, showing, for example:
- how much they have spent on their card over the year;
 - total repayments over the year;

- the amount of net borrowing/repayment;
- number of days they have borrowed (i.e. number of days they have held an interest-bearing balance on their card);
- average amount borrowed;
- average cost as an APR equivalent;
- total cost for credit;
- fees and charges incurred.

6.10 This approach would complement recent commitments agreed by banks and building societies covering 95% of the UK personal current account market and the OFT to provide similar annual cost summary to current account holders which will help them to focus on the value they are getting in a similar way to annual car or house insurance renewal quotes.⁵⁵ Consumers could be given a summary of the costs of their credit card in the form of an annual “e-statement” from which data could be exported into easy to use programmes (for example, the non-commercial credit card comparison tool on Moneymadeclear) so that consumers could easily input data about their actual usage to check whether their current product offers a good deal and help them shop around for other suitable products.

- 73. The Government invites views from stakeholders on ways to give consumers better information about credit and store cards.**
- 74. Would an annual statement be beneficial to consumers? Should it be provided to all consumers or only to a subset of consumers? What information should be included in such a statement?**
- 75. Could such a statement be provided in a consistent, portable electronic format? What would be the costs of providing such a statement? How could we ensure that consumers without internet access also benefited?**
- 76. How would this approach fit with the other policy options discussed?**

Simpler card lending products

6.11 Whilst many consumers welcome and benefit from additional features like promotional rates and reward schemes, for some the sheer complexity of card products presents a barrier to using their card with confidence, even with better information.

⁵⁵ http://www.ofc.gov.uk/advice_and_resources/resource_base/market-studies/current/personal/pca/

- 6.12** Some stakeholders have suggested that it may be possible to design a basic, cheap and accessible credit card product that consumers could use with confidence. This sort of product might be particularly well-suited to consumers who are new to credit or who have had difficulties managing credit in the past. Card companies, however, have questioned whether such a basic product could be designed without removing the flexibility that distinguishes cards from other forms of unsecured borrowing and whether a card of this type could be made profitable.
- 6.13** Another option is a benchmarking or labelling system whereby all card products could be assessed against a set of agreed standards. The system could require lenders to indicate the implications for the consumer of a particular feature where it might have an adverse impact for the consumer compared to the benchmarked standard. Such a system could allow freedom over product design while guiding those people who would be best served by a basic product in the right direction. People who wished to take advantage of other features would be able to choose more complex options, but the labelling system could ensure that they do so knowing the implications compared to cheaper and simpler alternatives.
- 6.14** In the paper “Reforming Financial Markets” published in July this year, the Government announced further analysis on these issues, which will include working with the FSA and other stakeholders, with a view to exploring the issues and developing potential solutions in order to undertake a more detailed consultation.⁵⁶ That work will focus as a priority on core financial products for all consumers.
- 6.15** Statutory rules on the advertising and marketing of credit are harmonised across the European Union through the revised Consumer Credit Directive, which comes into force in June 2010. Any additional legal requirements on the labelling of credit and store cards would therefore need to be developed and agreed with our European partners. UK lenders could, however, follow the example of major supermarkets and food manufacturers, which have worked with the Food Standards Agency to implement a voluntary labelling scheme. The Government invites views on whether a next phase of its work on simple, transparent products should examine the scope for such a system in the area of credit and store cards.

⁵⁶ www.hm-treasury.gov.uk/reforming_financial_markets.htm

- 77. Would a “stakeholder” card lending product with basic and accessible features be beneficial to consumers? What might such a card look like?**
- 78. What would be the costs to lenders of offering such a card?**
- 79. Is there merit in considering a standardised labelling system for credit and store cards? Could this be taken forward on a voluntary basis pending revised EU legislation?**
- 80. How would this approach fit with the other policy options discussed?**

Chapter 7: What happens next?

- 7.1** Following the receipt of responses to this consultation on the review of the credit and store card market by 19 January 2010, we will publish a Government response to the consultation by 20 April 2010. Any proposal for legislative change will be for the next Parliamentary session and will undergo further consultation. If legislation is taken forward, it will be subject to a Post-Implementation Review, which would be undertaken 3 to 5 years after implementation.

Annex A: List of Consultation Questions

CONSULTATION DOCUMENT

Chapter 1: Introduction

1. The Government calls on consultees to submit evidence about the current nature of the UK credit and store cards markets, including in particular:
 - The incidence of multiple credit card use, particularly among the most indebted consumers;
 - The use of personal credit cards for business purposes by the owners of small firms;
 - The consumer experience of using credit cards and dealing with their lenders; and
 - The profitability of credit card lending and the impact of the economic downturn on both consumers and lenders.

