Financial Conduct Authority

Credit Card Market Study

Annex 1: Further feedback on interim findings

July 2016

Views from stakeholders on interim findings

Introduction

1. In our interim report[1] we set out our initial observations on how competition functions in the credit card market and highlighted areas of potential concern. We published the interim report to give all interested parties an opportunity to comment on our emerging thinking and analysis. This also helps the robustness of our findings and promotes continued constructive engagement between the FCA, firms, trade associations, consumer bodies and other interested parties.

2. Most responses to the interim report focused on the proposed remedies rather than our interim findings.

3. Of the respondents who did comment on the findings, most were broadly supportive. Some respondents challenged aspects of our findings, while others highlighted issues they felt were missed in our interim findings.

4. We have grouped the responses and feedback under four broad headings:
   - approach to the market study
   - consumer shopping around and switching
   - firms' business models and cost recovery
   - problem credit card debt

Approach to the market study

5. Most respondents were broadly supportive of our approach to the market study, the areas of focus and our analytical approach. In particular, several respondents commented positively on the comprehensive analysis underpinning the interim report.

6. Some respondents raised specific issues with certain aspects of our approach. These are discussed below.

Scope of the market study

Feedback

7. One respondent asked the FCA to explore in the final report the credit card market's social purpose and clearly define what we think the market ought to achieve.

8. Another respondent raised concern that we appeared not to recognise the important role played by card schemes in generating innovation, increased competition and switching behaviour.

[1] FCA, *MS14/6.2: Credit Card Market Study: Interim Report (2015):* www.fca.org.uk/your-fca/documents/market-studies/ms14-6-2-ccms-interim-report

Our response

Under the Financial Services and Markets Act 2000 (FSMA), we have a statutory objective of ensuring that 'the relevant markets' function well. The relevant markets include the financial markets and the markets for regulated financial services. We also have three operational objectives:

- 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 in the markets for regulated financial services.

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. These functions include making rules and issuing general guidance to advance our consumer protection and market integrity objectives.

Although we use market studies as a key investigative tool for examining competition problems in the markets we regulate, we also consider our objectives for consumer protection and market integrity.

We set out the scope of the market study in our terms of reference, published in November 2014. This was consistent with our general approach to market studies in considering all our objectives. Respondents to our terms of reference were broadly supportive of the proposed scope.[2]

In the interim report, we highlight several innovations in the credit card market in recent years, including technological innovations such as contactless technology which has been developed by card schemes. We recognise that innovation, whether product innovation, search innovation or technological innovation, can lead to increased competition and benefits to consumers.

Market definition

Feedback

14. One respondent stated that a 'credit card' market is a perhaps a slightly outdated description or market definition and that credit cards fit within a much broader payments market.

[2] FCA, *MS14/6.1 Credit card market study terms of reference*: *Annex 1 (2014):* https://www.fca.org.uk/your-fca/documents/market-studies/ms14-6-1-credit-card-market-study-terms-of-reference

Our response

As set out in our terms of reference[3] and interim report[4] the focus of the study was credit card services offered to retail consumers by credit card providers through a range of distribution channels. Providers include banks, monolines and their affinity and co-brand partners. As set out in our terms of reference, we have looked at borrowing and payment functions of credit cards. Our focus, however, is on credit cards used as a form of revolving credit, given that was where most of our initial concerns lay.

We recognise there may be some substitutability between credit cards and other payment mechanisms on the payment side and between credit cards and other forms of unsecured lending on the borrowing side. We have not conducted a formal market definition exercise as part of this market study.

Use of consumer survey and academic research and international comparisons

Feedback

17. One respondent takes the view that consumer survey data, academic research and international comparisons should be given limited evidential weight in the FCA's decision making because consumer behaviour is likely to be different from what they report in surveys.

Our response

In reaching our interim findings, we considered evidence from many sources. While we recognise that, like all evidence, there are limitations to what we can conclude from consumer survey data, academic research and international comparisons, we still consider them informative. As such, we do not consider they were given an inappropriate level of evidential weight in reaching our findings.

Inconsistency of approach with high cost short term credit

Feedback

19. One respondent said our approach to the credit card market was inconsistent with our treatment of high cost short term credit (HCSTC). Specifically, they compare the relative inaction over credit cards with the maximum interest rates and cap on total repayment imposed on the much smaller HCSTC market.

[3] FCA, *Credit Card Market Study: Terms of Reference*

[4] FCA, *Credit Card Market Study: Interim Report,* para. 2.6

Our response

As set out in the terms of reference[5], our market study aimed to consider:

- 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.

The focus of our study was, therefore, different from our examination of HCSTC, where we had a statutory duty to introduce a price cap.[6] The analytical approach to design a price cap was based on modelling firms lending decisions, how these decisions would change under different price caps, the impact that those lending decisions would have on consumers and the profitability of firms. Our approach in this market study has therefore been consistent with the areas of inquiry we identified in our terms of reference.

Considering the market over time

Feedback

22. One respondent noted that consumers' use of credit cards had changed significantly over the past five years. They gave the examples of the steady decline in the proportion of interest-bearing balances and repayment rates being higher. They noted levels of delinquency and write-off are at historically low levels. In the respondent's view, these factors provide a very important longitudinal view, and have not been fully reflected in the interim findings.

