
Response to the super-complaint on credit card interest rate calculation methods by Which?

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BACKGROUND

1. Which? submitted a super-complaint to the OFT on 1 April 2007 relating to credit card interest calculation methods. Which? believes that there are six key features (other than the Annual Percentage Rate (APR)) which influence what card holders pay for credit on purchases, and that standardisation of these features would lead to enhanced competition on APRs. The six features are:

- **Interest free periods**,¹ that is whether an interest-free period is offered or not, and if so, whether it is conditional on the balance from the previous month being paid off in full.
- **End of interest charge**, that is whether interest is charged until the date of repayment in full or until the statement date before the cardholder repays the balance in full.
- **Interest calculation**, that is whether interest is calculated by multiplying the average daily balance in the month by the monthly rate or as a sum of the daily balances in the month multiplied by the daily rate.
- **Start of interest charge**, that is whether interest starts being charged from the date a purchase is made or the date it is posted to the account.
- **Statement day**, that is whether interest is charged until the day before a statement is produced, or until the day on which the statement is produced.

¹ Not to be confused with 0 per cent introductory deals.

- **Interest on interest**, that is whether the interest bearing balance in the current statement period includes interest charged on the previous month's statement.
2. Which? claims that summary boxes and terms and conditions on their own hardly ever provide sufficient information on issuers' interest calculation methods, and that variation in these methods means that APRs are not comparable between cards. Which? concluded that the existence of the six identified features prevented consumers from making an informed choice on the basis of price, and caused a consumer detriment of £0.4bn a year.
 3. The right to submit a super-complaint was created by section 11 of the Enterprise Act 2002 (the Act). A super-complaint is defined under section 11(1) of the Act as a complaint made by a designated consumer body that 'any feature, or combination of features, of a market in the United Kingdom for goods or services is or appears to be significantly harming the interests of consumers'. Which? is a designated consumer body.
 4. Section 11(2) of the Act requires the OFT, within 90 days after the day on which it receives a super-complaint, to publish a response stating whether or not it has decided to take any action in respect of the super-complaint and what action, if any, it proposes to take. Under section 11(3) of the Act, the response must state the OFT's reasons for its proposal. This document represents the OFT's response to Which?'s super-complaint on credit card interest rate calculation methods.
 5. On 7 October 2003 OFT made a submission to the Treasury Select Committee (TSC)'s inquiry into the Transparency of Credit Card charges. In its second supplementary response² OFT specifically turned to the issue of credit card interest calculation methods, and submitted that:

'We understand the arguments in favour of imposed standardisation in this area, but are not persuaded on the evidence available that it is either necessary or appropriate. As your [Clerk of the TSC] letter indicates, standardisation carries risks in terms of competition, innovation and consumer choice if firms are prevented from offering

² www.publications.parliament.uk/pa/cm200304/cmselect/cmtreasy/125/125we75.htm

alternative products which may be more beneficial to the consumer. For example, a firm may wish to offer a card product that has a lower interest rate than others but which always charges interest from the date a purchase is posted to the account until the date the credit is repaid. For some consumers this could be a relatively good deal, depending on the interest rate, and it would be regrettable if regulation blocked it. After all, an interest-free period is not an intrinsic property of a credit card, and millions of cardholders in fact pay interest each month.

Rather than constrain product choice, there may be merit in exploring the pros and cons of an industry 'standard' for the calculation of interest – possibly along similar lines to a CAT standard³ – with firms being free to deviate from that subject to appropriate transparency. This could be linked to the Summary Box approach. For example, firms could be required to indicate whether or not they calculate interest in accordance with the industry standard (which would be set out elsewhere in the document as well as publicly), and if not, would highlight as part of the Summary Box the ways in which the particular product differs from the standard and what impact this may have. Provided that this is done clearly, information could be enhanced in simple and practical ways without constraining commercial freedom or product design, innovation and choice.'

6. As part of the super-complaint process, OFT took this earlier policy approach into account in considering the super-complaint.