Chapter 2: The allocation of payments

Option 1: Do nothing beyond current legislative and regulatory activity

2. We would welcome evidence on the extent of consumer understanding of the order of payment allocation and its implications.
3. Will the implementation of the Consumer Credit Directive, combined with OFT guidance, provide sufficient consumer protection in this area?

Option 2: Improve information transparency on the allocation of payments

4. How could the allocation of payments be made more transparent for consumers?
5. What effect is improved transparency likely to have on consumer behaviour? Would it sufficiently address consumer detriment?
6. What might be the cost to lenders of implementing this change? What might be the longer term cost?

Option 3: Allocate repayments proportionally to debts incurring different interest rates

7. What effect might this option have on consumers?
8. How might lenders react to a requirement to allocate repayments on a proportional basis?

9. What might be the cost to lenders of implementing this change? What might be the longer term cost?
10. Are there alternative ways of structuring repayments which would be preferable?

Option 4: Allocate repayments to the most expensive debt first

11. What effect might this option have on consumers?
12. How might lenders react to a requirement to allocate repayments to the most expensive debt first?
13. What might be the cost to lenders of implementing this change? What might be the longer term cost?

Option 5: Allow consumers to pay off cash advances first

14. What effect might this option have on consumers?
15. How might lenders react to a requirement to allow consumers to pay off cash advances first?
16. What might be the cost to lenders of implementing this change? What might be the longer term cost?
17. Of the 5 options for reform of the allocation of payments, which do you prefer?

Chapter 3: Minimum payments

Option 1: Do nothing beyond current legislative and regulatory activity

18. Will the implementation of the Consumer Credit Directive, combined with OFT guidance, provide sufficient consumer protection in this area?

Option 2: Improve information transparency on minimum payments

19. What information on minimum payments would be the most useful to consumers and how often could it be provided?
20. What effect is improved transparency likely to have on consumer behaviour? Would it sufficiently address consumer detriment?
21. What might be the costs to lenders of implementing this change? What might be the longer term cost?

Option 3: Set a recommended minimum payment

22. Should there be a recommended minimum payment?
23. How could the recommended minimum payment be set?
24. What might be the unintended consequences of a recommended minimum payment? How might it impact on consumer repayment behaviour?

25. What might be the costs to lenders of implementing this change? What might be the longer term cost?

Option 4: Increase the minimum payment

26. Should the minimum payment increase?
27. On what basis should an increase in minimum payment be set?
28. How many consumers would be affected by an increase in the minimum payment, for example, if it were raised to 5%? How many of these consumers would be unable to meet these higher repayment levels? How many consumers holding balances on more than one credit card are likely to be affected?
29. Should an increase in the minimum payment apply to all consumers or to a subset of consumers?
30. What might be the costs to lenders of implementing this change? What might be the longer term cost?
31. What evidence do you have about the impact of previous reductions or increases in the level of minimum payments on cardholders?
32. Of the 4 options for the reform of minimum payments, which do you prefer?

Chapter 4: Unsolicited limit increases

Option 1: Do nothing beyond current legislative and regulatory activity

33. What evidence do you have that unsolicited credit limit increases are not associated with financial difficulties?
34. Will the implementation of the Consumer Credit Directive, combined with OFT Guidance, provide sufficient consumer protection in this area?

Option 2: Improve information transparency on unsolicited credit limit increases

35. How could information about credit limits be made clearer and more accessible to consumers?
36. What particular information do you think would be most effective in encouraging cardholders to be more proactive in managing their credit limit?
37. What might be the cost to lenders of implementing this change? What might be the longer term cost?

Option 3: Limit the size and/ or frequency of individual limit increases

38. Would limits on the frequency and/ or size of credit limit increases be sufficient to address the issues in this area?
39. What would be appropriate limits? Who should set them?

- 40. Under this approach, how could consumers' ability to request a new increase be preserved?
- 41. What might be the cost to lenders of implementing this change? What might be the longer term cost?

Option 4: Ban all unsolicited limit increases

- 42. Do you have evidence that consumers who apply for a credit limit increase are a significantly worse credit risk than consumers that do not?
- 43. Should lenders be banned from offering unsolicited limit increases? Should a ban apply to all consumers?
- 44. What do you believe would be the benefits and risks to consumers? How severe are any risks?
- 45. What might be the cost to lenders of implementing this change? What might be the longer term cost?
- 46. How could a ban be implemented in a way which minimises unintended impacts on both consumers and lenders?

