Financial Conduct Authority

Market Study MS14/6.1

Credit card market study: terms of reference

November 2014

Contents

Annex

We are asking for comments on the scope of the market study as set out in this terms of reference by 5 January 2015.

You can send them to:

Patricia Bascunana-Ambros
Competition Department
Policy, Risk & Research Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Email: creditcardmarketstudy@fca.org.uk

We make all responses available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this terms of reference from our website: www.fca.org.uk.

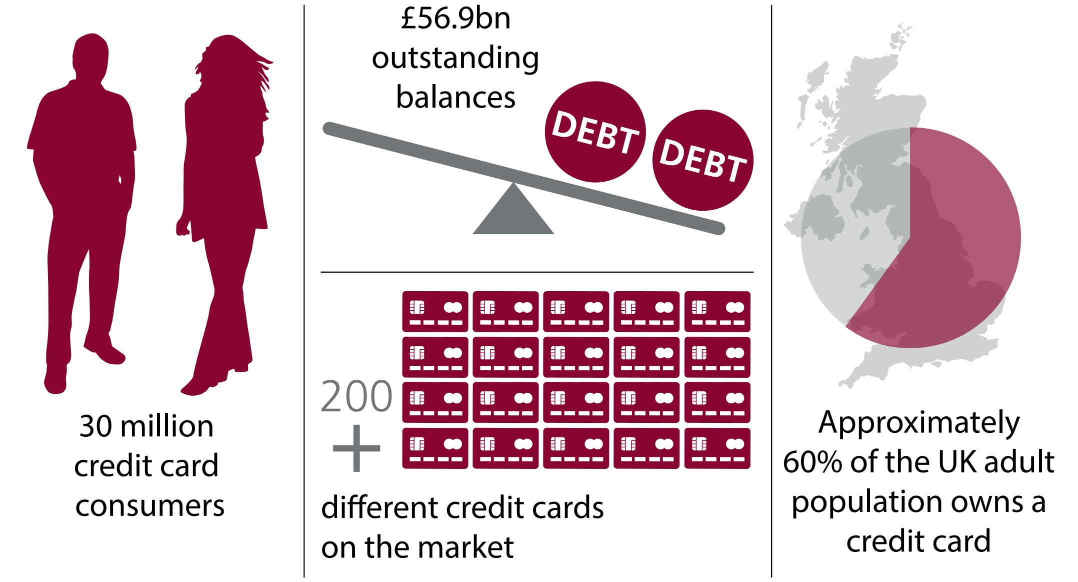
Abbreviations used in this paper

APR	Annual Percentage Rate
BBA	British Bankers' Association
BIS	Department of Business, Innovation & Skills
BTs	Balance transfers
CCA	Consumer Credit Act 1974
CCD	Consumer Credit Directive
CONC	Consumer Credit Sourcebook
CP	Consultation paper
EU	European Union
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
HCSTC	High-cost short-term credit
ICB	Independent Commission on Banking
MIF	Multilateral interchange fee
OFT	Office of Fair Trading
PCA	Personal current account
PCWs	Price comparison websites
PSR	Payment Systems Regulator
SME	Small and medium-sized enterprises

1.
Executive summary

1.1 We took over regulation of consumer credit in April 2014. The credit card market is now one of the largest areas of unsecured lending under our remit. There are currently around 30 million credit card consumers[1] that together account for an estimated £56.9 billion of outstanding credit card balances.[2] Credit cards remain a particular feature of the UK payment sector compared with the rest of Europe, with the UK Cards Association estimating that more than 70% of EU credit cards are held by British consumers.[3]

Scale of UK market



1.2 Before taking on the regulation of consumer credit, we carried out work to improve our understanding of these markets, including the credit card market. While we found that the market appeared to be working well for many consumers, we also had some significant concerns.

1.3 Although there are a range of firms and some people do shop around and switch, competition may not always be working in the best interests of consumers. For a variety of reasons, consumers may not be choosing or using a credit card that best meets their needs. Competition may be focused on particular card features that may not represent long-term value or sustainability. Those paying interest on balances may be paying more than they realise or expected. Some

1 https://assets.digital.cabinet-office.gov.uk/media/534ea933e5274a3774000005/The_UK_Cards_Association_response_to_competition_between_PDLs_and_other_credit_providers_WP.pdf
2 www.theukcardsassociation.org.uk/wm_documents/Quarterly%20Market%20Trends%20Q1%202014.pdf
3 UK Cards Association 'Annual Report' 2014, pg 8

consumers use up their credit limits quickly or repeatedly make minimum payments without considering how they will repay their credit card debt. A proportion of consumers may also be over-borrowing and taking on too much debt, and there are signs that some issuers may profit more from higher risk borrowers (by which we mean customers at greater risk of credit default).

1.4 With the launch of this credit card market study we intend to build up a detailed picture of the market and assess the potential issues we have identified. We plan to focus on credit card services offered to retail consumers by credit card providers including banks, mono-line issuers and their affinity and co-brand partners.

1.5 Although we will consider credit cards both as a borrowing and payment mechanism, we intend to focus primarily on the use of credit cards as a means of revolving credit given that this is where many of our initial concerns lie. We will consider related products (such as debit cards, other payment methods including store cards/charge cards and other unsecured lending), to the extent that they affect the credit card market but they are not an area of focus in their own right.

1.6 We anticipate that the level of interchange fees and the regulation of card payment systems will fall within the purview of the newly established Payment Systems Regulator, so we do not propose to focus on these issues in depth. We will, however, consider, the possible implications of the proposed interchange fee cap on the evolution of the credit card market.

1.7 Based on our current understanding of how the credit card market works, we have identified three main areas we would like to explore as part of the market study:

- the extent to which consumers drive effective competition through shopping around and switching
- how firms recover their costs across different cardholder groups and the impact of this on the market
- the extent of unaffordable credit card debt; in particular whether some consumers are over-borrowing or under-repaying on their balances and whether firms have incentives to provide unaffordable lending that leads to consumer detriment

1.8 We will also consider whether particular concerns arise in distinct parts of the credit card market, such as in the higher risk consumer segment.

1.9 New entrants wanting to issue credit cards face a number of barriers, however rates of new entry into this market over time look reasonable. On this basis barriers to entry is a secondary focus for the study, although we are interested in hearing from any stakeholders who do have particular concerns in this regard.

1.10 The themes we have identified here are starting points, not conclusions, and we will explore them further during the course of the market study. We are interested in stakeholders' views on these or any other issues in the credit card market and we welcome feedback on any aspect of this terms of reference. Please respond with any comments on the scope of the market study by 5 January 2015 to creditcardmarketstudy@fca.org.uk. We will be engaging with stakeholders on the substance of the issues set out in this document in due course.

2. Introduction

Why are we conducting a credit card market study?

2.1 We took over the regulation of consumer credit in April 2014, which brought around 50,000 consumer credit firms, active in a diverse range of markets, into the FCA's financial regulation. In 2013/14, we carried out work to improve our understanding of several sectors, including credit cards. The credit card market was naturally a focus because it touches the lives of many consumers (around 30 million) who together currently owe £56.9bn.