THE MARKET

7. Credit cards offer deferred payment for goods and services, including cash advances, up to a preset limit, and consumers receive a bill at the end of the billing cycle. The card issuer usually demands a minimum payment against the outstanding balance, but beyond this the customer can choose how much of the bill he or she wishes to repay, up to and including 100 per cent of the balance outstanding. Any balances which are not repaid will incur interest at the rate advertised by the card issuer.

³ CAT standards are applied to financial products to show whether they met certain standards on Charges, Access and Terms.

8. The table below gives an overview of the credit card market in the United Kingdom from 2000-2005. The number of cards in issue has increased dramatically over this period (from 47.1 million to 69.9 million), as has total transaction value (from £66.1 billion to £99.6 billion).

Figure 1 Credit cards: Number in issue, total annual transaction volumes and value, 2000-05

	Number in issue*	Transaction volumes	Transaction value	Average no. of transactions per card per year**	Average transaction value per card per year**
	M	bn	£bn		£
2000	47.1	1.4	66.1	30	1,403
2001	51.7	1.5	71.6	29	1,385
2002	58.8	1.6	81.1	27	1,379
2003	66.8	1.6	91.4	24	1,368
2004	69.9	1.7	99.4	24	1,422
2005	69.9	1.7	99.6	24	1,425
% change 2000-05	+48	+21	+51	-18	+2

* at year end

** calculated using number of cards in issue in the given year

Note: transactions incorporate UK purchases and cash acquisitions, and transactions (purchases and cash acquisitions) made outside the UK

Source: APACS/Mintel

9. The figure below shows the volume, value and average transaction value of credit and debit card purchases in the United Kingdom in 2005. Of all transactions made on credit cards, purchases account for 89 per cent by volume and 84 per cent by value.

Figure 2 Summary of debit and credit card purchases in the UK, annual transaction value and volumes, 2005

UK purchases		Debit cards	Credit cards
Volume	m	4,084	1,674
Proportion of total transactions	%	65	89
Annual change	%	+ 11	-3
Five-year change	%	+ 75	+ 32
Value	£m	170,672	99,554
Proportion of total transactions	%	53	84
Annual change	%	+ 14	-
Five-year change	%	+ 125	+ 51
Average transaction value 2005	£	41.79	59.47
Annual change	%	+ 3	+ 3
Five-year change	%	+ 29	+ 14

Source: APACS/Mintel

10. Research carried out by Mintel⁴ shows that the majority of credit card holders (61 per cent) held only one credit card, but that a significant proportion (approximately 38 per cent) held more than one credit card, and that just under half (47 per cent) of the credit-card-holding sample had taken out a new card at least once over the past three years. Almost half of the sample (47 per cent), however, had neither changed their credit card provider in the past three years nor had any intention of doing so.

11. The table below shows the market share of the main card issuers in the United Kingdom calculated by the number of customers. The table shows that the top five brands accounted for 51 per cent of the credit card market. In the debit card market, however, the same top five brands

⁴ Credit and Debit Cards, Finance Intelligence, July 2006 - Mintel

accounted for 70 per cent of the debit card sector (by volume of customers).

Figure 3: Estimated market share (by number of customers) of the top twenty credit card brands in the United Kingdom, April 2006

Issuer	Market Share
Barclays/Barclaycard	15.3
Lloyds TSB	12.0
Halifax	8.7
NatWest	8.0
HSBC	7.3
Capital One	6.7
Tesco Personal Finance	5.3
Egg	4.7
M&S Money	4.0
The Royal Bank of Scotland	3.3
Alliance and Leicester	2.7
Abbey	2.7
Nationwide	2.7
American Express	2.7
Bank of Scotland	2.0
Co-operative Bank	2.0
Mint	1.3
Sainsbury's Bank	1.3

Source: Mintel⁵

CONSUMER BEHAVIOUR AND CARD USAGE

12. Central to Which?'s argument for standardisation is that 'the easiest way for consumers to compare credit cards is to use the APR advertised by credit card issuers'. Which?'s survey⁶ found that 51 per cent of consumers believe that comparing the APR that credit cards charge was the best way of telling which card was the cheapest.