Option 5: Allow consumers to opt in to receiving unsolicited limit increases

- 47. To what extent do you think that an 'opt-in' model for credit limit increases would rectify the problems identified in relation to unsolicited credit limit increases?
- 48. What might be the unintended consequences of this option, including the implications for low and grow lending?
- 49. Should consumers be required to opt in to each individual increase or to all increases?
- 50. How could an opt in be implemented so that consumers would not harm their chances of getting the card they want?
- 51. Could a fully flexible approach be made to work?
- 52. What might be the cost to lenders of implementing this change? What might be the longer term cost?
- 53. Of the 5 options for the reform of unsolicited credit limit increases, which do you prefer?

Chapter 5: Re-pricing of existing debt

Option 1: Maintain the Statement of Principles

- 54. The Government would welcome further evidence of whether or not the Statement of Principles has been effective. In particular, we would welcome evidence since November 2008 of:

- Trends in re-pricing activity by lenders and the impact of the Statement of Principles on the scale and nature of re-pricing activity;
- Whether consumers are aware of their choices under the Statement of Principles and able to exercise them effectively;
- How consumers have chosen to exercise their choice following a re-price (e.g. take up of the option to pay down their balance at the existing price, take up of alternative products, switching);
- The extent to which consumers understand risk-based re-pricing and the explanations provided to them by lenders;
- Volume of complaints on re-pricing (received by lenders, consumer groups or FOS) and the nature of those complaints;

55. Should the Statement of Principles be placed on a statutory footing? Should the Statement of Principles be extended, for example, by providing a longer notification period?

Option 2: Further measures to provide consumers with better information about risk-based re-pricing decisions

56. How could transparency on risk-based re-pricing be improved? At what stage would it be most appropriate to provide additional information (e.g. pre-contract, monthly statements, when customer requests)?

57. How could measures to improve transparency be balanced against the risk of information overload?

58. What might be the cost to lenders of implementing this change? What might be the longer term cost?

59. Do you think that increased transparency around changes to interest rates would be sufficient to address problems reported by consumers?

Option 3: Define the factors that it would be fair for lenders to take into account when changing an individual's price on grounds of risk

60. Should there be a list of the factors that lenders can take into account when changing an individual's price on grounds of risk?

61. Who should decide what those factors are?

62. How could such a definition be made flexible enough to adapt to future changes?

63. What are the possible unintended consequences of this approach?

Option 4: Limit the size and/or frequency of interest rate increases on existing debt

- 64.** Should there be limitations on the size of any interest rate increase on existing debt? What should these be?
- 65.** Should there be further limitations on the frequency of interest rate increases? What should these be?
- 66.** What effects might these limitations have on consumers?
- 67.** How might lenders react to these limitations?
- 68.** What might be the cost to lenders of implementing this change? What might be the longer term cost?

Option 5: Prohibit re-pricing of existing debt

- 69.** What effect might a ban on re-pricing of existing debt have on consumers?
- 70.** How might lenders react to such a ban?
- 71.** What might be the cost to lenders of implementing this change? What might be the longer term cost?
- 72.** Of the 5 options for tackling the re-pricing of debt, which do you prefer?

Chapter 6: Simplicity and Transparency

Annual e-Statement

- 73.** The Government invites views from stakeholders on ways to give consumers better information about credit and store cards.
- 74.** Would an annual statement be beneficial to consumers? Should it be provided to all consumers or only to a subset of consumers? What information should be included in such a statement?
- 75.** Could such a statement be provided in a consistent, portable electronic format? What would be the costs of providing such a statement? How could we ensure that consumers without internet access also benefited?
- 76.** How would this approach fit with the other policy options discussed?

Simpler card lending products

- 77.** Would a “stakeholder” card lending product with basic and accessible features be beneficial to consumers? What might such a card look like?
- 78.** What would be the costs to lenders of offering such a card?

- 79.** Is there merit in considering a standardised labelling system for credit and store cards? Could this be taken forward on a voluntary basis pending revised EU legislation?
- 80.** How would this approach fit with the other policy options discussed?

EQUALITY IMPACT ASSESSMENT QUESTIONS

Context

1. Do you have any further evidence on how the use of credit and/or store cards varies amongst different groups of consumers (e.g. older people, younger people, ethnic minorities, people with disabilities or long term health conditions, single parents, households on low income etc)?
2. Do you have any evidence of any barriers to take-up and use of credit and/ or store cards amongst different groups of consumers?

Chapter 2: The allocation of payments

3. Do you have any evidence on how the use of the cash withdrawal facility in credit cards varies amongst different groups of consumers?
4. To what extent does it matter if cash withdrawal from a credit card becomes more difficult? Is this more of an issue for some groups of consumers?
5. Are there any other equality issues we need to consider in this area?