[5] FCA, *Credit Card Market Study: Terms of Reference*

[6] FCA, *PS14/16 Detailed rules for the price cap on high-cost short-term credit (2014):* www.fca.org.uk/your-fca/documents/policy-statements/ps14-16

Our response

We agree that understanding developments over time is important in informing our findings. In the interim report, we considered a number of different trends over time. For example, we considered changes in the proportion of new accounts opened via different acquisition channels, and how the terms of balance transfer offers had evolved over time.

For this final report, we have carried out further analysis within our areas of focus, looking at potential problem credit card debt over time. This has enabled us to consider three aspects. First, how those identified by the indicators of potential problem credit card debt in 2014 got there (that is, their potential problem credit card debt states, if any, in previous years). Second, what happened to those who were in potential problem credit card debt in 2010 (that is, their potential problem credit card debt states, if any, in subsequent years). Third, gain more insight into the duration of persistent debt and systematic minimum repayment behaviour. The findings of this analysis are set out in Chapter 5 and in greater detail in Annex 2.

We also note that UK Cards' annual publication[7] provides a helpful summary of changes and trends in the market.

Shopping around and switching

26. Several respondents (from industry and consumer bodies) highlighted market features they consider inhibit effective shopping around and switching. These are set out below.

Effectiveness of switching

Feedback

27. One consumer body respondent noted that switching is not of itself proof of a well-functioning market and does not incentivise firms to reward loyalty. They note that switching helps drive effective competition only if consumers switch away from high prices and poor service to better value products. They argue that the interim report does not produce any evidence that this happens in this market. The respondent suggests it would be useful for the FCA to analyse the potential savings from switching for higher and lower risk borrowers.

28. Also, in their view, in a well-functioning market, there should be no significant difference in how customers are treated based on whether they are 'back-book' or new customers.

[7] UK Cards Association, *UK Card Payments 2016 (2016)*: http://www.theukcardsassociation.org.uk/wm_documents/UK%20Card%20Payments%202016%20FINAL%20website.pdf

Our response

We agree that switching is not proof of a well-functioning market. As we note in the interim report, 'when looking at estimated switching rates, the rates by themselves do not tell us whether the market it working well or not. For example, it could be that although we observe high switching rates, consumers are making bad choices and switch to worse products. Conversely, low switching rates are not necessarily a cause for concern if there is evidence of low switching costs (in this case low switching rates may only indicate that consumers are content with their current products)'.[8] It could also reflect that firms are competing harder to retain existing consumers.

As part of the market study we conducted analysis on the potential benefits of switching, including how much consumers could save by choosing a credit card with a better interest rate. Please see Annex 4 of our interim report for further details.

The feedback received does not give us cause to revise our overall findings on shopping around and switching. We remain of the view that, while credit cards can be complex, often for good reason given the flexibility of the product and because usage patterns may vary, this makes it difficult for consumers to compare offers and identify the best offer for them. We continue to believe transparency could be improved around credit card products and their features. This would enable consumers to choose the best deals.

Balance transfers

32. A number of respondents raised points concerning balance transfer products. These are discussed in detail below.

Early removal of promotional offers

Feedback

33. Two respondents raised concerns about the early removal of promotional offers (such as 0% balance transfer offer) when consumers miss a payment during their offer period:

- One industry respondent raised concern that such early removals are overly punitive, disproportionate to the costs incurred by the firms and actively leverages information asymmetries. They added such measures impact the consumer's credit rating, which then make it harder for that consumer to shop around and secure alternate credit.
- This issue was also raised by a consumer body that expressed concern that this was likely to lead to high interest charges and was not consistent with Treating Customers Fairly.

[8] FCA, *Credit Card Market Study: Interim Report,* para. 4.34

Our response

In the interim report, we set out how some firms withdraw a consumer's promotional offer (such as their 0% balance transfer offer) if the consumer fails to make a minimum payment by the due date or if the consumer exceeds their credit limit.

As set out in the interim report, based on figures submitted by firms, it appears that for most firms that withdraw promotional offers, around 5% to 10% of their consumers on promotional offers lose their offer before the end of the promotional period. For some firms, the figure is considerably higher.

We also found that financial promotions did not outline the impact, if any, on the initial promotional offer should a consumer miss or make a late payment.

We agree that the detriment consumers may incur from losing their promotional offer may be considerable and would encourage firms to consider how their approach aligns with the principle of treating their customers fairly. As set out in the interim report, we are pursuing this issue through supervisory action with individual firms whose percentage of promotional withdrawals is considerably higher than the average.

Charging interest on fully paid purchases during a BT offer period

Feedback

38. One respondent stated that the complexity and opaqueness of charging structures meant that consumers are likely to incur unexpected charges on fully repaid purchases during a balance transfer (BT) offer period. The respondent added that it is difficult to understand why firms would charge interest in this manner if they do not normally charge interest on fully repaid purchases.

Our response

In the interim report, we set out how interest-grace periods work[9] although we did not explicitly reference how this interacts with purchases during a BT period.

In the case where a consumer has transferred a balance on to the card and has not paid that balance off, if they have a 0% balance transfer deal then they will not be incurring interest on that BT element of the balance. However, because there is overall an outstanding balance on the card then for new purchases, interest starts accruing from the date transactions are applied to the account. Some cards also have a 0% purchase deal which would mean that there is no interest accrued on purchases either, although in many cases the duration of purchase deals are shorter.