13. Which? described credit card users as using their cards in one of three ways:

- 'full payers' - those who use their credit cards for purchases which they then repay at the end of each statement period. Full Payers do not

⁵ Credit and Debit Cards, Finance Intelligence, July 2006 - Mintel

⁶ Online omnibus survey commissioned by Which? in March 2007.

use credit cards to borrow money for more than one month and they do not incur any interest charges unless they have a card with no interest free period

- 'part and full payers' - those who sometimes pay off their purchases in full at the end of the statement period, and sometimes pay off only part of the balance, and
- 'never payers' - those who never pay off their purchases in full at the end of a statement period.

REGULATORY FRAMEWORK

Relevant legislation

14. There is no current legislation which deals specifically with the six issues raised by Which? However, there are a number of regulations which cover related issues, particularly the Consumer Credit (Total Charge for Credit) Regulations 1980 as amended, which define how to calculate APRs, and the Consumer Credit (Advertisements) Regulations 2004 and the Consumer Credit (Agreements) Regulations 1983 (as amended) which specify the assumptions about the use of a credit card to be adopted when calculating the APR shown in advertisements or agreements.

Consumer Credit Directive

15. Directive (87/102/EEC) was originally adopted in 1987 and is based on minimum standards of consumer protection in a few key areas. The proposal for a new Consumer Credit Directive is intended to establish a single European market for the consumer credit sector as well as ensuring a high standard of consumer protection within Member States. Political agreement was reached on the text of this new Consumer Credit Directive at the Competitiveness Council on 21 May. If adopted the new Directive will harmonise the law of Member States governing agreements with consumers for unsecured credit of sums from €200 to €100,000. The proposal contains provisions defining the calculation of APR and the assumptions to be used in relation to credit card APRs which closely parallel the current UK provisions. It would also regulate the information contained in advertisements and agreements.

16. There are still a number of processes to be gone through before this Directive is formally adopted. In particular the European Parliament now has to conduct its second reading of the proposal. After the Directive has been formally adopted the UK would have two years to transpose the Directive. The Department of Trade and Industry (DTI) will lead on the transposition process.

Review of regulations

17. DTI also plans to carry out a review of a number of current consumer credit regulations, including those on advertising, agreements and pre-contract disclosure, to consider what changes might be made in advance of, or separately from, transposition of the Directive. DTI has confirmed that it will consult on any changes, and findings from the super-complaint response and any subsequent OFT work could feed into this process.

RESEARCH

18. To inform this Response, OFT undertook a number of different forms of research. The OFT carried out its own analysis of the issue, commissioned an independent survey of card holders, considered complaints levels in this area, met with various stakeholders, sent a questionnaire to 24 United Kingdom card issuers, and asked regulators from other countries whether they had considered any of the issues raised in the super-complaint.

SUMMARY OF RESEARCH

19. The OFT's own analysis of the issue confirmed Which?'s finding that the six issues identified would affect the cost of credit on credit card purchases. OFT considered, however, that a number of other features could also affect the total cost of credit for credit card holders, such as the order in which payments are made (that is, whether the most expensive credit was paid off first or not), and the cost of credit for cash advances and other features of credit cards.

20. The OFT also considered the methodology chosen by Which? to assess the consumer detriment figure of £0.4bn. That figure is the amount of extra interest card issuers would have to charge card holders if they

moved to using Which?'s benchmark calculation method if they wanted to remain revenue neutral (that is, they would not lose any income from standardising their method).