Chapter 3: Minimum payments

6. Would certain groups of consumers benefit more from a recommended minimum payment than others?
7. Do you have any evidence as to how an increase in the minimum payment could impact different groups of consumers?
8. Are there any other equality issues we need to consider in this area?

Chapter 4: Unsolicited limit increases

9. Do you have any evidence as to whether certain groups of consumers might be disadvantaged by a ban of unsolicited credit limits?
10. Are there any specific equality issues we need to bear in mind when considering an opt-in model for credit limit increases?
11. Are there any other equality issues we need to consider in this area?

Chapter 5: Re-pricing of existing debt

12. Do you have any evidence as to whether certain groups of consumers are more vulnerable to interest rate re-pricing?
13. What are the relative merits and disadvantages of a ban on re-pricing for different groups of consumers?
14. Are there any other equality issues we need to consider in this area?

Chapter 6: Simplicity and Transparency

- 15.** Are there any specific groups of consumers for which an e-statement would not be useful?
- 16.** Are there any other simplicity and transparency measures that you think we should consider that would be of particular value for certain groups of consumers?

Annex B: Glossary

Allocation of Payments	The method whereby any credit or store card payment from a consumer is allocated to different elements of the debt attracting different interest rates or charges.
APACS Card Payment Group	The predecessor to the UK Cards Association.
Balance transfer deals	A balance transfer deal allows consumers to transfer some of their debts from another card and pay the sum off at a reduced interest rate (often 0%) for a set period of usually between 3 and 14 months. After this period ends, the balance will usually attract the standard variable rate of interest.
Banking Code	This is a voluntary code that sets standards of good banking practice for financial institutions (including credit card issuers) to follow when they are dealing with consumers in the UK. It is supervised by the Banking Code Standards Board. The provisions of the Banking Code which relate to credit cards will become part of the Lending Code from 1 November 2009.
Banking Code Standards Board	This body supervises the Banking Code. It will be succeeded by the Lending Standards Board from 1 November 2009.
Base Rate	This is now officially called the bank rate. It is the main interest rate in the economy, set by the Bank Of England, upon which other rates are based.
Credit Card	A card issued by banks, retailers and other financial institutions that allows the card holder to make purchases on credit. A credit limit is established on an individual basis and interest is charged on the outstanding balance.
Credit Card Summit	This took place in November 2008 and was chaired by the Consumer Minister and attended by all key players in the credit and store card market. They agreed a statement of Fair Principles, which governs how and when they will change a customer's interest rate when their individual risk profile alters.

Credit Limit	The maximum amount a consumer can spend on a credit or store card.
Credit Reference Agency	Credit reference agencies provide lenders with information about potential borrowers, which they then use to make lending decisions. The information shared may include information about a borrower's previous credit history. They hold certain information about most adults in the UK. This information is called your credit reference file or credit report.
Consumer Credit Directive	The Consumer Credit Directive is EU legislation that must be implemented by all EU countries by June 2010. It aims to create a common credit market across the EU and to ensure high levels of consumer protection.
Finance and Leasing Association	The Finance & Leasing Association is the leading trade association for the asset, consumer and motor finance sectors in the UK. Its members include banks, building societies, finance houses, credit and store card providers, motor finance companies and asset finance and leasing companies.
Financial Ombudsman Service	The Financial Ombudsman Service is a public body set up by Parliament. It is the official independent expert in settling complaints between consumers and businesses providing financial services.
Financial Services Authority	The Financial Services Authority is the main City regulator whose job is to protect investors' interests.
Irresponsible Lending Guidance	This draft Guidance was launched for public consultation by the OFT in August 2009. The consultation closed on 21 October 2009 and the OFT will issue the final Guidance in early 2010. The Guidance will provide guidance on lending behaviours and practices which the OFT considers to be irresponsible and would call into consideration a firm's fitness to hold a consumer credit licence.
The Lending Code	The Lending Code replaces the Banking Code from 1 November 2009. It includes all the key credit related provisions in the existing Banking Code. It will also include the fair principles on risk based re-pricing agreed by lenders at the Credit Card Summit.