Recent innovation has seen one firm charging no interest on fully repaid purchases during the balance transfer period.

We recognise that consumers accustomed to paying no interest on fully repaid purchases may incur unexpected charges as a result. We would expect firms to make clear to consumers when they are taking out a card with a balance transfer that they will incur interest on all purchases while an outstanding balance remains, if this is the case.

Presentation of balance transfer fees

Feedback

43. Three respondents raised an issue with the price transparency and comparability of balance transfer offers, in particular how balance transfer fees are presented:

- Two consumer groups raised an issue with the price transparency and comparability of balance transfers, arguing it is difficult for consumers to work out their total cost of credit, and to compare offers.
- An industry respondent also advocated greater prominence of the costs relating to balance transfer fees on comparison websites, noting that the balance transfer fee is not as prominent as other costs on comparison websites. Likewise, where positive features and negatives features are displayed, the balance transfer fee does not feature in the same way as other fees.

[9] FCA, *Credit Card Market Study: Interim Report,* para. 3.28

Our response

In the interim report, we found balance transfers a significant feature of the market – they are popular with consumers and provide a valuable role in facilitating competition for existing consumers with outstanding balances. We found that consumer understanding of balance transfers was mixed. Our consumer survey found that some consumers with balance transfers may not fully understand how they work. Only 59% of respondents who had made a balance transfer to or from their main card in the last 12 months correctly answered three true or false questions about 0% balance transfer deals. Work by Which? also found that consumers often struggle to understand the true cost of balance transfer deals.[10]

We agree that consumer understanding of balance transfers is mixed and that firms and price comparison websites (PCWs) need to be clear about the fees associated with such deals.

Recent innovation and developments in this area have seen firms and PCWs developing tools to help consumers identify the most appropriate product for them, as well as increased competition on balance transfer fee and duration.

Price comparison websites (PCWs)

Feedback

47. Three respondents agreed with our finding that headline rate offer presentation may not aid comparison:

- A consumer group noted that it was very important to provide clear information to borrowers using plain, simple English and simple terms without mathematical calculations or APR and interest rates that people find hard to follow.
- Another respondent suggested that credit card users would benefit greatly from more tangible monetary expressions tailored to their own card use. It also suggested that we promote a costs calculator to help consumers better understand and compare different credit card products.
- A third respondent commended the FCA for highlighting this issue.

48. One industry respondent commented that the benefits of competition between credit card providers often depends on the nature of competition in the PCW market. PCWs can constrain the prices a provider can charge through other channels by using 'most favoured nation' (MFNs) clauses[11]. It added that CMA found an adverse effect on competition from wide MFNs concerning private motor insurance and that we should consider the impact of these types of clauses on competition and whether more action is needed.

[10] Which?, *'0%' balance transfers misleading consumers (2015)*: https://press.which.co.uk/whichpressreleases/0-balance-transfers-misleading-consumers/

[11] The CMA categorised MFNs into two classes – Narrow MFNs are clauses state that the price quoted through the PCW to consumers will always be competitive with the price on the PMI provider's own website, i.e the price on the PMI provider's own website will never be cheaper than the price on the PCW. Wide MFNs are clauses state that the price quoted through the PCW to consumers will always be competitive with any of the prices available, whether on the PMI provider's own website (as for narrow MFNs) or on other PCWs, i.e the price on other sales channels will never be cheaper than the price on the PCW.

Our response

In the interim report, we noted that the presentation of headline rate offers through PCWs may not aid the comparison process because it does not account for the fact that a consumer may not be eligible for that rate/offer.

Our review of a sample of contracts between credit card providers and PCWs found that some 'narrow MFNs' were in operation, as outlined in Annex 7 – A review of price comparison websites. These clauses outline that credit card providers must not offer their product on their website on more favourable terms than those available on the PCW. Our review of a sample of contracts did not find any 'wide MFNs' in use as identified by the CMA in their private motor insurance investigation. We considered that in light of our overall finding that the credit card market was working well for most consumers and that we did not identify any specific limitation on price competition because of PCWs, we did not consider it necessary to conduct further analysis of the contractual provisions between PCWs and credit card providers. However, if specific evidence is brought to our attention that MFN, or similar, clauses are having an adverse effect on competition, we will reconsider our decision.

Use of differential pricing at acquisition

Feedback

51. Some firms raised concerns that the presentation of offers involving differential pricing[12] at acquisition inhibits consumers' ability to choose the best deal and could have an adverse impact on competition:

- One industry respondent expressed the view that many consumers are re-priced at acquisition and this could significantly distort competition. Consumers can apply for a product without knowing that they may not receive the headline rates and offers. It may also call into question whether the advertising for that product could really be viewed as 'clear, fair and not misleading'.
- A second industry respondent advocated that, while firms should retain the option to undertake range pricing if they choose, firms should always give equal prominence to the range of APRs that successful applicants may receive.
- Regarding quotation searches, a third respondent proposed that, where the range of promotional periods or possible APRs is broad, consumers should be provided with a more detailed assessment and a more accurate indication of the APR and promotional period they are likely to receive.

[12] This practice is referred to in different terms, including 'differential pricing', 'risk-based pricing' and 'range pricing'. It refers to the practice whereby a consumer applying for a card with a given headline rate (either APR or promotional offer) is offered less favourable terms (usually due to risk).