2.2 Credit cards have many useful functions, for example they allow people to cover unexpected costs, they are widely accepted and secure and, for certain purchases, provide more protection for consumers than alternative payment methods. While we found that the market appears to be working well for many consumers, we found areas that we needed to look at in more detail. In relation to consumers we found that: [4]

- a significant number of consumers appear to have a limited understanding of how to manage spending on their credit cards in a sustainable way
- repeated direct mail, pre-filled card applications and credit cards being sold as part of packaged bank accounts, lead some consumers to take out credit cards with little or no shopping around
- consumers who do shop around focus on one or two features (0% balance transfers, reward schemes, APR) and may not form a rounded view of value for money

2.3 In relation to firms and their offers we found that:

- there are a range of issuers, such as banks, mono-line issuers (firms that only provide credit cards) and issuers that primarily target those higher risk customers with a weak credit history
- there is strong competition for certain consumer groups, particularly those seeking 0% balance transfers
- interest seems to generate the most revenue for credit card issuers
- interchange fees appear to be used to pay for rewards (an interchange fee is paid by the merchant acquirer to the card issuer when the cardholder makes a payment)
- most cards have a complex combination of features

4 www.fca.org.uk/firms/firm-types/consumer-credit/consumer-credit-research/credit-cards

2.4 In April 2014 we published these findings, highlighting the following concerns:

- Credit cards provide a free service for many, but the market may not be working well for certain groups of customers – for example, over-borrowing on credit cards may be a significant problem for some consumers.
- There are a range of behavioural factors at play that may lead consumers not to choose or use cards in a way that best meets their needs – for example, consumers find the multiplicity of credit card features confusing and focus on one or two features when making their selection, there is also evidence that certain consumers select a credit card without considering alternative products, e.g. when responding to direct mail or pre-filled credit card application forms.
- Consumers paying interest on balances may be paying more than they realise or expected. They may also be subsidising users for whom card usage is free.
- Some consumers tend to use up credit limits quickly, repeatedly making minimum payments and not considering how they will repay their credit card debt.
- A proportion of consumers may be using credit cards unsustainably and taking on too much debt.

2.5 In light of this, in our *Business Plan 2014/15*[5] we announced our intention to launch a market study into credit cards to build our knowledge of this market and assess these concerns. The market study will identify what, if any, action we may take. During the course of the market study we will engage with industry stakeholders, as well as consumers, representative bodies (both consumer and industry) and Government departments.

2.6 Although we are not formally consulting on the proposed scope of the market study we welcome feedback on any aspect of the terms of reference. In particular we welcome any views that parties may have on the concerns we have identified, including evidence that such concerns are not well-founded.

Our objectives

2.7 Under the Financial Services and Markets Act 2000 (FSMA), we have a strategic objective of ensuring that ‘the relevant markets’ function well: the relevant markets include the financial markets and the markets for regulated financial services.[6] We also have three operational objectives to[7]:

- secure an appropriate degree of protection for consumers
- protect and enhance the integrity of the UK financial system
- promote effective competition in the interests of consumers

5 www.fca.org.uk/static/documents/corporate/business-plan-2014-2015-interactive.pdf
6 Section 1B(2) FSMA.
7 See sections 1B(3)(c)), 1E(1) FSMA. It also has the operational objectives of consumer protection and integrity: see sections 1B, 1C and 1D of FSMA.

2.8 As well as promoting effective competition in the interests of consumers, we also have a duty to promote effective competition when using our general functions to advance our consumer protection and market integrity objectives.

2.9 Although we use market studies as a key investigative tool for examining competition issues in the markets we regulate, our approach also takes into consideration our consumer protection and market integrity objectives. Consistent with our approach to market studies in general, we will have regard to all our objectives when conducting the credit card market study and if we find that the market could be made to work better, we have a range of powers to introduce appropriate remedies. For further information, please refer to our guidance on the approach we take to advancing our objectives.[8]

8 www.fca.org.uk/static/documents/fca-approach-advancing-objectives.pdf

3.
Overview of the credit card market

History of credit cards

3.1 Credit cards are payment cards that allow the cardholder to pay for goods or services on credit up to an agreed limit, to withdraw cash and transfer balances. There are now 59 million cards in issue in the UK.[9]

3.2 Barclays issued the first UK credit card ('Barclaycard') in 1966,[10] followed by Natwest, Midland, Lloyds and RBS in 1972 through the Joint Credit Card Company under the name 'Access'.

3.3 Until 1976, when the government allowed cards to offer extended credit, customers were required to pay their card balances in full each month.

3.4 The credit card market remained focused around two providers – Barclaycard and Access – throughout the 1980s. However, the Building Society Act 1986 enabled building societies to compete with high street banks and offer their own credit cards. Subsequently, TSB, the Halifax, Leeds Permanent and the National and Provincial offered Visa credit cards and the number of credit cards available increased.

3.5 Between 1990 and 2010 the credit card market expanded significantly again as new providers entered the UK market, such as Capital One, Citibank, Egg, Smile and MBNA. Furthermore, credit card business models began to change as cards were issued by non-bank mono-line firms. According to the Independent Commission on Banking (ICB), there were 34 new entrants between 2000 and 2010.[11]

3.6 The take up of credit cards grew rapidly in the UK and, according to APACS, by 1999 half of UK adults held a credit card.[12] By 2013, on average there were more than two credit cards held per cardholder in the UK.[13]

3.7 Cards issued for affinity or co-brand partners developed rapidly in the 1990s. These cards typically involved issuing credit cards with the brand of a charity, membership group or commercial business alongside the brand of the card issuer. Revenues derived from such cards were shared between the affinity or co-brand partner and the card issuer.

3.8 Over the same period, card issuers increasingly used loyalty or incentive programs to incentivise card sales and increase the value of purchases by cardholders. Since 1990 there has been a reduction in the number of cards requiring an annual fee.

9 www.bba.org.uk/news/press-releases/july-2014-credit-card-market/.
10 APACS '40th birthday of the credit card' http://faculty.ksu.edu.sa/ALFURAIH/Credit%20Card%20Fraud/anniversary.pdf.
11 Independent Commission on Banking, Final Report p.321-322. A new entrant was defined as a firm with no market share in 2000 that subsequently gained any market share or share of new business. The report acknowledges there is some uncertainty in the precise figures. Note that the figure does not delineate between issuers and affinity partners.
12 UK Cards Association 'UK Card Payments 2014'.
13 Ibid.

3.9 The UK Cards Association reported that the industry realised “reasonable returns” until 2007 but only broke even between 2007 and 2009. By 2010 they report that the credit card market was “largely unprofitable” due to increasing bad debts and regulation[14], indicating that the profitability of the credit card business reflects the stage of the economic cycle.

3.10 At the end of 2013, the UK Cards Association reported that there was £56.9bn outstanding in credit card balances, of which approximately £34bn incurs interest, £23bn does not.[15] The credit card market is now one of the largest areas of unsecured lending under our remit.

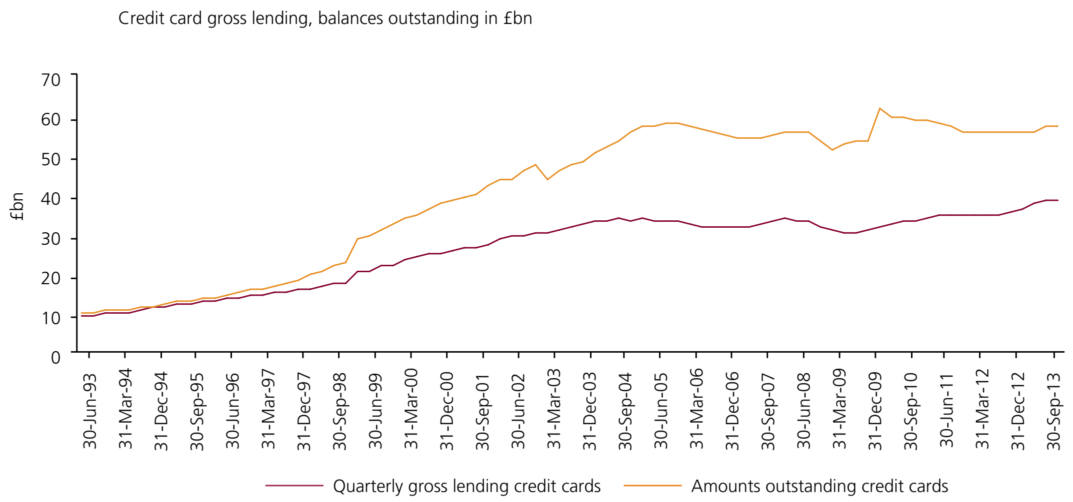
3.11 Credit cards remain a much greater feature of the UK payment sector than in the rest of Europe with the UK Cards Association estimating that more than 70% of EU credit cards are held by British consumers.[16]

Lending trends

3.12 Bank of England data shows that gross and net lending have begun to rise again after the financial crisis.

3.13 Figure 1 illustrates that in the mid-1990s quarterly gross lending[17] and the amount outstanding on credit cards were aligned. However, they began to diverge in 1997 and the amount outstanding began to significantly exceed gross lending, so there was a significant expansion of credit and less was being paid back than lent out.

