

MS14/6.2: Annex 2

Market Study

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# Credit Card Market Study

Interim Report: Annex 2 – How credit card products are regulated

November 2015

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## Consumer credit regulation

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1. Credit cards are regulated under the Consumer Credit Act 1974 (CCA), the Payments Services Regulations 2009 and our Consumer Credit Sourcebook (CONC). CONC contains rules transposed from Office of Fair Trading (OFT) guidance, including the Irresponsible Lending Guidance, as well as CCA provisions that have been repealed and replaced by FCA rules. The FCA is under a duty to review and provide a report to HM Treasury on the retained CCA provisions before 1 April 2019.<sup>1</sup>
2. Some of the CCA and CONC provisions implement the Consumer Credit Directive (CCD) which is a maximum harmonisation measure in a number of key areas, such as advertising, pre-contract information, information in credit agreements and APR calculation. The Directive also requires Member States to introduce domestic measures in relation to pre-contract explanations and creditworthiness assessments, but allows some discretion in these areas.
3. Of particular importance is the requirement – which applies to all regulated credit agreements – to give pre-contract credit information in a standardised form (the SECCI) together with an adequate explanation, focusing on the key costs and risks of the credit. The intention is to enable the consumer to assess whether the product is suitable and affordable, how much it could cost and what could happen if things go wrong, to facilitate understanding and shopping around. The CONC rules<sup>2</sup> stipulate minimum content of the explanation in the case of credit cards.
4. If a credit advertisement indicates an interest rate or cost figure this triggers the requirement to provide standardised information in the form of a representative example, including a representative APR. The representative APR must be an APR at or below which at least 51% of consumers entering into agreements as a result of the advertisement are expected to pay. The representative APR is also triggered in other circumstances, for example if the advertisement includes comparative information or is aimed at consumers who consider their access to credit restricted.
5. For credit cards,<sup>3</sup> the APR of a given product is calculated by assuming that the credit limit is drawn down in full on the first day of the agreement and repaid in 12 equal monthly instalments with no further transactions. If the credit limit is not known at the advertising or pre-contract stage, it is assumed to be £1,200, unless it is known that the credit limit will be less than this.
6. CONC also sets out a number of provisions formerly contained in OFT guidance, which apply specifically to credit cards (and store cards). These provisions originate from commitments given by credit/score card issuers to Government, which were subsequently reflected in industry codes and OFT guidance. For example:
  - Firms are required to allocate repayments to the debt subject to the highest rate of interest.<sup>4</sup>
  - Firms must not, other than where a promotional rate of interest ends, increase the rate of interest on a credit card where the consumer is two or more payments

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<sup>1</sup> Articles 20 and 21 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2014, S.I. 2014/366. The review is as to whether “the repeal (in whole or in part) of provisions of the Consumer Credit Act 1974 would adversely affect the appropriate degree of protection for consumers.”

<sup>2</sup> In particular, CONC 4.2.5R and 4.2.15R(1).

<sup>3</sup> CONC Appendix 1.2.5R.

<sup>4</sup> CONC 6.7.4R.

- in arrears, has agreed a repayment plan with the firm or is in serious discussions with a debt adviser with a view to a debt management plan.<sup>5</sup>
- Firms must set minimum repayments for credit cards entered into since 1 April 2011 at an amount that covers at least the interest, fees and charges that have been applied to the account plus one percentage of the amount outstanding.<sup>6</sup>
  - The consumer must have the option to pay any amount they choose (at or above the minimum) when making automated repayments,<sup>7</sup>
  - Firms must not increase, or offer to increase, the credit limit if the consumer is at risk of financial difficulties or has indicated that he does not wish to have any credit limit increases (or declines an offer of an increase).<sup>8</sup>
7. CONC 7 includes rules concerning arrears, default and recovery. These include the requirement on firms to have policies and procedures, for example for customers that fall into arrears,<sup>9</sup> the requirement to treat customers in default or in arrears difficulties with forbearance and due consideration,<sup>10</sup> the requirement to suspend active pursuit of a debt for a reasonable period where the customer informs the firm that a repayment plan is being developed,<sup>11</sup> and the requirement not to impose default charges which are higher than necessary to recover a firm's reasonable costs.<sup>12</sup>
8. The retained CCA provisions also contain a number of important consumer protections with regards to credit cards. One of the best known is set out in section 75 of the CCA, and provides that the credit card issuer is jointly and severally liable for any breach of contract or misrepresentation by the retailer or trader concerning specified credit agreements where the cash price is over £100 and not more than £30,000. In practice this allows consumers to claim money back from their credit card company where, for example, a shop goes out of business before it is able to deliver the paid-for goods.
9. Sections 83 and 84 of the CCA set out consumers' liability for unauthorised transactions. There is a limit of £50 liability for unauthorised transactions made before the card issuer is notified where the card has been lost or stolen. There is no limit on the consumer's liability for transactions made prior to notification of the card issuer where the card has been used by an individual who had the card with the cardholder's consent. Where the card details are used to make a purchase where the consumer does not need to be present, such as online, and the consumer still has the card in their possession, they will not be liable for any losses.
10. In 2003 the OFT began an inquiry into the 'default charges' levied by credit card companies when, for example, a cardholder exceeded their credit limit, or where they forgot to make the minimum monthly payment. The investigation was carried out in light of the Unfair Terms in Consumer Contracts Regulations. In its 2006 report,<sup>13</sup> the OFT said that many of these default charges were unlawful. It stated that it would act upon receiving notice of any charge over £12 as a penalty, unless

<sup>5</sup> CONC 6.7.10R.