Our response

In the interim report, we noted that firm strategies varied in their approach to differential pricing at acquisition. Some firms offer consumers applying for the same card different prices or promotional terms based on their risk profile. Other firms have a policy of not varying pricing at acquisition in this way and will either offer the headline terms or decline the application.

We also noted that consumers may not end up choosing the best card for them because they cannot effectively compare the different cards available to them. We gave the example that consumers may not know the actual terms they will be offered when they apply for a credit card due to firms' differential pricing.

We recognise that differential pricing at acquisition can have benefits, such as allowing pricing to vary according to risk, and do not propose to constrain firms' abilities to use differential pricing at acquisition.

However, as noted in the interim report, differential pricing and its communication to consumers may contribute to consumers not choosing the best product for them.

As stated in PS16/15 (May 2016)[13], we share respondents' concerns about firms not always making clear to consumers whether the product price or terms could change on application. This may also be of particular concern where a product is stated to be 'pre-approved' or 'guaranteed' (and we would remind firms of CONC 3.3.3R and the guidance at CONC 3.3.4G[14]).

The industry (including lenders, PCWs and CRAs) are well placed to improve quotation search tools. This would allow consumers to see a reasonably accurate indication of their eligibility and the potential price and terms of a product before applying for credit. It could also make clear to consumers any limitations on the offer and whether or not the product price or terms could change on application.

As announced in PS16/15, we welcome cross-sector work this year by the British Bankers' Association, the Finance & Leasing Association and the UK Cards Association. This will:

- assess the extent to which recent market innovations help consumers to shop around
- identify any areas where improvements may be helpful for customers.

This could include opportunities to develop industry standards for quotation search tools usage. This would address the issues identified above and raise awareness of these tools among consumers.

Re-pricing of existing consumers

Feedback

59. One industry respondent raised concern about seemingly widespread re-pricing of existing consumers. The respondent asked whether this was fair or detrimental to consumers. They submitted that most UK credit card issuers operate various

[13] FCA, *PS16/15: Feedback on CP15/33, Consumer credit: proposals in response to the CMA's recommendations on high-cost short-term credit (2016)*: www.fca.org.uk/your-fca/documents/policy-statements/ps16-15-consumer-credit-proposals-from-cma-hcstc-recommendations

[14] FCA, *CONC: Consumer Credit sourcebook: 3.3*: www.handbook.fca.org.uk/handbook/CONC/3/?view=chapter

methods of re-pricing existing customers, not only risk-based re-pricing but also re-pricing for profitability. The respondent adds that customers are often not told the reason for the re-pricing, since there is no regulatory requirement to do so. This means customers are unlikely to know whether they are re-priced due to being higher risk or for other reasons.

Our response

In the interim report, we note that changing a consumer's interest rate after an account is opened is common in the credit card market. We set out three broad scenarios where consumer re-pricing takes place. Namely risk-based, retention and portfolio-wide.

Data from UK Cards shows the number of accounts being re-priced upwards trebled in the second half of 2015, with 1.1% of accounts being re-priced in Q3 2015 and 1.4% of accounts being re-priced in Q4 2015 (a total of 1.3 million accounts). The average size of the price increase was 3.4% in Q3 and 3.5% in Q4.

Present FCA rules in CONC 6.7 require a 60 day period after the firm announces an increased rate of interest, during which a customer can give notice of account closure. An increase must be for a valid reason and we give guidance on examples of valid reasons. These include recovering genuine increased funding costs of credit under the agreement and a change in risk presented by the consumer, which justified the change in interest rate. The latter would not generally include missing a single payment or failing to repay in full on one of two occasions. Further, if a firm increases the rate of interest based on a change of risk presented by the consumer, the firm must notify the consumer of that fact and, if requested, provide an explanation, which may be a generic explanation for such increases. We recognise that the ability for firms to re-price consumers is an important feature of a revolving credit product given that funding costs, market conditions and an individual consumer's risk can change over time. We do not propose to limit firms' ability to do so beyond existing CONC requirements.

Firms should also note though that there are other rules and regulations relevant to re-pricing that may affect firms' ability to re-price consumers. In addition to complying with existing CONC requirements, firms should ensure that any re-pricing they carry out complies with other relevant consumer legislation. This includes, but is not limited to, ensuring that contractual terms relied on to carry out re-pricing are compliant with the unfair terms provisions of the Consumer Rights Act 2015 (or the Unfair Terms in Consumer Contracts Regulations 1999 for contracts entered into before 1 October 2015).

Extent to which credit searches actually damage credit scores

Feedback

63. Two trade bodies in their responses note the interim report's focus on shopping around damaging credit scores concerns consumers' perception of the impact of their credit score. They suggest further work should be done to understand whether the evidence supports this perception and whether gaps in the provision of quotation searches are really having a detrimental impact.

Our response

In the interim report, we set out relevant results from our consumer survey. It showed that some consumers, particularly higher risk consumers, were concerned about the impact of multiple applications on their credit rating. As part of the interim report, we did not explore in detail the actual impact on credit scores. We would be interested in any work that stakeholders have done in understanding this issue further. However, as noted in the final report we are keen to ensure that consumers are able to shop around without damaging their credit score and further work in this area is being undertaken by the BBA, FLA and UKCA.