Figure 1 – Credit card gross lending and balances outstanding (1993-2013)



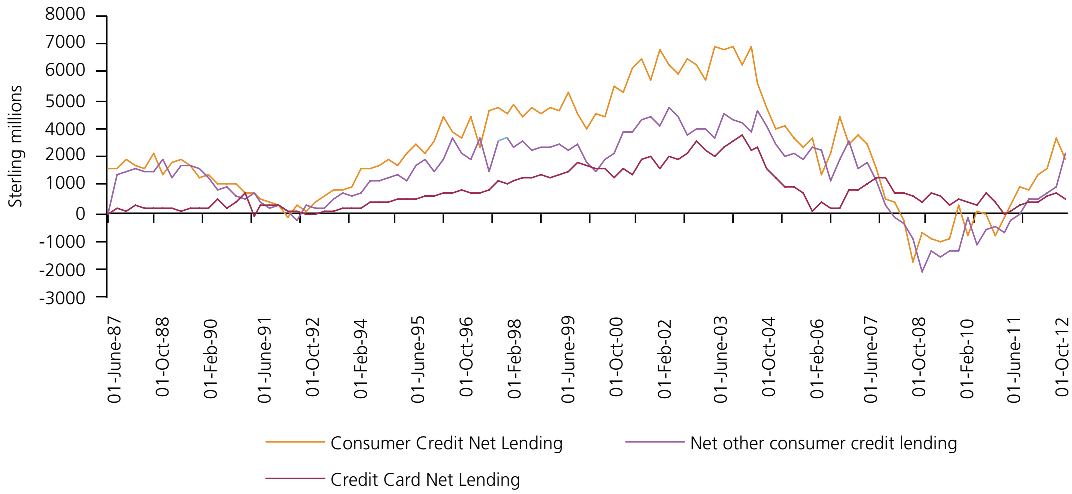
Source: Bank of England LPQVZQO, LPQVZRJ

14 www.theukcardsassociation.org.uk/wm_documents/credit_and_store_cards_review_-_the_uk_cards_association.pdf
15 For further details, see www.theukcardsassociation.org.uk/wm_documents/Quarterly%20Market%20Trends%20Q1%202014.pdf
16 UK Cards Association ‘Annual Report’ 2014, pg 8.
17 Gross lending is the total value of new loans advanced by an institution in a given period.

3.14 There was a dip in the amount outstanding on credit cards from 2006, and then again between 2009 and 2010. This reflected a combination of consumers paying down outstanding debts, and an increase in the number of write-offs for banks and buildings societies, which reached a 20-year peak in 2010.[18]

3.15 During the financial crisis, credit card net lending[19] showed less volatility than other forms of consumer credit. Figure 2 illustrates that net credit card lending has begun to increase since 2011, indicating that consumer appetite for borrowing and lender appetite for lending, has returned.

Figure 2 - Net consumer credit card lending to individuals compared to other consumer credit 1987-2012



Source: Bank of England LPQB3PS, LPQVZQX, LPQB4TU

3.16 As part of the market study we will be exploring the lending incentives and profitability of firms and how these have changed over time. We will also explore consumer repayment behaviour.

Interest rates

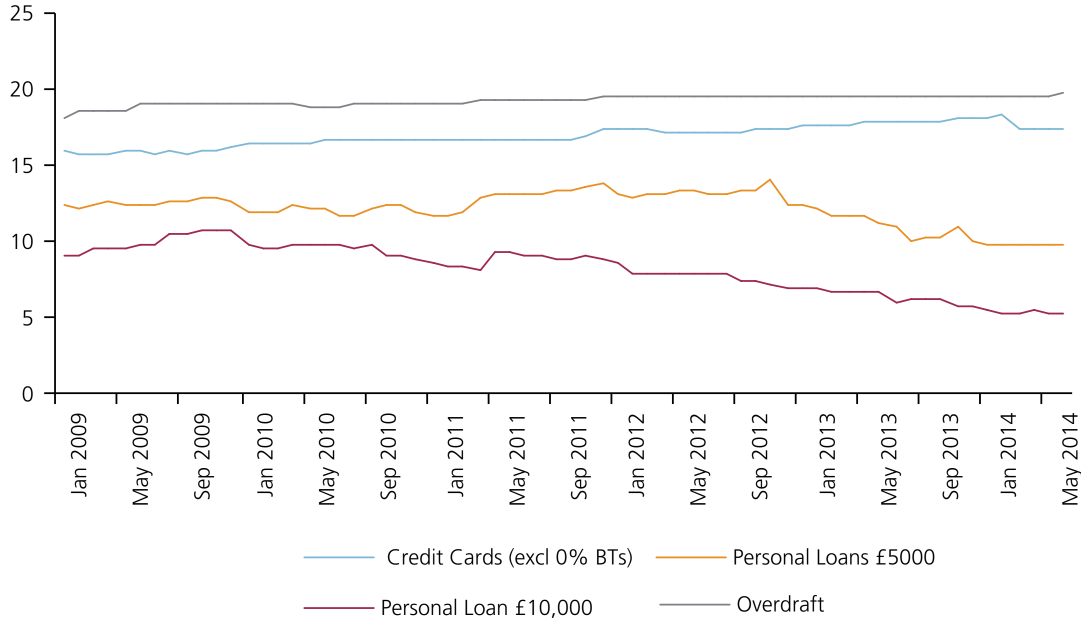
3.17 Following a long-term declining trend in credit card interest rates, they have steadily increased since 2009.[20]

18 Bank of England.

19 The difference between gross lending and gross repayments of debt in a given period.

20 Bank of England. For further details please see: www.bankofengland.co.uk/statistics/Pages/iadb/notesiadb/household_int.aspx.

Figure 3 - Quoted interest rates on consumer credit 2009-2014



Source: Bank of England Loan Pricing July 2014, chart 2.7

3.18 While we would not expect the quoted or advertised interest rates for credit cards, personal loans or overdrafts to be the same, given the different nature of the products and their risk profiles, we note that the quoted interest rate for credit cards has increased broadly in line with overdrafts, both of which differ significantly from the trajectory of rates for personal loans.

3.19 However, given the change in economic climate, low Bank of England base rate, falling write offs and the increased consumer appetite to borrow, we would expect there to have been an impact on price. This market study will, therefore, explore the extent to which firms are competing on interest rates, particularly introductory offers such as 0% balance transfers, and whether competition is working effectively for consumers in that regard.

The product and the firms involved in credit card provision and payment

3.20 Credit cards come with a lot of flexibility in how much of the outstanding balance must be paid off each month. Cardholders who do not pay the balance in full at the end of a month will incur an interest charge (other than during a 0% introductory period).

3.21 The cardholder is also required to make a minimum payment (typically a percentage of the outstanding balance or a minimum amount). Failure to do so will result in the cardholder incurring a penalty charge and may affect the borrower's credit history.