The Lending Standards Board	This succeeds the Banking Code Standards Board from 1 November 2009. It will supervise the Lending Code.
Member State	A Member State is any one of the 27 sovereign states that are members of the European Union.
Minimum Payment	The minimum amount that a consumer must pay on the outstanding debt on their credit or store card each month.
Office of Fair Trading (OFT)	The OFT is the UK's consumer and competition authority. Its mission is to make markets work well for consumers. It is a non-ministerial Government department. It administers and enforces the Consumer Credit Act and licenses credit and store card providers.
Risk based re-pricing	This is the practice by which interest rates are altered in response to changes in the "risk cost" of serving a particular consumer or group of consumers.
Self-regulation	This is the practice whereby regulation is not imposed by Government, but is undertaken voluntarily by industry.
UK Cards Association	The UK Cards Association is a trade body that represents credit, debit and charge card issuers.
US CARD Act 2009	The Credit Card Accountability Responsibility and Disclosure (CARD) Act 2009 is a federal law passed by the United States Congress and signed by President Barack Obama on May 22, 2009. It is comprehensive credit card reform legislation that aims to establish fair and transparent practices relating to the extension of credit under an open end consumer credit plan, and for other purposes.
uSwitch	uSwitch.com is an online and phone based comparison and switching service that provides comparisons on a range of services including gas, electricity, home phone, broadband providers and personal finance products.

Annex C: List of Organisations Receiving Consultation

LIST OF ORGANISATIONS RECEIVING CONSULTATION

Advertising Association
Advertising Standards Authority
Advice UK
Age Concern
Association of Finance Brokers (AFB)
Association of Independent Financial Advisers (AIFA)
American Express
Arab Bank plc
Association of British Credit Unions Ltd (ABCUL)
Auriemma Consulting Group
Banco Santander
Bank of England
Bank of Ireland
Banking Code Standards Board
Barclaycard
Bar Council
Berwin Leighton Paisner LLP
Britannia Building Society
British Bankers Association (BBA)
British Chambers of Commerce
British Cheque Cashier Association (BCCA)
British Retail Consortium (BRC)
C Hoare & Co
Callcredit Ltd
Capital One
Cattles plc
Chelsea Building Society
Church Action on Poverty
Citigroup
Citizens Advice
Citizens Advice for Scotland
City of London Law Society
Communities and Local Government
Community Development Finance Association (CDFA)

Competition Commission
Confederation of British Industry (CBI)
Consumer Council for Northern Ireland
Consumer Credit Association (CCA)
Consumer Credit Counselling Service (CCCS)
Consumer Credit Trade Association (CCTA)
Consumer Finance Association (CFA)
Consumer Focus
Consumer Focus Scotland
Consumer Focus Wales
Co-operative Bank
Council of Mortgage Lenders
Coventry Building Society
Credit Action
Credit Services Association (CSA UK)
Debt Resolution Forum
Debt Management Standards Association (DEMISA)
Department for Food, Environment and Rural Affairs
Department for Work and Pensions
Department of Enterprise, Trade and Investment Northern Ireland
Elavon
Equality and Human Rights Commission
Equifax
European Commission
European Credit Research Institute (ECRI)
Experian
Federation of Small Businesses (FSB)
Finance and Leasing Association (FLA)
Financial Markets Law Committee
Financial Services Authority (FSA)
Financial Services Consumer Panel
Financial Ombudsman Service (FOS)
Forum of Private Business
Help the Aged
HM Treasury
HSBC
Information Commissioner's Office (ICO)
Insolvency Service
Institute of Credit Management (ICM)
Institute of Directors (IOD)
Joseph Rowntree Foundation
Laser UK

Law Society
Law Society of Scotland
Local Authorities Coordinators of Regulatory Services (LACORS)
Local Better Regulation Office (LBRO)
Lovells
Lloyds Banking Group
MBNA
Mind
Ministry of Justice
Money Advice Liaison Group
Money Advice Trust
Money Advice Scotland
Moneysavingexpert.com
Moneysupermarket.com
National Australia Group
Nationwide Building Society
Northern Bank
Northern Ireland Assembly Government
Northern Ireland Insolvency Service
Northern Ireland Office
Northern Rock
Office of Fair Trading
Provident Financial plc
Royal Association for Disability Rights (RADAR)
Rethink
Royal Bank of Scotland
SAGA
Scotland Office
Scottish Government
Standard Chartered
Tesco Personal Finance
Trading Standards Institute (TSI)
Trades Union Congress (TUC)
UK Cards Association
UK Card Services Ltd
University of Bristol Personal Finance Research Centre
University of York
Vanquis Bank Ltd
Wales Office
Welsh Assembly Government
Which?

Annex D:

Code of Practice on Consultations

1. Formal consultation should take place at a stage when there is scope to influence policy outcome.
2. Consultation should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Consultation exercise should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

COMMENTS OR COMPLAINTS

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

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London
SW1H 0ET

Telephone Tunde on 020 7215 0412
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