Feedback on rejected applications

Feedback

65. One consumer body encouraged the FCA to make sure that consumers whose applications for credit cards are rejected receive information about why they were rejected.

Our response

Section 157 of the Consumer Credit Act 1974 requires a creditor to tell a customer if it decides not to proceed with an application for a prospective regulated credit agreement on the basis of credit reference agency information. In that case, the creditor must include the contact details for the relevant agency. The customer has a right to seek his or her credit file from the agency for a £2 fee.

Firms' business models and cost recovery

67. Respondents to the interim findings did not challenge the main discussion of cross-subsidisation. Several respondents did make comments on other aspects of this area of investigation, which are discussed in detail below.

Higher returns in the higher risk segment

Feedback

68. Three consumer groups raised higher returns in the higher risk segment as a concern and suggested that this was an area the FCA should look at further.

69. One group noted that in a properly functioning market, the higher returns should be competed away. That they continue suggests problems in this sector need to be explored further.

70. Another group suggested we do further work in this area to assess if a small number of firms are taking advantage of a subpopulation restricted to accessing subprime credit.

71. The third group argued we should increase the focus on this part of the market in the final report as the credit card market is not working well for consumers vulnerable to financial difficulties.

Our response

In the interim report, we observed that there might be less competitive pressure on firms in the higher risk segment than in the lower risk segment due to: fewer firms operating in this segment, a limited selection of products and consumers focusing on the likelihood of acceptance. We also looked at the relative rates of return between products from both higher and lower risk segments and found, while being cautious about placing too much weight on the result, that between 2010 and 2014, returns were on average higher for higher risk products, typically by around 6%.

We consider that competition is working less well in the higher risk segment. The main barriers to serving this segment, other than commercial viability, appear to be the reputational and regulatory risks associated with higher risk and higher cost lending.

We remain of the view that these features are likely to lead to less competitive pressure on firms in the higher risk segment than in the lower risk segment and that competition is working less well for consumers in this segment.

If higher risk consumers had a greater choice of firms offering products to them and were more comfortable searching around for the best deal, then we believe this would increase competitive pressure in this segment and reduce prices for consumers. Wider FCA work on quotation searches[15][16], the development of open access to data (APIs) and wider work on PCWs, should enable consumers to shop around without damaging their credit score.

Default fees and charges

Feedback

76. Two consumer groups highlighted concerns around default fees and charges in the higher risk segment.

77. The first respondent noted the finding that credit builder 'low and grow' cards are likely to have more income from default fees and charges. They expressed concern about this finding given that these cards are aimed at less experienced consumers and people more vulnerable to financial difficulty. They suggest that these cards are not necessarily suited to the needs of these borrowers and do not always help borrowers to build a good credit record.

78. The second respondent noted the FCA's analysis that 'low and grow' card users are more likely to have exceeded their credit limit than the generality of card users (20% of 'low and grow' cardholders compared with 7% of card users overall). While they appreciate this is a minority of 'low and grow' cardholders, they note that nonetheless it represents a sizeable and worrying number of consumers. While these cards may be useful products for consumers to build their credit rating and to smooth income and expenditure, they suggest that this evidence indicates that such cards do not always work for consumers and may in fact risk damaging already fragile credit scores.

[15] FCA, *CP 15/33 Consumer credit: proposals in response to the CMA's recommendations on high-cost short-term credit (2015):* www.fca.org.uk/static/fca/documents/consultation-papers/cp-15-33-cma-remedies.pdf.

[16] FCA, *PS 16/15 Feedback on CP15/33 Consumer credit: proposals in response to the CMA's recommendations on high-cost short-term credit (2016)*: www.fca.org.uk/news/ps16-15-consumer-credit-proposals-in-response-to-cma-recommendations-on-high-cost-short-term-credit

Our response

In the interim report, we found that most default fees are a material but small proportion of total income (around 2% to 7%). For firms operating in the higher risk segment, the proportion is higher at 9%.

In March 2016, one credit card firm, NewDay, announced that it will refund over £4 million to over 180,000 customers following disclosures made to the FCA.[17] In 2015, NewDay reported that it had undertaken a review of its business in preparation for the FCA's new regulatory regime for credit, which commenced in April 2014. This included looking at the fairness of its charging model. NewDay had identified that, in a small number of circumstances, default fees and other charges triggered additional charges in a way they considered unfair. In addition, delays in posting transactions also meant some customers incurred additional charges NewDay felt were unfair. NewDay determines that approximately 3% of its customers will be due redress under its scheme.

We expect all firms to consider the fairness and impact of their default fees and charges. It is important that firms, where they identify concerns in relation to their fees, disclose those concerns to the regulator, proactively act on those concerns and keep the regulator informed.

Following the responses received, we carried out further analysis looking at the extent to which consumers in the higher risk segment ended up in potentially problematic debt (as measured by our indicators of potential problem credit card debt) having taken out a credit card. This analysis is set out in Chapter 5, and in greater detail in Annex 2.

This analysis raised concerns about how appropriate these products are for some of the target consumers. We found that a quarter of credit cards in the higher risk segment opened in 2013 were in severe or serious arrears in 2014. While we would expect the rate of debt problems to be higher among higher risk customers, this analysis raises questions around the effectiveness of the affordability assessments carried out in this segment. Where necessary, if these issues are identified we will undertake supervisory action.