3.22 A range of firms are involved in credit card provision and payment transactions:

- The credit card **issuer** – issues the card, funds the payment of transactions and in doing so provides credit to the cardholder.

- The merchant **acquirer** – captures credit card payments at point of sale and then processes the payment transactions so that the retailer is paid by the card Issuer.
- Cards are part of a **card scheme**, e.g. Visa, MasterCard and American Express which ensure point of sale acceptance in the UK and worldwide.
- **Retailers or merchants** – accept cards from one or more particular schemes for payment for goods or services.
- **Affinity or co-brand partners** – are not directly involved in issuing the credit cards or processing transactions but typically are charities, membership groups or commercial businesses that lend their brands and give access to their customers or members to card issuers in return for a share of revenues or profits.

3.23 We understand that large retail banks are still the main credit card issuers, together with some mono-line firms.

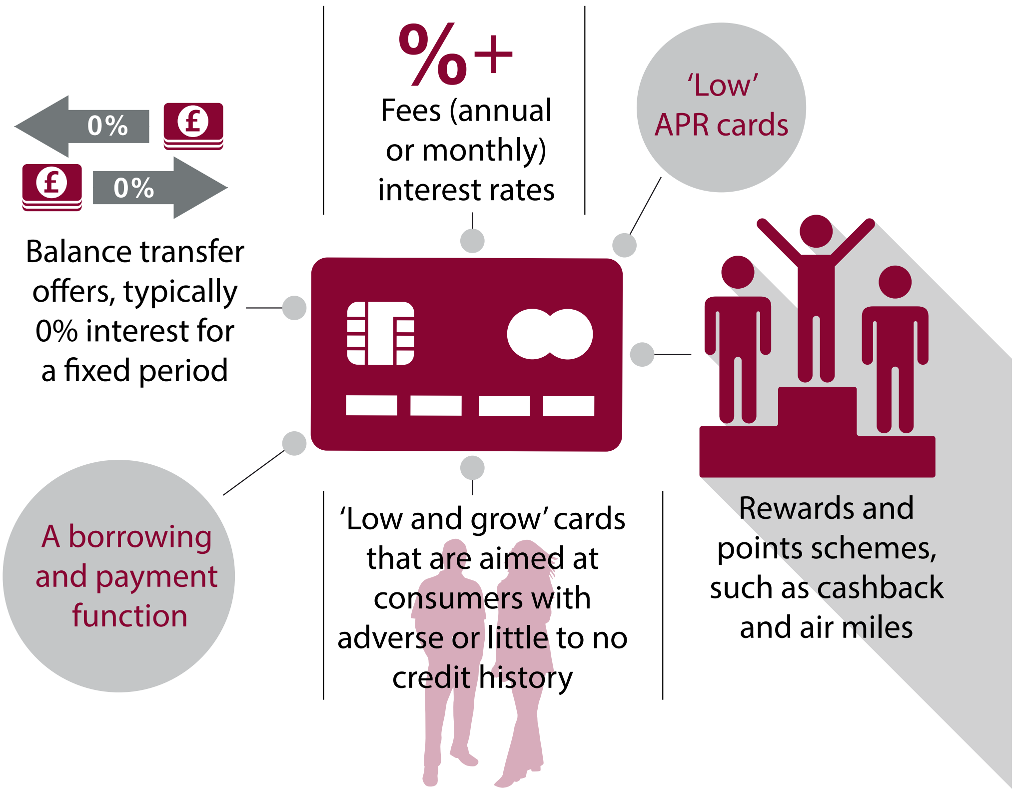
3.24 As of October 2014, we believe that there are 33 issuers (i.e. firms that are members of payment schemes that can issue their own card directly and to other affinity or co-brand partners) and more than 200 credit card products available for consumers to choose from.

3.25 Most credit cards have a combination of price and non-price features, including but not limited to:

- A **borrowing and payment function** – credit cards can be used as a revolving form of credit as well as a payment mechanism.
- **Rewards** – rewards and loyalty schemes, such as cashback and air miles.
- **Balance transfers** – products where a balance on one credit card is paid by another credit card. A range of promotions offer 0% balance transfers.
- **Fees** (annual or monthly) and interest rates.[21]
- **0% interest on new purchases** - products that allow consumers to spend on their credit card without incurring interest for a specified period of time.
- **'Low' APR cards** – products that typically offer products with a lower APR and do not have additional introductory rates or offers.
- **'Low and grow'** – products specifically aimed at consumers seeking to build their credit rating.

21 There are differing interest rates on purchases, cash advances, balance transfers, and sometimes money transfers. Default charges, typically £12, apply when a consumer goes over their credit limit, is late making a payment, or when a payment fails. See Annex 1 for more information regarding consumer protection.

Key features of credit cards



Cardholders' use of credit cards

3.26 According to the UK Cards Association, around 30 million adults have credit cards, accounting for approximately 60% of the UK adult population. Which? estimates that there has been a reduction in the number of people reported to use credit cards, from 62% in 2012 to 56% in 2014[22]. However, the UK Cards Association reports that overall spending on credit cards increased from 13.3bn in June 2013 to 13.8bn in June 2014 which they attribute to increased credit card use amongst transactors who pay off their outstanding balance within the offer period.[23]

How credit cards can be used

3.27 The flexibility offered by credit cards as both a borrowing and payment mechanism means consumers can use them in a variety of ways. For example, the extent to which they need to use their credit card limit, how they choose to repay and whether they use it for regular spending or as an emergency credit facility.

3.28 Research shows that few consumers fully use their credit limit – the UK Cards Association estimate that the average utilisation rate is about 25%,[24] which they argue implies that most accounts have unused credit because cards are sometimes held as a financial safety net to cover unforeseen circumstances.

22 Which? Report "Credit Britain 2", September 2014.
23 The UK Cards Association (2014), Card Expenditure Statistics June 2014: www.theukcardsassociation.org.uk/wm_documents/June%202014%20Full%20Report.pdf.
24 UK Cards Association 'UK Card Payments 2014'. The utilisation rate is the proportion of the available credit that has been borrowed.

3.29 The rate of growth in the number of purchases made has now outstripped the growth in the value of purchases, as consumers are using their credit cards more but for lower value payments. According to the UK Cards Association the number of purchases increased from 213 million in 2013 to 260 million in 2014, which also resulted in an increase in total spending from 13.3bn in 2013 to 13.8bn in 2014. However, the average value for a credit card transaction declined by 32p to £60.13 in the same period, which UK Cards attributes to changing consumer preferences for card use, online spending and contactless cards.[25]

Repayment

3.30 Bank of England data shows that from early 2010 to early 2013 the monthly amount of repayments on credit cards remained broadly consistent, despite a drop in 2013. There was, however, a rise in gross lending over the same period and outstanding balances have continued to grow (see figure 1). We will, therefore, examine the extent to which consumers engage in unaffordable borrowing as part of our analysis.

3.31 'Transactors' are typically consumers who use credit cards mainly as a payment mechanism usually paying off their balance in full at the end of the month thus incurring little or no interest on balances. 'Revolvers' are typically consumers who revolve their outstanding balance from one period to the next, often paying less than the full repayment amount on their credit card. As a result they are charged interest on the borrowing. Revolvers may pay no interest on their borrowing where they are using 0% balance transfer products, although they could still be paying interest on balances accrued by using the credit card to withdraw cash or access foreign currency.

3.32 According to the UK Cards Association, 61% of consumers in 2013 were 'transactors', 39% were 'revolvers' including 11% who were 'partial payers' and 6% who were 'minimum repayers'.[26] We understand that 1.1 million (3.7%) of credit card holders have spent at least 12 months making only the minimum repayments.[27]

3.33 While transactor/revolver are useful initial distinctions, our analysis may reveal further consumer segments and/or patterns of repayment in which the dynamics of competition operate differently. For example, some consumers may pay off their balance in full each month for several months then buy a large item, which they repay over a longer period, thereby exhibiting both transactor and revolver behaviour.