21. Which? considered that the benefits to consumers of the standardisation of the six features would be that card issuers would then change their APR to reflect these costs, and consumers could then exercise choice more effectively. Currently, many consumers are not aware that differences in these six features exist, and therefore do not understand that these differences can have an effect on the cost of credit.
22. The primary purpose of our survey of credit card holders was to find out the extent to which consumers actually compare credit card products, and to what extent features such as APR, and the six issues highlighted in the super-complaint, have an effect on decision making. The key result of the survey was that only 30 per cent of consumers shopped around for their credit card and compared it with other credit cards. Credit card holders were asked whether they had considered each of the six features raised by Which? when they chose their most recent card (whether or not they shopped around by comparing how these features applied to other credit cards). The least considered feature (the interest calculation method) had been considered by 17 per cent of card holders, while 39 per cent of card holders had considered the length of the interest free period for purchases. The survey showed that most consumers did not actively compare credit cards, and those that did had a patchy approach to which features they looked at.
23. The OFT sent a questionnaire to 24 card issuers in the market, asking questions about how interest was calculated for their card products, and seeking their views on standardisation of the features identified by Which?. A large majority of card issuers considered that standardisation would reduce the issuer's ability to innovate to meet consumer demand, therefore reducing consumer choice. We were told that different calculation methods act as a 'competitive differentiator' and one issuer thought standardisation would lead to higher costs for the consumer.
24. Some of the issuers were open to the idea of benchmarking, which could involve creating a 'norm' that was not obligatory, but deviation from which must be highlighted. Other issuers mentioned the USA's Truth in

Lending Act, (commonly known as Regulation Z) which provides a set number of interest calculation methods as a better possibility. Card issuers are required to clearly advertise which methods are used for each card product. However, many issuers thought that benchmarking could result in more confusion for consumers as any deviation from the benchmark would be perceived unfavourably, whether or not that was the case.

25. Many issuers could see the value in describing the method of calculation in a fully clear and consistent manner, allowing market forces to operate unhindered. Many commented that the credit card industry had already gone to great lengths to improve transparency, for example, with summary boxes.

26. Most international regulators approached by the OFT had not looked at the issues raised. OFT looked at complaint levels that the issue has generated for a number of organisations, including APACS, BBA and Consumer Direct. In all cases the complaint numbers were negligible. BBA did not consider that the six features raised by Which? were a major factor in consumers' deliberations when choosing a card, but did think that, for some consumers who did shop around, some or conceivably all of the six features might contribute to the decision making process, amongst other things, such as the colour or shape of the card, if partially sighted. APACS considers that the high level of competition between card issuers brings major benefits to consumers in that, by varying product features, the issuers in effect waive amounts of interest to a greater or lesser degree; standardisation as Which? propose it would prevent such competition and produce less good deals for the consumer.

ANALYSIS

27. Which?'s starting point is that APRs are the easiest way for consumers to compare credit cards. Although OFT believes that APRs currently provide the best method of comparing different credit cards, OFT's recent research showed that many consumers did not base their most recent credit card choice on advertised APRs. Moreover, because cards are used in different ways the APR itself has less value to consumers whose usage patterns differ from the assumptions contained in the APR calculation. Standardisation of card features that would lead to a more comparable

APR would not address these problems. Standardisation may also lead to lower overall cost of credit for some customers whilst others may see this rise depending upon payment patterns.

28. The evidence from all of these sources led to a number of conclusions:

- consumers do not generally choose cards on the basis of all the features which affect the cost of credit, including the six identified by Which?
- many consumers do not choose cards on the basis of APR or any other comparison at all
- standardisation of the six features that Which? have identified as having an effect on the cost of credit would, therefore, only partly resolve the problem, and would lead to reduced product choice for those consumers who do shop around
- the problem with many consumers being unable to choose the card most appropriate for them goes wider than the six issues raised by Which?, and goes wider than just interest on purchases, and
- any solution must involve the total charge for credit on credit cards, not just some parts of it.

THE WAY FORWARD

29. The OFT believes that any future work in this area would need to be much wider in scope than Which?'s super-complaint (Which? also suggested that OFT should, in addition to standardising the six features, carry out additional, wider research into the cost of credit for credit cards and similar products). Subject to further consideration of each issue, it might, for example, include, store card issuers, non-purchase transactions, and other features of interest calculation and APR. The OFT also took into account the wider on-going work in financial services and of the level of regulatory burden that would be placed on the industry by any further major initiatives. The OFT therefore considered three main options:

- a market study
- to take no action at all, or
- to work with the industry to improve transparency surrounding interest calculations.