Profitability of consumers in problem credit card debt

Feedback

84. One industry respondent referred to our finding that those customers with persistently high levels of credit card debt, who may be struggling to repay, are profitable for firms. They state that the detailed work described in the interim report makes clear that the findings about profitability apply only to higher risk customers that have persistent levels of credit card debt. Further, they note that the profitability analysis (as acknowledged by the FCA) does not take into account the cost of capital and that this omission has a different impact on different customer groups – for example, the higher risk segment will have a higher cost of capital.

[17] www.fca.org.uk/news/credit-card-provider-newday-to-provide-redress-to-customers

Our response

In the interim report, our analysis focused primarily on marginal return from products. The findings about profitability do not apply only to high risk customers but it is true that the pattern is stronger for that group. We did not seek to factor in economic or regulatory capital costs. As set out in Annex 6 of the interim report, we did consider whether this would have a material impact on our conclusions. Our sensitivity checks showed that it would alter absolute profitability but would not overall affect our conclusions regarding firms' incentives.

The analysis in the interim report[18] found that the persistent debt group returns, on average, a higher rate of return than all other groups in the higher risk segment. In the lower risk segment, returns are comparable with the minimum payment and no problem credit card debt categories. These consumers are, on average, profitable for firms although not significantly more than other lower risk consumers.

Impact of the Interchange Fee Regulation

Feedback

87. One respondent thought that the effects of Interchange Fee Regulation go much wider than is referred to in the interim report and that the interim report underplayed their importance to competition.

88. Another respondent noted that it will be important to monitor the actual impacts of the Interchange Fee Regulation as they become evident across the market.

89. One small business respondent flagged a concern that some merchant service providers are exploiting the changes and charging more for their services.

Our response

As set out in our terms of reference[19], we did not propose to focus on the Interchange Fee Regulation in any great detail, as it falls primarily within the purview of the PSR, but would consider the implications of the interchange fee cap on credit card business models as part of our analysis.

In the interim report, we set out the potential impact of the Interchange Fee Regulation on firm income and possible firm responses to the changes. In this final report, we consider recent events in firms' response to the cap on interchange fees.

While the concerns raised concerning merchant service providers are out of the scope of this market study, we have noted the issue and have also shared the response with the PSR.

Problem credit card debt

93. There was widespread agreement among respondents that problem credit card debt was an important issue and that we were right to focus on over-borrowing and under-repayment in the interim findings and proposed remedies.

[18] FCA, *Credit Card Market Study: Interim Report,* para. 6.111

[19] FCA, *Credit Card Market Study: Terms of Reference*, para. 4.3

94. One respondent was critical that the interim report took too sanguine an attitude to those in persistent debt and who exhibit systematic minimum repayments.

95. We received two academic submissions. The first pointed us to further relevant literature on the effect of minimum payment information on the amount consumers repay. The second presented the results of early analysis of consumer behaviour in the credit card market that covered (i) switching, (ii) delinquency, (iii) the allocation of payments across multiple cards and (iv) the impact of direct debit on minimum repayment behaviour.

Indicators and metrics of potential problem credit card debt

Feedback

96. Several industry respondents raised questions about the potential problem credit card debt indicators we used in the interim report. These included **general methodological comments**:

- One respondent stated that more sophisticated definitions of potential problem credit card debt were needed, as the current definitions include many consumers who may not be at risk. This respondent also noted that for the purposes of the FCA's analytical work and the market study, these groupings were broadly appropriate and represented different types of behaviour and risks. But care should be taken, they believed, to avoid using these definitions as hard cut-offs and should not be considered in isolation.
- Another two respondents believed more effective ways to identify potential problem credit card debt could be used than those proposed in the interim report. One of them suggested a 'repayment ratio'[20] as a potential measure of persistent slow and low repayment.

97. Respondents also made **comments concerning specific indicators**:

- **Severe arrears** – one respondent stated an important distinction could be made between customers in arrears and those that are charged-off and they noted that these should be considered as distinct groups when developing remedies.
- **Persistent debt** – four respondents made comments about the persistent debt indicator. One consumer body responded that to understand potential detriment to consumers, it would like to see the absolute level of debt and the ratio of debt to income analysed. An industry respondent considered the FCA's approach of using a credit limit utilisation metric as a good starting-point but used alone it insufficiently identified the relevant group of interest and longer term persistence of high credit utilisation, credit turnover and affordability should also be considered. Another industry respondent stated that utilisation should not be used in isolation without consideration of credit limit because it is an unreliable indicator of consumers managing their debt poorly and unfairly penalises firms who have a conservative credit line policy. A third respondent noted that in the higher risk segment, in which consumers are often offered very low starting limits, high utilisation is unlikely to be a clear sign of problem credit card debt.
- **Systematic minimum payments** – one respondent noted that categorising systematic minimum repayers based on the number of months the consumer makes a minimum repayment can be a misleading indicator of low repayment. On one hand, consumers captured by the indicator may make very large payments in the months when they pay more than the minimum, and on the other, there will be consumers not captured by the indicator that pay just above the minimum

[20] Total repayments made relative to the total minimum payments requested over 12 months.

every month. Another respondent agreed that minimum repayment is not a reliable indicator of problem credit card debt in and of itself, and that consumers might wish to make minimum payments for a number of rational, economic reasons. A third respondent observed that the profile of consumers making systematic minimum repayments was not homogenous, with some financially constrained from making higher repayments and others able to pay more but choosing not to for a variety of reasons.