3.34 Additionally, some revolvers may take advantage of 0% balance transfer promotions and make partial or minimum repayments, even though they could afford to repay in full each month.

Regulatory framework

3.35 The market study will take account of the current regulatory framework and any forthcoming regulatory or legislative changes that may affect credit cards. In particular we note the forthcoming European regulation of interchange fees, which may affect credit card business models. We will investigate what impact this change is likely to have on the market. Annex 1 summarises how credit cards are currently regulated and forthcoming regulatory changes that may affect how the market currently operates.

25 The UK Cards Association (2014), Card Expenditure Statistics June 2014: www.theukcardsassociation.org.uk/wm_documents/June%202014%20Full%20Report.pdf.

26 UK Cards Association 'UK Card Payments 2014'.

27 Ibid.

4.
Scope of the market study

What the market study will address

4.1 The market study will focus on credit card services offered to retail consumers by credit card providers (including banks, mono-line issuers and their affinity and co-brand partners) through a range of distribution channels.

4.2 Although we will look at both the borrowing and payment function of credit cards, we intend to focus on the use of credit cards as a form of revolving credit, given that this is where most of our initial concerns lie.

4.3 We will take the following into account as part of the market study, but only to the extent that they are relevant to the assessment of whether the credit card market is working well for consumers:

i. other payment mechanisms: debit cards, charge cards, store cards, online and mobile payments

ii. other unsecured lending[28]

iii. card schemes / issuer services

iv. interchange fees

Consideration of (i) to (iii) above will also be relevant to understanding the customer route to market and to put credit card borrowing and transactions into context. In relation to items (iii) and (iv), we anticipate that the level of interchange fees and the regulation of card schemes will fall within the purview of the PSR. We do not propose to focus on these issues in any great detail, although we will consider the implications of an interchange fee cap on credit card business models as part of our analysis.

What the study does not seek to address

4.4 This market study will not consider the provision of business credit card services to SMEs/corporates. Our analysis, however, is likely to capture smaller SMEs (sole traders and medium-enterprises) that use their personal credit card for business financing.

4.5 Furthermore, the study will not cover charge cards and store cards for the following reasons:

28 Such as personal loans and overdrafts.

- The number of credit cards far exceeds charge cards. Charge cards tend to have higher (or no) credit limits, annual fees, and are often used for corporate purposes. Charge cards (some American Express and Diners) can be used for payments like credit cards, but balances have to be repaid in full at the end of the month, so they cannot be used to borrow for longer periods. Our concerns about revolving credit therefore do not arise.
- Store cards are provided by a retailer (the card issuer can be another institution) and can only be used for purchases with that retailer (so are not part of a card scheme). Store cards typically provide discounts and/or rewards, but tend to have lower credit limits. Retailers are increasingly moving away from traditional store cards to offering store-branded credit cards, which have similar features to store cards.[29] Given the trend of these cards becoming store-branded credit cards, we have not included them as a focus of the market study.

Issues we will be focusing on

4.6 Based on our current understanding of how the credit card market works, we have identified three main areas we would like to explore over the course of the market study:

- The extent to which consumers drive effective competition through shopping around and switching.
- How firms recover their costs across different customer groups and what impact this has on the market.
- Unaffordable credit card debt, in particular whether some consumers are over-borrowing / under-repaying on their balances, and whether firms have incentives to provide unaffordable lending that results in consumer detriment.

4.7 We will also consider whether any specific concerns arise in distinct parts of the credit card market, such as in the higher risk consumer segment.

4.8 It is important to note that this sets out our scope, we have not reached any conclusions and the themes we have identified will be explored during the course of the market study.

4.9 For each of these areas we will collect evidence from consumers, trade and consumer bodies as well as firms, to identify whether there is, and if so the extent of, any consumer detriment. In addition, we will assess what factors (structural features, consumer and firm behaviours) are driving any identified concerns.

4.10 We note that, although new entrants wanting to issue credit cards face a number of barriers, these do not appear to be preventing entry.[30] The ICB reports that new entrants have captured an 18% share of new business (equating to an 11% share of the total market) between 2000 and 2010. Estimates by the ICB also indicate the market for credit cards is less concentrated than other retail financial markets.[31]

29 The number of store cards in issue decreased by two thirds between 2002 and 2012. https://assets.digital.cabinet-office.gov.uk/media/534ea933e5274a3774000005/The_UK_Cards_Association_response_to_competition_between_PDLs_and_other_credit_providers_WP.pdf

30 Barriers include the need to join and be accepted to a cards scheme (e.g. Visa, Mastercard), advantages to the larger banks of a branch distribution network and the ability to cross-sell from other products, credit informational advantages (for example where a customer holds a personal current account with its credit card provider) and access to capital markets.

31 Independent Commission on Banking, Final Report p.321-322.

4.11 For this reason, we do not plan to investigate in any great depth barriers to entry or market structure on the supply side other than in the context of barriers to innovation/new business models. We would, however, be keen to hear from stakeholders who have any concerns in this regard.

The extent that consumers drive effective competition through shopping around and switching

4.12 Consumers can drive competition if they are able and willing to compare different products and choose or switch to the one that represents the best value for money for them. Suppliers facing active and engaged consumers must sell products that meet consumers' needs at a competitive price.

4.13 Evidence from a survey carried out by the OFT suggests that this may not be happening, with the majority of consumers not actively shopping around (comparing offers from different providers) when choosing a credit card.[32] The evidence on the proportion of consumers who switch between providers is mixed.[33] It is unclear to what extent the results account for customers using multiple cards rather than switching from one credit card to another. Equally, it may be the case that certain consumers have a higher propensity to switch than others. We will explore this in greater detail during the market study.

4.14 We recognise that consumers' ability and willingness to compare credit card offers and switch may vary among individuals and consumer groups. Depending on the features of the market,[34] the pressure consumers, who actively shop around and switch between providers, exert on firms may or may not benefit other consumers who are less active in the market.

4.15 Based on our current understanding of the market we have identified a number of factors that could influence consumers' ability and willingness to effectively shop around and/or to switch between credit card providers:

- fees, charges and product complexity
- transparency and fairness of terms and conditions
- distribution channels
- consumer behavioural biases

4.16 Each of these factors is explained briefly below and will be explored further in the market study.

Fees, charges and product complexity

4.17 In its report on credit card comparisons, the OFT noted that credit cards are inherently complex products as a result of being used for different purposes, such as a payment tool domestically, abroad or over the internet, and a credit tool for purchases and cash advances.[35]

32 For example, the OFT found in 2008 that about 70% of consumers who took out a credit card in the previous three years did not shop around at all (OFT, Credit card comparisons, February 2008, OFT987, para. 1.1).

33 TNS-BRMB's research found that 7% of respondents switched provider within a year (TNS-BMRB, Credit and Store Card Research, prepared for BIS, 10 January 2010, page 36. UK Cards Association Annual Report 2014 reports that 20% of consumers switched their credit card user, page 8.

34 In particular whether credit card providers are able to identify and distinguish between consumers who are more or less likely to shop around and switch if they are not satisfied with their current credit card contract.

35 OFT, Credit card comparisons, February 2008, OFT987, paras. 1.2 and 4.6.

4.18 Credit cards have multiple price and non-price features. For example, many cards have more than one interest rate – a rate for balance transfers, an introductory rate on purchases, a rate for cash withdrawals and a 'go-to' rate.[36] Different features are also often expressed in different ways, such as a percentage for an interest rate, a percentage or stated amount for monthly repayments, or rewards in cash or points for different values that are subsequently redeemable for goods and services.