Market study

30. As set out in the OFT's guidance, *Market studies*,⁷ the principal outcomes of a market study are:

- giving the market a clean bill of health
- publishing information to help consumers
- encouraging firms to take voluntary action
- encouraging a consumer code of practice
- making recommendations to the Government or sector regulators
- investigation and enforcement action against companies suspected of breaching consumer law or competition law, and
- a market investigation reference to the Competition Commission.

31. A market study following directly from the super-complaint does not seem to be the most effective OFT action. While enforcement action by the OFT, and a recommendation for legislative change could not be ruled out, many of the solutions reached via a market study could be implemented only by legislation or by agreement with the industry, and the resource cost on OFT and on the industry of a market study would be significant.

Take no action

32. The second option considered by the OFT was to find that no further action was required. The evidence, particularly complaint statistics, demonstrates that this issue is not a priority for consumers. It is, however, clear that detriment to consumers does exist insofar as many consumers seem to be unable to choose the best card for their needs (we have not been able in the time available to calculate our own measure of detriment), and to take no action would self-evidently not address this issue. In these circumstances, taking no further action was not the best option.

Negotiated approach to address consumer choice issues

33. The third option considered was to move straight from the super-complaint to initiating a negotiated approach to resolving the issues. This approach would lead to two of the possible outcomes that a market study

⁷www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft519.pdf

could recommend, that is, encouraging firms to take voluntary action, and to publish information to help consumers, and would be significantly less resource-intensive for both OFT and the industry than a full market study.

34. Many of the card issuers and other organisations contacted by the OFT acknowledged that more work could be done on making the cost of credit for card products more transparent and comparable. This approach would be best suited to addressing the primarily informational problems which consumers seem to face in deciding which credit card to choose. It also has the potential to bring genuine improvements to consumers' ability to choose the right card product, and will not impose an undue regulatory burden on the card industry.

OFT'S PROPOSED ACTION

35. The OFT will initiate a negotiated approach to finding a way for consumers to make well informed decisions about the best card products for their needs, without restricting the commercial freedom of card issuers. While a recommendation for new or revised legislation cannot be ruled out, any such recommendation is likely to have to be within the context of existing and forthcoming legislation. The OFT expects to work with the credit card industry (which has already introduced a number of transparency initiatives to provide customers with clear and up-front information in order that they choose the product most appropriate to their needs), with consumer groups such as Which?, and with regulators and government bodies. It is expected that this will last up to six months. The OFT will then report on the agreed recommendations, conclusions, and, if appropriate, agreed actions.

36. Possible areas of inquiry could include building on the transparency work that has already been started by the industry, looking at introducing tools that will not only allow comparison of card features, but also of the cost of credit for potential card holders; voluntary standardisation of some card features; the role to be played by financial intermediaries and the possibility of a consumer education campaign on the subject. Any solutions reached would, however, rely on voluntary agreement from card issuers, which would be subject to competition law. OFT will monitor the implementation and effectiveness of any recommendations that are made.

37. Should this negotiated approach fail to produce workable recommendations for improvement within the initial period of six months, along with timetables for implementation, OFT will consider what further action, if any, needs to be taken.

NEXT STEPS

38. The OFT has concluded that the outcome of the super-complaint should be work undertaken with the banking industry and consumer bodies in a voluntary initiative to increase transparency surrounding the cost of credit arising from the use of credit cards. This course of action would seek to address the key concern raised by Which? that consumers often choose a credit card which is not the best available for their needs.

39. OFT will shortly invite card issuers, trade associations, consumer bodies, government departments and regulators to take part in this negotiated approach. Others who wish to contribute to this process should contact the OFT. The results of this approach will be publicised in six months.