<sup>6</sup> CONC 6.7.5R.

<sup>7</sup> CONC 6.7.6R.

<sup>8</sup> CONC 6.7.7R and 6.7.8R.

<sup>9</sup> CONC 7.2.1R.

<sup>10</sup> CONC 7.3.4R, CONC 7.3.5G provides examples of what forbearance may include.

<sup>11</sup> CONC 7.3.11R.

<sup>12</sup> CONC 7.7.5R.

<sup>13</sup> OFT, *Calculating fair default charges in credit card contracts – a statement of the OFT's position* (2006): [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/284445/oft842.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284445/oft842.pdf)

there were exceptional business factors at play. Whether or not an individual charge constituted a penalty fee would be for a court to ultimately determine.

11. The Payments Services Regulations 2009 (PSRs) set out, for example, requirements for information to be provided by payment service providers concerning payment transactions, including in relation to framework contracts, such as a credit card agreement. Certain provisions of the PSRs are disapplied for regulated credit agreements in favour of CCA provisions, for example, concerning proposed changes to the terms of the framework agreement. The PSRs also set out detailed provisions on authorisation of payment transactions, again some of which are disapplied for regulated credit agreements in favour of CCA provisions. The PSRs implement the Payment Services Directive, which is a maximum harmonisation measure.

## Interchange Fee Regulation

12. Interchange fees have been the subject of competition law investigations and regulatory scrutiny at European and national levels for many years (domestically and internationally).<sup>14</sup>
13. On 29 April 2015 the European Parliament and the Council of the European Union adopted the Interchange Fee Regulation (IFR), which was published in the Official Journal of the European Union on 19 May 2015.<sup>15</sup> Provisions within the IFR take effect on different dates, notably the introduction of interchange fee caps on 9 December 2015 and most of the provisions relating to business rules on 9 June 2016.
14. The IFR will affect interchange fee arrangements in the UK for both credit and debit cards. The default interchange fee cap set in the IFR is 0.2% of the value of the transaction for debit cards and 0.3% for credit cards.
15. The IFR provides for national discretions in two key areas:
  - Member States can decide to implement lower caps on interchange fees for domestic card transactions than the caps in the IFR and, for debit cards, Member States may choose to apply a weighted average interchange fee until 9 December 2020; and/or
  - Member States can, based on an assessment of market shares, exempt three-party card systems that operate with licensee issuers or acquirers from the IFR until 9 December 2018.
16. In the UK, these decisions are for HM Treasury. Following consultation, HM Treasury announced on 8 October 2015<sup>16</sup> its decision to:
  - Take no further action in respect of the interchange fee caps on domestic credit card transactions but to apply a weighted average approach to domestic debit card transactions; and
  - Grant three-party card systems that operate with licensee issuers or acquirers the time-limited exemption from the domestic interchange fee caps as long as the value their annual transactions is less than 3% of all card-based transactions in the UK.

<sup>14</sup> In the UK, the CMA closed its competition law investigations into MasterCard and Visa's domestic interchange fee arrangements on 6 May 2015 on the grounds of administrative priorities in light of the IFR soon coming into force. (<https://www.gov.uk/government/news/cma-closes-mastercard-and-visa-investigations-following-eu-regulation>).

<sup>15</sup> European Parliament & European Council, *Regulation (EU) 2015/751 on interchange fees for card-based payment transactions* (2015): [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2015.123.01.0001.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.123.01.0001.01.ENG)

<sup>16</sup> HM Treasury, *Interchange fee regulation: consultation response* (2015): [www.gov.uk/government/consultations/interchange-fee-regulation](http://www.gov.uk/government/consultations/interchange-fee-regulation)

17. In addition, HM Treasury is responsible for designating one or more competent authorities under the IFR. On 8 October 2015, HM Treasury announced its decision to designate the PSR as the overarching authority that is empowered to supervise and enforce compliance with the IFR. HM Treasury also decided to assign a role to the FCA, where certain provisions of the IFR overlap with the FCA's role as supervisor under the Payment Services Regulations 2009.
18. Since the regulation of interchange fees and card payment systems more generally falls within the purview of the PSR, we do not focus on these issues in any great detail, although the implications of an interchange fee cap is reflected in our analysis.<sup>17</sup>

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<sup>17</sup> A programme of work is being carried out by the PSR to develop its policy position on card payment systems. The purpose of this programme of work is to: develop the PSR's understanding of card system fees and how they may be affected by reactions to the IFR; build its understanding of the provisions on business rules and functional separation included in the IFR and their potential impacts; develop its policy for monitoring compliance with and enforcing the IFR, subject to it being designated as a competent authority; and gather information on other possible concerns parties may have relating to indirect access to card payment systems, transparency of information and the decision making process, governance and how service users' interests are represented in decision making in card systems. For more information on the PSR's programme of work, see the PSR's Policy Statement of March 2015 and its Indicative Policy Work Programme for 2015/16, available at: <https://www.psr.org.uk/psr-publications/policy-statements/policy-statement-151> and <https://www.psr.org.uk/psr-publications/annual-plans-and-reports/policy-work-programme-2015-16>. In June 2015, the PSR published a Call for Input as the first stage in its programme of work. See: <https://www.psr.org.uk/psr-publications/consultations/cards-call-for-input>