- **Estimated repayment term** – one industry respondent expressed reservations with our approach to estimating repayment terms and the conclusions that could be validly drawn from this analysis. Another industry respondent submitted evidence from their portfolio that in most cases estimated repayment terms overstate actual repayment times, with recent payment amounts correlating well with near term future payment amounts but repayments being far more variable in the longer term.
- **Cost of credit** – one respondent believed the cost of credit was not an effective outcome measure or indicator for potential problem credit card debt. We defined this in the interim report as total interest and charges on an account divided by the total value of transactions. The respondent noted that the value of this metric reduces with higher spend and that initiatives designed to help consumers pay down their debt (for example, payment plans that block new spend) may actually result in increasing consumers' cost of credit as measured by this definition.
- **Looking at indicators over time** – two respondents noted that consumers change behaviour over time, moving in and out of the potential problem credit card debt segments and that the FCA should avoid inferring too much about consumer behaviour based on snapshots or over small time horizons.

Our response

In the interim report, we set out indicators to assess the scale and nature of potentially problematic credit card debt. We remain of the view that these indicators are fit for this purpose. This analysis can be found in Annex 2.

We acknowledge in the interim report that the choice of thresholds necessarily involved subjective judgement, particularly for the persistent debt and systematic minimum repayment indicators and, for that reason, the problem credit card debt indicators were best interpreted collectively. We also noted each indicator has a number of limitations – in some cases they will capture some consumers that do not have problem credit card debt issues (for example, consumers making minimum repayments will be doing so for only a temporary period before resuming higher payments) and in other cases, individual indicators will neglect aspects of unaffordable credit card debt (for example, consumers making above minimum repayments are doing so with difficulty).

We regard the indicators of potential problem credit card debt used in the interim report as appropriate for the further analysis we are undertaking for this final report. In developing any remedies, we will give full consideration to the thresholds for applying any remedy to assess its appropriateness, taking into account consumers who would be covered by the remedy.

Alongside the final report, we are publishing further sensitivity analysis of the potential problem credit card debt indicators which gives greater insight into some of the underlying consumer behaviour. This analysis can be found in Annex 2.

Multiple cards

Feedback

102. Several consumer bodies raised the issue of consumers holding multiple cards as an area for further investigation.

103. One consumer body respondent noted that many consumers, particularly those with problematic credit card debt, will have more than one credit card and that the analysis should look at the individual consumers and the bundle of cards they have.

104. Another consumer body in their response noted that of their clients, those with multiple credit cards tend to have much larger credit card debt. They suggest the final report should consider the role of multiple cards in debt problems and how multiple credit card debt problems build over time.

105. A third respondent shared these concerns and suggested that further analysis would be particularly warranted concerning the types of credit card 'offer' that can result in consumer detriment. They also suggested getting a better understanding of the consumer journey into financial difficulty, including the role that offers such as 0% balance transfers, interest-free credit periods, unsolicited credit limit increases, and affordability checks play in the decline of a consumer's financial situation.

106. A fourth respondent put forward several suggestions for further areas to consider:

- the effects of multiple credit card use on people at risk of financial difficulties or already in financial difficulties

- whether evidence shows people are using credit cards as part of a cycle of debt and using one card to pay another card or other type of loan
- whether evidence shows people are keeping up with their household bills by using (or 'maxing out') credit cards to pay rent and mortgage payments and other essentials
- how credit card companies are sharing data and what affordability checks are suitable where someone has or is applying for multiple cards
- whether it is the role of the regulator to say how many cards are 'too many' for people to hold
- understanding the consumer journey using multiple cards where they end up in financial difficulty

Our response

We agree it is important to understand problem credit card debt at the consumer rather than account level. This is why the potential problem credit card debt indicators used in the interim report look across the various accounts held by a consumer, and the consumer is then assigned to the 'worst' arrears status across all their accounts.

Since publishing the interim report, we have undertaken significant additional analysis to explore multiple cards. The findings of this analysis are set out in Chapter 5 of the report, with greater detail on the underlying analysis in Annex 2.

Firms' incentives to deal with consumers with high levels of credit utilisation or systematic minimum payment behaviour

Feedback

109. One industry respondent disagreed that firms in the lower risk segment have no particular incentives regarding consumers with high levels of credit utilisation or systematic minimum payment behaviour. They agreed that these categories of consumers are profitable but stated that it was in every firm's interest to ensure that consumers do not fall into arrears, noting that consumers in arrears generate significant costs for firms. They argued that firms have incentives to identify which pockets of consumers are struggling to repay their credit card balances, as opposed to customers who exercise a choice not to pay off a greater proportion of their balance.

110. Another industry respondent disagreed that our finding of 'little evidence of firms intervening with customers currently meeting minimum repayments but exhibiting other signs of potentially problematic credit card debt (e.g. maintaining a high credit limit utilisation)' reflected current practice.

Our response

In the interim report, we recognise that firms have clear incentives to minimise default across their portfolio. However, we are concerned with firm incentives regarding those making systematic minimum repayments or in persistent debt as they are profitable and in many cases these consumers will never end up in arrears or default.