4.19 In principle, a variety of product features may offer consumers valuable choice, increasing the likelihood that consumers find a card that closely matches their needs. However, the number of product features, and the fact that they can in some instances be presented in different ways, is likely to make assessing value for money and comparing credit card products difficult for consumers.[37]

4.20 Price comparison websites (PCWs) can help consumers assess and compare specific credit card features and are a significant characteristic of this market. However, they may not fully address the problem of product complexity. Because an individual's interest rate may differ depending on individual credit scores and personal circumstances, PCWs do not allow consumers to make comparisons based on the actual terms and conditions they will be offered. They also cannot allow for comparisons to be made on the full costs and benefits associated with individual cards, taking into account the full suite of credit card features and the consumer's (past or predicted) credit card usage.

4.21 We will investigate the extent to which product complexity, including complex fees and charges, remain a feature of this market and the role of PCWs in helping consumers cut through such complexity.

4.22 Previous concerns have been raised around the opaqueness and level of credit card fees and charges. In 2003 the OFT began an inquiry into credit card 'default charges', and in 2006 found that many default charges were unlawful. As a result it issued a statement suggesting a £12 cap on such charges (unless exceptional business factors were in play).[38] Rules have also been introduced over the years to improve transparency and ease comparison.

4.23 During the course of the market study we will be considering the impact of credit card fees, charges and terms and conditions on consumers' willingness and ability to effectively shop around.

Transparency and fairness of terms and conditions

4.24 We consider that some features of credit cards may not be transparent. This has implications for the price consumers pay and their willingness and ability to shop around effectively and switch between providers.

4.25 Firstly, the exact terms and conditions of a credit card contract (e.g. the credit limit) are not clear to consumers until they have applied and been accepted for a specific credit card, as the advertised terms and conditions can differ from those offered.[39] As a result, consumers may not have full or accurate information on the product features that matter to them when choosing a credit card, which naturally inhibits effective comparison of offers.

36 The 'go-to' rate is the interest rate reverted to once promotion interest rates end.

37 For examples on reward schemes and their comparability, see Which?, Credit Britain 2, September 2014, pages 16-17.

38 Statement on the OFT's position with respect to default charges: www.gov.uk/government/uploads/system/uploads/attachment_data/file/284445/oft842.pdf

39 See, for example, BIS Regulations (now superseded) implementing the Consumer Credit Directive, Quick Start Guide, August 2010, page 5. Regulation requires that the representative APR shown in an advertisement reflects (at least) 51% of business expected to result from it. This implies that almost half of the consumers who apply for a credit card product could get it under conditions different from what has been advertised.

4.26 Consumers may select the first credit card they get accepted for because of concern that multiple applications could negatively affect their credit score and their ability to access credit in the future.[40]

4.27 Secondly, the representative APR that some consumers may use as a basis for informing their choice of credit card has a number of shortcomings. Although it is a good indication of potential cost for larger-sum fixed-term loans, it has significant limitations. For example, it is not such a good indicator of cost for other types of credit, in particular credit cards where some consumers repay their balance in full each month. The outcome could be that consumers relying solely or largely on representative APR to inform their choice of credit card may choose a card that does not best meet their needs.

4.28 Thirdly, responses to a BIS consultation in 2009 on the 'Review of the Regulation of credit and store cards' suggest that some consumers may view the terms and conditions and other documentation of credit cards as 'opaque' and 'designed to disguise potential costs'.[41] Respondents noted that they regularly received booklets setting out new terms and conditions, with no indication of which were new and how the changes would affect them.[42]

4.29 The industry has taken steps to increase transparency in the credit card market, via the use of 'summary boxes' setting out key information on the main features of credit cards. The UK Cards Association has issued best practice guidelines[43] to its members, and elements have been incorporated into the Lending Code.[44] Since 2011 it has been a statutory requirement to provide pre-contract credit information in a standard format for most regulated credit agreements, including credit cards. This derives from the Consumer Credit Directive, and lenders are also required to provide an adequate pre-contract explanation highlighting key costs and risks.

4.30 We will explore whether consumers have the relevant information on key product features at the outset and the extent to which they consider the terms and conditions to be unclear. In both cases, this could lead to consumers incurring fees and charges that they were not aware of and did not expect when they selected a card. We will also consider the impact of new technologies such as whether applying for a new card using a smartphone or tablet may limit the ability of consumers to look at the terms and conditions.

Distribution channels

4.31 The ways in which consumers take-up credit cards may influence the extent that consumers shop around. Qualitative research suggests that some consumers accept, rather than actively search for credit card products.[45] This could be the case where consumers respond to direct mail, in particular pre-filled credit card application forms, accepting a credit card contract without considering whether an alternative may better meet their needs. This research also indicates that consumer circumstances might influence consumers' likelihood of accepting rather than actively searching for a credit card product, with consumers in difficult financial situations being more susceptible to marketing.[46]

40 According to Which? only a small number of lenders offer quotation searches that do not affect the credit score of the applicant: see Which? Credit Britain 2, September 2014, page 19.

41 TNS-BMRB, Credit and Store Card Research, prepared for BIS, 10 January 2010, page 48.

42 Ibid, page 113.

43 See www.theukcardsassociation.org.uk/best_practice_guidelines/.

44 The Lending Code is a voluntary code of practice setting standards for financial institutions to follow when they are dealing with their personal and small business customers in the UK. Compliance with the Lending Code is monitored and enforced by the Lending Standards Board. See www.lendingstandardsboard.org.uk/about.html.

45 Jigsaw research, Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts, 7 April 2014, page A14. The research is conducted among consumers with the highest usage of overdrafts and revolving balances on store and credit cards.

46 Ibid pages A14 and 15.

4.32 Other consumers may go straight to their personal current account (PCA) provider for a credit card. We understand that a significant proportion of credit cardholders still take out credit cards with their PCA provider (either through an online application or in-branch). It may be that these consumers do not consider whether alternative providers would offer them products that are better value for money.

4.33 We will explore how consumer behaviour and outcomes vary by distribution channels in the credit card market.

Consumer behavioural biases

4.34 Behavioural biases are important in retail financial markets as they can significantly affect the outcome for consumers. The complex nature of financial products can mean consumers apply rules of thumb that in some cases may not be optimal. Also, financial decisions often require making trade-offs between the present and the future, so some consumers may make choices that are not in their best interest in the long-run.[47] We expect that the following biases are particularly relevant in the credit card market.

4.35 *Present bias* – FCA guidance on applying behavioural economics to financial services notes that consumers tend to weight immediate benefits more heavily than future costs.[48] When choosing a credit card, consumers may focus disproportionately on features that bring immediate benefits, such as an introductory rate, and not consider the overall cost of the credit.

4.36 *Limited attention* – Consumers may have limited attention[49], which makes them less likely to assess all the product features when making a decision and more likely to only focus on those features that are prominent in marketing material.

4.37 *Overconfidence* – Consumers may be overconfident[50], which may lead them to underestimate the likelihood of incurring interest charges and fees.[51]

4.38 During our market study we will explore the extent to which consumer biases influence the effectiveness of shopping around and switching. We will also consider whether and to what extent firms exploit these biases in the design and marketing of credit card products.

How firms recover their costs across different customer groups and what affect this has on the market

4.39 It is commonly believed that there is considerable cross-subsidisation in credit card markets, but there is limited research on the extent to which this might actually occur.

4.40 'Cross-subsidisation' is not necessarily anticompetitive or detrimental. There may be an issue, however, where it: (i) creates a barrier to entry and expansion, e.g. by impeding the development of new business models or product offerings that benefit consumers; or (ii) results in certain consumer groups being unduly disadvantaged (which could be the case, for example, where a small group of cardholders contribute a disproportionately large amount to providers' income).

47 FCA, Applying behavioural economics at the Financial Conduct Authority, April 2013, page 16.
48 Ibid, page 17.
49 Ibid, page 18.
50 Ibid.
51 Fees that arise only when a certain event occurs for example, the individual exceeds his/her credit limit or misses a payment.

4.41 The focus of our analysis will be on understanding how firms recover their costs across different cardholder groups. We will look at the risk-adjusted price paid. We will consider the characteristics of the cardholder groups involved and the effect their different levels of profitability have on the incentives of firms seeking to expand or enter the market with new business models or product offerings.

4.42 In particular, we intend to examine in more detail:

- The suggestion that firms may be charging revolvers more for their borrowing than the cost of extending the debt, to cover the cost of extending borrowing to transactors.
- Whether highly indebted customers are generating a disproportionate amount of revenue for firms.

4.43 Our analysis will also consider the forthcoming changes to interchange fees and the ramifications this could have on the profitability of consumers, particularly transactors. This work will inform our assessment of how providers recover their costs across different cardholder groups, and the effect it could have on competitive dynamics and consumer welfare.

Unaffordable credit card debt

4.44 In some instances consumers may be taking on such levels of credit card debt that they are unable to repay the full credit card balance within a reasonable timeframe (over-borrowing). It may also be the case that some consumers are repaying their debt slower than would be optimal, incurring avoidable costs (under-repayment). We also recognise that consumer circumstances may change over the lifetime of the credit card product, such that an initially affordable credit limit may over time become unsustainable.

4.45 The market study will explore whether, and the extent that, these are problems for consumers. It will also explore the drivers that lead consumers to over-borrow on credit cards and under-repay their outstanding credit card balances, including how such behaviour might affect the profitability of lending.

4.46 There is already a substantial amount of published research on the drivers of over-borrowing and under-repaying on credit cards, identifying a number of consumer behavioural biases as key drivers of this behaviour.[52] Given the flexibility (e.g. consumers can draw on credit at any point up to the credit limit), design (rewards and other features that encourage spending) and accessibility of credit cards compared to other consumer credit products biases may be particularly pertinent in the credit card market. We will explore this in more detail during the market study.

4.47 There is more limited existing analysis on the profitability of providing credit cards to over-indebted consumers. Therefore a key focus of our analysis will be on understanding whether and why firms might provide unaffordable lending.

52 See, for example, Lawrence M. Ausubel, The Failure of Competition in the Credit Card Market. The American Economic Review 1991, Vol 81, No. 1 pp. 50-81, and Neil Stewart, The Cost of Anchoring on Credit-Card Minimum Repayments, Psychological Science, 2009 Vol 20. No 1. Pp 39-41.

Why firms might offer unaffordable lending

4.48 We will review firms' incentives regarding affordable lending and sustainable repayments. In particular, for the main credit card products provided by firms, we will analyse:

- firms' business strategies, exploring the consumer segment targeted, the needs the product is intended to fulfil and the intended method of income generation
- revenue streams actually generated in practice by each of these products and the link between revenue and consumers' use of the product
- profitability of products, focusing on any offering where profitability is reliant on income streams from particular cardholder segments.

4.49 We will also look at how bad debt is treated by firms, both their accounting policy for the provisioning of bad debt and how they treat those who fall into arrears. We will look as far as possible into how firms manage credit control, bad debt and the extent to which risk affects product design and financial performance. We will focus on the credit card market, but where firms bundle and resell debts, either through a third party or a department of their own firm, we will explore the effect on consumer outcomes.

4.50 We note that in its 2009 consultation paper, BIS laid out a series of concerns regarding firm practices in this market and their impact on consumer indebtedness.[53] These included setting low minimum repayment amounts, unsolicited credit limits, allocation of repayment amounts and risk based re-pricing. We will look at these and any other issues regarding consumer understanding of repayment, in the context of the extent to which consumers' behaviour affects revenue. We will consider the extent to which existing rules fully address these issues and whether there are any concerns remaining that need to be remedied.

Over-borrowing on credit cards

4.51 There is some anecdotal evidence suggesting that over-borrowing on credit cards is a problem for at least some consumers. As part of the study, we will explore how wide-spread and significant the problem is.

4.52 We note that debt charities[54] and findings from our earlier research into credit cards[55] have identified some concerns about the possible detriment (financial and non-financial distress) experienced by consumers as a result of high levels of debt (including credit card debt).

4.53 Also, wider concerns about the level of consumer indebtedness and the role credit cards play have been raised in a range of forums.[56] These concerns have often been raised in the context of the level of aggregate household debt (including credit card debt) and the potential implications for the health of the economy – potentially affecting economic growth and raising financial stability concerns. [57]

53 See Department for Business, Innovation and Skills (BIS). A Better Deal for Consumers: Review of the Regulation of Credit and Store Cards, October 2009.

54 See, for example, StepChange, Statistics Yearbook, Personal debt 2013.

55 See www.fca.org.uk/firms/firm-types/consumer-credit/consumer-credit-research/credit-cards.

56 See, for example, a Library Note for the House of Lords on The Impact of Personal Indebtedness in United Kingdom Households, Especially on Children, 15 August 2014.

57 According to the Bank of England, "The financial position of households has implications for both monetary and financial stability. The ease and cost of access to new borrowing affects households' ability to bring forward spending, and high debt levels can make household consumption more sensitive to shocks such as unexpected changes to their income. Also, households' ability to service their debts, and the extent to which they find debts a burden can have important implications for the stability of the financial system". See, Bank of England, The financial position of British households: evidence from the 2013 NMG Consulting survey.

4.54 There are a number of factors that could be encouraging consumers to over-borrow, in particular on credit cards. Academic literature suggests that consumer behavioural biases could be key drivers, mainly present (or sometimes referred to as 'immediacy') bias and overconfidence.[58]

4.55 In this context, present bias may result in consumers enjoying the immediate benefits of spending and deferring the cost to future periods. Overconfidence may mean that consumers over-estimate their ability to control future spending and borrowing. This may encourage consumers to build up a balance with the expectation that they will pay it off at the end of the month, but do not.

4.56 We will look at whether credit cards are marketed and sold in a way that exploits or exacerbates consumer behavioural tendencies with respect to over-borrowing. We will also consider the extent to which the availability of multiple cards (i.e. several available credit limits at any point in time) affects consumer borrowing, particularly in times of financial distress.

Under-repayment of credit card balances

4.57 When consumers borrow on their credit card they are free to choose how much to repay in a given month, as long as it is at or above the minimum repayment set out in their terms and conditions. Since April 2011, for new credit card contracts, firms are required to ensure the minimum repayment is set at a level that avoids negative amortisation, i.e. at a level sufficient to cover interest rates and other fees on the account, plus 1% of the amount outstanding.[59]

4.58 The smaller the amount the consumer repays each month, the longer it takes to pay back the debt and the higher the overall cost will be. This raises the concern that some consumers may incur costs that could be avoided.

4.59 Cardholders' may repay only the minimum amount each month for a number of, often rational, reasons. A 2009 survey finds that of those identified as cardholders making the minimum payment, 15% did so because they had a promotional balance and wanted to take full advantage of this.[60] Other consumers (24%) stated that they only paid the minimum payment because they had more expensive debts elsewhere.[61]

4.60 However, of those who stated that they made only the minimum payment on at least one of their cards, 56% noted that this was because they could not afford to pay more.[62] This result reinforces the concern that perhaps consumers are overconfident about their ability to repay their credit card balance.

4.61 It could be that some cardholders decide to make minimum repayments even when they could afford to pay more. They may not be aware of the cost implications of their repayment behaviour. Repaying less than they can each month could be driven by behavioural biases, such as anchoring effects (where consumers use the minimum payment as a reference point when deciding how much of their credit card balance to pay off) and present bias (where consumers place greater value on the additional cash each month for immediate expenditure). This may lead consumers to revert to paying the minimum amount, even though this is not optimal for them in the long run. We will explore this as part of the market study.