Regarding current practice on intervening with customers meeting minimum repayments but exhibiting other signs of potentially problematic credit card debt, we recognise that there is some good practice currently although it appears limited. As set out in the interim report, we believe more could be done to intervene earlier with consumers exhibiting signs of potentially problematic credit card debt.

Interaction with consumers' wider financial situation

Feedback

113. A number of respondents noted it was important to understand consumers' credit card debt within their wider financial situation and how credit card debt interacts with other forms of unsecured debt consumers may also be holding.

114. One consumer body noted that markets do not operate in isolation, and that for those unable to access HCSTC since the introduction of the price cap, one of the alternative sources of credit is credit cards. Another consumer group noted that many consumers with problem HCSTC also have credit card debt and that the final report should explore how credit cards interact with other forms of credit, particularly unsecured credit.

115. Two other consumer bodies provided insight from their experience of credit card debts in the context of multiple debts and how they may be used to service other essential expenditure.

116. One industry respondent provided evidence from their consumer base that some consumers captured by the potential problem credit card debt indicators also have large saving deposits with them and therefore that some consumers may have the means to pay off debt but choose not to do so.

Our response

To further develop our understanding of the interaction with consumers' wider financial situation, we conducted a review of the existing research carried out by consumer groups and others.

Research from Which? states that "spending is higher than ever per household, with consistent growth evident since 2012"[21]. This increase in spending takes place despite stagnant income growth and the research suggests consumer debt is accumulating as a result[22]. It is estimated that the average consumer credit debt was around £6,800 per household in 2016[23]. Approximately £2,400 was credit card debt[24], which is the most frequent type of consumer debt[25] [26].

The Money Advice Trust reported increasing costs leading to the reduction of the budgets of households[27]. Research from StepChange also shows that consumers with restricted household budgets are more likely to be showing signs of financial difficulty[28]. Some households rely on consumer credit to cover essential costs[29] [30].

Which? found that about one in five households does not hold any savings[31]. Having no or low savings makes people less resistant to a change in their circumstances, such as loss of employment[32] [33]. The available research shows that such changes contribute to problematic debt[34] because credit can be used as a safety net[35].

We agree that it is important to understand the issues identified in the credit card market in the context of consumers' wider financial situation. This is particularly important in informing effective remedy design. However, at the same time we are mindful of keeping the study focused on the issues identified in relation to credit cards.

[21] Which?, *State of Consumer Finances (2016):* http://consumerinsight.which.co.uk/report/state-of-consumer-finances-2016

[22] Which?, *State of Consumer Finances (2016):* http://consumerinsight.which.co.uk/report/state-of-consumer-finances-2016

[23] The Money Charity, *June 2016 Money Statistics (2016)*: http://themoneycharity.org.uk/media/June-2016-Money-Statistics1.pdf

[24] The Money Charity, *June 2016 Money Statistics (2016)*: http://themoneycharity.org.uk/media/June-2016-Money-Statistics1.pdf

[25] Which?, *State of Consumer Finances (2016):* http://consumerinsight.which.co.uk/report/state-of-consumer-finances-2016

[26] GFK, *GFK/UK Cards: Credit Card Market Research (2015)*

[27] Money Advice Trust, *Changing Household Budgets (2014):* https://www.nationaldebtline.org/EW/Documents/Changing%20household%20budgets.pdf

[28] StepChange, *Life on Edge (2014)*: http://www.stepchange.org/Portals/0/StepChangeLifeontheEdgereport.pdf

[29] StepChange, *Life on Edge (2014)*: http://www.stepchange.org/Portals/0/StepChangeLifeontheEdgereport.pdf

[30] GFK, *GFK/UK Cards: Credit Card Market Research (2015)*

[31] Which?, *State of Consumer Finances (2016):* http://consumerinsight.which.co.uk/report/state-of-consumer-finances-2016

[32] FCA, *Consumer credit and consumers in vulnerable circumstances (2014)*: https://www.fca.org.uk/news/consumer-credit-consumers-vulnerable-circumstances

[33] StepChange, *Life on Edge (2014)*: http://www.stepchange.org/Portals/0/StepChangeLifeontheEdgereport.pdf

[34] FCA, *Consumer credit and consumers in vulnerable circumstances (2014)*: https://www.fca.org.uk/news/consumer-credit-consumers-vulnerable-circumstances

[35] Money Advice Trust, *Changing Household Budgets (2014):* https://www.nationaldebtline.org/EW/Documents/Changing%20household%20budgets.pdf

Creditworthiness and affordability

Feedback

122. One industry respondent disagreed with the finding in the interim report that firms do not typically conduct regular affordability assessments once an account is active. They noted that CONC requires an affordability assessment to be undertaken for credit limit increases and that firms offering credit limit increases will regularly undertake an affordability assessment.

Our response

CONC 6.2.1R states that before significantly increasing a credit limit, the lender must undertake an assessment of the customer's creditworthiness. We have found that firms have different procedures before deciding whether to give a credit limit increase and this area will be explored further through our policy work.

How consumers in arrears are treated in practice

Feedback

124. One consumer body respondent noted that the interim report does not provide much information on how firms treat people in arrears in practice.

Our response

In Q4 2016, the FCA will report the findings of its thematic review of early arrears management in unsecured lending. The review examines how customers are treated by lenders when they first experience arrears and payment difficulties and includes a range of unsecured lending products including credit cards, personal loans and retail finance.

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