58 See, for example, Stephan Meier and Charles Sprenger, Present-Biased Preferences and Credit Card Borrowing, American Economic Journal: Applied Economics 2010 Vol 2, No. 1 pp 193-210.

59 Consumer Credit sourcebook, September 2014, para. 6.7.5.

60 The UK Cards Association, Credit and Store Cards Review, January 2010, page 125.

61 Ibid.

62 Ibid.

5.
What are the potential outcomes of the market study?

5.1 There are a range of potential outcomes to a market study undertaken by the FCA. In particular, we may:

- take no further action
- make new rules, including changes to or potential withdrawal of rules
- use firm-specific enforcement powers, for example changing firm permissions or adding requirements
- make proposals for enhanced industry self-regulation
- publish handbook guidance.

5.2 At this stage we remain open minded as to the potential outcomes of this market study. We will provide further information on any potential outcomes and remedies during the course of the study.

Other FCA work relating to credit cards

5.3 In parallel to the credit card market study, there is ongoing and related FCA work which, where appropriate, will feed into our analysis:

- We consulted in June (CP14/8) on minor changes to our Handbook in relation to consumer credit, and we are planning a further consultation in January.
- We will proactively engage with authorised firms as part of our supervisory business-as-usual programme. For some firms, this will include firm-specific 'deep dives' looking at particular aspects of their credit card business. We will also continue to respond to emerging issues through our 'event driven' supervision work.
- We consulted on the price cap for high-cost short-term credit (HCTSC) in July 2014. We made it clear in the Consultation Paper (CP) 14/10 that credit cards are not within scope of the price cap, as they are open-ended and not substantially repayable in 12 months, therefore falling outside our definition of HCSTC. However, some respondents to the CP thought that credit cards should be included within the scope of the cap. Our research shows that mainstream credit options, such as credit cards, do not appear to be considered or used by consumers instead of HCSTC. We will keep this under review.

6. Next steps

6.1 In addition to examining existing published research and analysing information that we already hold, we plan to commission consumer research as well as collecting new information from market participants through information requests, interviews and industry roundtables.

6.2 We will be engaging with industry stakeholders as well as consumers, representative bodies (both consumer and industry) and Government Departments.

6.3 Post-launch interested parties will have an opportunity to provide us with feedback on the scope of the study and the issues we plan to focus on. We would welcome any written feedback on the scope of the market study by 5 January 2015. We will be engaging on the substance of these issues in due course.

6.4 To contact the market study team please email creditcardmarketstudy@fca.org.uk.

Annex 1
Regulatory framework

1. This annex outlines the relevant regulations and self-regulatory requirements in place for credit cards and the relevant competition law developments in relation to payment systems.

Consumer credit regulation

2. Credit cards are regulated under the Consumer Credit Act 1974 (CCA) and our Consumer Credit sourcebook (CONC). CONC contains rules transposed from OFT guidance, including the Irresponsible Lending Guidance, as well as CCA provisions that have been repealed and replaced by FCA rules. The retained CCA provisions are due to be reviewed by 2019.

3. Some of the CCA and CONC provisions implement the Consumer Credit Directive (CCD) which is maximum harmonisation in a number of key areas, such as advertising, pre-contract information, 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.

4. 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 customer 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 stipulate minimum content of the explanation in the case of credit cards.

5. To further aid transparency and ease comparison, the CCD established requirements around credit advertising. Specifically, if an advert includes an interest rate or cost figure this triggers a representative example, including a representative APR. The CONC rules (deriving from CCA regulations) require the representative APR to reflect at least 51% of business expected to result from the advertisement. For credit cards, 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. For example:

   - firms are required to allocate repayments to the debt subject to the highest rate of interest

   - firms must not, other than where a promotional rate of interest ends, increase the rate of interest on a credit card where the customer is two or more payments 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

- 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 customer's account plus one percentage of the amount outstanding

7. The retained CCA provisions 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 where the transaction is over £100 and not more than £30,000. In practice this allows customers 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.

8. Sections 83 and 84, meanwhile, set out customers' 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 customer'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 customer does not need to be present, such as online, and the customer still has the card in their possession, they will not be liable for any losses.

9. In 2003 the Office of Fair Trading (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, 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 there were exceptional business factors at play. The OFT suggested that the £12 'cap' was intended as an initial step towards fair practice and compliance with the law. A default charge should only be used to recover certain limited administrative costs. Whether or not an individual charge constituted a penalty fee would be for a court to ultimately determine.

10. In a related development, in March 2010 credit card issuers committed to improve protections for customers, including in relation to unsolicited increases in credit limits, increased interest rates and ending the practice of applying repayments to the balance with the cheapest interest rate. The commitments were subsequently incorporated into the Lending Code (the voluntary code to which most banks and card issuers subscribe). Key elements were also included in the OFT's Irresponsible Lending Guidance, and have been brought across into our CONC rules.

Competition law and regulation pertaining to card payment systems

11. There are important competition law and regulatory developments impacting on card payment systems. The main focus of competition and regulatory scrutiny to date has been the arrangements for the charging of interbank fees, known as interchange fees, in four-party card payment systems. There has been some degree of scrutiny of non-fee related business rules or practices, although often this has stemmed from them being seen to amplify underlying concerns about fee arrangements rather than raising distinct concerns.

12. The Competition and Markets Authority (CMA) has open investigations into MasterCard and Visa's domestic multilateral interchange fee (MIF) arrangements.[63]

63 On 4 November 2014, the CMA announced its decision not to progress its investigations into MasterCard's and Visa's interchange fee arrangements at the present time. The CMA reached this decision in light of the European Commission's proposed interchange fee regulation, which is expected to cap MasterCard's and Visa's interchange fees. The CMA has indicated that its investigations remain open and, if the regulation were to not address the suspected harm, the CMA would look again at continuing proactively with its investigations. See www.gov.uk/government/news/cma-decides-not-to-progress-interchange-fee-investigations-at-the-present-time.

13. On 24 July 2013, the European Commission (the Commission) published a proposal for a Regulation of the European Parliament and Council on interchange fees, which includes caps on cross-border and domestic interchange fees.[64] We expect the Regulation to be adopted in the coming months, with some or all of its provisions coming into force during 2015. The exact scope and content of the Regulation may also change up to its adoption, but the Commission's initial proposal was for a cap of 0.2% (of the value of the transaction) for consumer debit card transactions and 0.3% for consumer credit card transactions.

14. More broadly, we note that card payment systems fall within the remit of the newly established Payment Systems Regulator (PSR). The Treasury issued its consultation on the designation of payment systems for regulation by the PSR on 14 October 2014. They have proposed designating the two largest card payment systems in the UK, MasterCard and Visa. The Treasury is expected to reach its decision well in advance of the PSR's operational launch in April 2015.

15. The PSR published its consultation paper, '***A new regulatory framework for payment systems in the UK***', on 13 November 2014.[65] That set out the PSR's proposed regulatory framework, including the regulatory tools, reporting, access and governance requirements that it proposes to apply to payment systems, as well as outlining further areas of work from April 2015 onwards.

16. Since, we anticipate that the level of interchange fees and the regulation of card payment systems will fall within the purview of the PSR, we do not propose to focus on these issues in any great detail, although the implications of an interchange fee cap will be reflected in our analysis.

64 COM/2013/0550 final - 2013/0265 (COD), available at: http://ec.europa.eu/internal_market/payments/framework/index_en.htm

65 See: www.fca.org.uk/psr/our-consultation

Financial Conduct Authority

PUB REF: 004956

25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk