



Store cards market investigation

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The Competition Commission has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by ✂.

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Store cards market investigation

Contents

	<i>page</i>
Summary.....	1
Store cards.....	1
Store cards.....	1
Store cardholders.....	1
Retailers offering store cards.....	2
Store card credit providers.....	2
The store card sector.....	3
The relevant economic markets.....	3
Competitive assessment.....	3
Upstream competition.....	3
Downstream competition.....	4
Features that prevent, restrict or distort competition.....	6
Detrimental effects on customers.....	7
The need for remedial action.....	7
Decisions on remedies.....	8
Full information on statements.....	8
APR warning on store card statements.....	9
Provision and prominent display of facility to pay by direct debit.....	9
Separate offer of payment, purchase and price protection insurance.....	10
Implementation.....	10
Findings.....	11
1. Introduction.....	11
2. Background to the reference.....	14
3. The store card sector.....	15
Introduction.....	15
Characteristics of store cards.....	15
Other plastic cards.....	16
Budget cards.....	16
Loyalty cards.....	17
General debit and credit cards.....	17
Store-branded credit cards.....	17
Summary.....	17
Key store card sector data and trends.....	17
Data for 1999 to 2004.....	18
Projections for 2005 and 2006.....	19
Longer-term trends.....	20
The emergence of SBCCs.....	20
Characteristics of store cardholders.....	22
The retailers offering store cards.....	24
The store card providers.....	25
The provision of store card services.....	26
Store card insurance.....	29
Store card and credit card income analysis.....	31
Current state of, and recent developments in, the store card sector.....	33
Reductions in APRs and risk-based pricing on store cards.....	33
Store card projections, taking account of recent developments.....	36
4. Regulatory and self-regulatory framework.....	38
A. The regulatory framework.....	38
The CCA.....	38

	Recent regulations under the CCA.....	38
	Unfair terms in contracts	39
	Consumer credit bill.....	39
	OFT recommendations.....	40
	The regulation of consumer contracts for insurance	41
	The Unfair Commercial Practices Directive.....	41
	B. Sector self-regulation.....	42
	Post-contractual information.....	42
	C. Investigations into issues relevant to store cards	43
	OFT investigation of default charges on credit cards	43
	OFT market study of the PPI sector	44
	FSA investigation of PPI.....	44
5.	The statutory questions.....	45
6.	Market definition.....	46
	Introduction	46
	The provision of store card credit services to retailers: ‘the upstream market’	46
	Is each contract a separate market?	47
	Whether the market is wider than ‘store card credit services’	47
	Upstream geographical market	50
	Upstream insurance market	50
	Conclusion on the market for the provision of store card credit services to retailers.....	51
	The provision of consumer credit through store cards: ‘the downstream market’	51
	Store card characteristics.....	51
	Economic market definition	56
	Assessment: whether each store card programme supplies consumer credit within a wider market, including credit cards.....	64
	Assessment: whether each store card programme supplies consumer credit within a wider market, including other store cards	81
	SBCCs.....	83
	Downstream geographic market	83
	Downstream insurance market.....	83
	Conclusion on market definition	85
	Summary of findings and conclusions on market definition	85
7.	Competition for store card credit services to retailers	88
	Introduction	88
	General views of the parties.....	88
	Entry.....	89
	Regulatory requirements for setting up as a store card credit provider.....	90
	Economies of scale	92
	Contract length and other features of contracts	93
	Switching and switching costs.....	96
	Ease of switching	96
	Costs of switching	98
	Benefits to retailers.....	99
	Findings.....	102
8.	Competition for consumer credit through store cards—the downstream market	103
	Introduction	103
	The provision of store card services	103
	APRs	104
	How APRs are set.....	105
	Whether APRs are above competitive levels	120
	Overall findings on APRs	137
	Late payment fees.....	138
	Introduction.....	138
	The setting and pricing of late payment fees.....	138

	Late payment fee application policies	138
	Retailers' role in the setting and levying of late payment fees	139
	Awareness of late payment fees by retailers' customers and store cardholders.....	139
	Costs attributable to late payment fees	141
	Findings on late payment fees	142
	Overall findings on late payment fees	142
	The sale of insurance with store cards.....	143
	Introduction.....	143
	Arrangements between credit providers and retailers.....	143
	The offer of insurance to cardholders.....	146
	Findings on insurance	149
	Overall findings on insurance	150
	Information on cardholder statements.....	151
	Overall findings.....	152
	Cost-reflective APRs	152
	Conclusions.....	154
9.	Findings and conclusions.....	155
	Detrimental effects on customers.....	157
	Estimate using cost-reflective APRs	157
	Estimate using excess profits.....	158
	Finding on the customer detriment.....	158
	The need for remedial action	159
10.	Remedies	161
	Overview	161
	Framework for decision on remedies	161
	General issues raised in response to proposed remedies	162
	Consideration of specific remedies	163
	Full information on statements	163
	APR warning on statements.....	166
	Provision and prominent display of facility to pay outstanding balances by direct debit.....	175
	Separate offer of payment, purchase and price protection insurance.....	177
	Decisions on remedies.....	179
	Full information on statements	179
	APR warning on store card statements.....	180
	Provision and prominent display of facility to pay outstanding balances by direct debit.....	180
	Separation of payment protection insurance from the PPI package	181
	Recommendations for action by others.....	181
	Implementation.....	181

Appendices

1.1	Terms of reference
1.2	Varied terms of reference
1.3	Variation of the terms of reference
1.4	Conduct of the inquiry
1.5	Evidence posted on the CC website
1.6	Submissions and oral evidence
3.1	Store cards and their APRs at the end of March 2005
3.2	Market shares of store card providers
3.3	Store card insurance
3.4	Details of store card insurance cover
4.1	Information provided on monthly statements
6.1	Two controlled experiments to reduce APRs offered to store cardholders

- 7.1 History of entry into the store card market
- 7.2 New programmes from 1999 to 2003
- 7.3 Providers' outsourcing arrangements
- 7.4 Length of contracts
- 7.5 Contracts reaching termination date, 2005 to 2015
- 7.6 Evidence of switching
- 7.7 An assessment of tenders
- 7.8 Incidence of switching
- 7.9 Switching provider of a store card programme: providers' approach and customers' rights
- 7.10 Payments to retailers
- 8.1 Income and costs of store card providers
- 8.2 Application credit scores, balances and profitability
- 8.3 APR changes over time
- 8.4 Approach to measuring profits and the cost of capital
- 8.5 Detailed financial information on store card providers
- 8.6 Comparative analysis of profitability of store card providers
- 8.7 Information on late payment fees
- 8.8 Cost-reflective APRs
- 8.9 Analysis of store card profitability over the life cycle
- 9.1 Quantification of consumer detriment
- 10.1 Notice of possible remedies
- 10.2 Illustration of proposed card statement format

Glossary

Company directory

Summary of findings

This summary should be read in the context of the full report, of which it forms a part.

The reference

1. On 18 March 2004, the Office of Fair Trading (OFT) referred to the Competition Commission (CC) for investigation the supply of the following services ('the reference services') in the UK: (a) store card credit services to retailers and services related thereto (store card credit services); and (b) consumer credit through store cards. The CC subsequently sought a variation of the reference and on 3 March 2005, the terms of reference were varied to refer to the supply of the following services (the reference services): (a) store card credit services to retailers and services, including insurance services, related thereto (store card credit services); and (b) consumer credit through store cards and insurance purchased in association with the provision and use of those store cards.¹

Store cards

2. Store cards are used by retailers as a means of generating customer loyalty. They are usually defined as plastic cards, branded with a retailer's name or trademark, which can be used for payment or credit only in that retailer's outlets and, in the case of co-branded store cards, other 'accepting' retailers. Co-branded store cards such as Duet and Style have a network of accepting retailers. Store cardholders pay for their goods or services with the store card and, after a period of interest-free credit, receive a statement which is issued monthly; cardholders can then choose to settle the balance in full or in part. Incentives to take out a store card have traditionally been offered at the point of sale, typically in the form of a discount on purchases made at the time (or shortly after) the store card is taken out. More recently, some retailers have replaced or supplemented the initial discount with reward schemes (in the form of vouchers that can be redeemed in store) or other benefits.
3. Store cards offer a method of payment and a source of credit that is retailer-specific. They may be distinguished from budget cards because these do not have associated retail benefits such as initial discounts, reward schemes and privileges; from loyalty cards because these are not a method of payment or a source of credit; from general credit cards because these do not bear a retailer's brand, generally do not offer retailer-specific benefits, and are accepted in a wide range of outlets; and finally from store-branded credit cards (SBCCs) because, although these are branded with the retailer's name and logo and usually offer benefits such as discounts and vouchers, they (like general credit cards) are widely accepted as a means of payment and source of credit.

Store cardholders

4. Store cards are held by all sectors of the adult population, although they are more likely to be held by women than men and slightly more likely to be held by those on higher incomes. We did not find that the majority of those who generally incur interest

¹In the early stages of our investigation we considered data for the period 1999 to 2003. As the inquiry progressed, we added relevant information for 2004. Subsequently, we sought projections for 2005 and 2006 from relevant parties. Naturally, from the beginning, we recognized that, given the expected length of the investigation, there would be changes and developments in the store card market. We took these into account in our analysis and interpretation of the data.

on their account (known as 'revolvers') found it difficult to access other sources of credit. About 80 to 85 per cent of revolvers have at least one credit card. The average balance across all store cards was about £150 per active account. Average balances were £250 for those paying more than the minimum payment each month but less than the full amount, and £800 for those paying the minimum amount or less. Revolvers told us that the main reasons for borrowing on their store card related to spreading the cost and budgeting rather than the unavailability or expense of other credit sources.

Retailers offering store cards

5. Department stores and clothing retailers account for the bulk of retail sales paid for with a store card. Data obtained from 54 retail groups with store card programmes in 2003 showed that 41 per cent classified themselves as clothing retailers and accounted for about 13 per cent of store card sales, while 37 per cent classified themselves as department stores and accounted for about 70 per cent of store card sales.

Store card credit providers

6. A few retailers, notably Argos, finance and operate their store card programmes in-house. However, most now contract with store card credit providers (providers) who finance and administer the store card on their behalf. As well as Argos, the main providers during our inquiry were Creation Financial Services Limited (Creation), General Electric Consumer Finance UK (GECF), HSBC Group (HSBC), Ikano Financial Services Limited (Ikano) and Style Financial Services Limited (Style). GECF is the largest provider by some margin, having a share in the range 50 to 70 per cent, depending on whether measured by the number of active accounts, the size of balances, the number of retail sales or cardholder revenue. HSBC is the second largest by virtue of its two main store card programmes, those for John Lewis Partnership (JLP) and Marks & Spencer plc (Marks & Spencer). None of the other providers had shares greater than between 10 to 20 per cent on any of the above measures in 2004 and some were well below that range.
7. The core functions of the provider include credit risk management, account processing, the provision of capital and marketing. The retailer provides the distribution channel—that is, access to its customers—and is often jointly responsible for marketing the store card. The retailer also funds cardholder discounts and other promotional or loyalty benefits. By taking out a store card, a cardholder enters into a direct contractual relationship with the provider, not with the retailer. Providers issue store cards only to customers who satisfy their credit criteria; the credit assessment is usually carried out while the customer is in the store. Acceptance rates for store cards (that is, the proportion of successful applicants) are usually over 65 per cent and often significantly more; these rates are generally higher than those for general credit cards.
8. Retailers and providers in most cases share the incentive to maximize cardholders' continuing use of the store card to obtain credit. We found that 43 per cent of store cardholders who use their card in a particular month settle their balance in full and do not incur interest charges; the remaining 57 per cent do incur interest charges (of whom 77 per cent make more than the minimum monthly payment and 23 per cent the minimum or less).
9. Providers often offer store card insurance to customers when they take out a store card. Payment protection insurance covers card repayments in the event of accident, illness, unemployment or death. It is often sold as a package of insurance that might

also include one or both of purchase protection (covering damaged, lost or stolen purchases) and price protection (under which cardholders are refunded the difference when purchases are reduced in price within a given period).

10. The main sources of income for store card providers are interest income on balances not settled within the interest-free period; card-related insurance income; income from fees levied for late payment of accounts; and other income, including merchant fees from certain retailers. Providers may also benefit from income resulting from the cross-selling of other financial products and services to store cardholders. The providers' main costs include funding and bad debt costs, payments to retailers (including profit share, commission payments and other payments, for example to support retailers' marketing of the store card) and operating costs.

The store card sector

11. The sector is mature: measured by total store card debt, the size of the sector remained broadly constant for many years until the end of 2002, when there were 17.5 million active store card accounts (that is, accounts that have been used within the previous 12 months). Since then, the sector has declined. Even so, store cards continue to be important: at the end of 2005, there were 11.4 million active store card accounts, with outstanding balances of about £2,300 million. Providers' revenue from store cardholders was around £670 million in 2004.

The relevant economic markets

12. We found two relevant economic markets: an upstream market, consisting of the supply of store card credit services to retailers and services, including insurance services, related thereto in the UK; and a downstream market, consisting of the supply of consumer credit through store cards and insurance purchased in association with the provision and use of those store cards in the UK. At the downstream level, we found that customers for consumer credit through store cards did not show any significant sensitivity to changes in annual percentage rate (APR) and, in particular, that credit cards did not provide competitive constraints on store card APRs sufficient for us to consider them to be in the same market. We found that retailers were concerned about the APR on their store cards relative to those of their competitors' store cards, and that this inter-comparison between retailers was the most significant factor constraining APRs in the sector from rising. However, this same concern has not, at least until very recently, provided pressure on retailers to reduce store card APRs.

Competitive assessment

Upstream competition

13. Turning to our competitive assessment, we have concluded that the upstream market displays no feature which prevents, restricts or distorts competition and that it is competitive. In particular, we found that there were no discernible barriers to entry into the market by financial institutions with an established reputation and the requisite in-house or outsourced capacity, as evidenced by HSBC's gaining the store card programmes of JLP (in 2003) and Marks & Spencer (in 2004), and Barclaycard's securing the House of Fraser contract for store card services as from 2007. While we identified some remaining hurdles for providers aiming to tender for an existing contract on its expiry, relating to informational asymmetries and the hand-over of portfolios, we decided that these could be surmounted and had been successfully cleared in many cases.

14. We further found that a shift in the balance of negotiating power from the providers in favour of the retailers had enhanced competition and had resulted in an increase in retailers' share of the total returns generated by store cards. However, we found that this enhanced competition did not necessarily imply that the additional benefits gained by retailers were being passed on to consumers, for example in the shape of lower prices or more innovation, because of the consumer insensitivity to store card APRs.

Downstream competition

15. At the downstream level, we found that, as at the end of 2005, most store card programmes had APRs that were clustered around 30 per cent. We considered how this had come about. Providers' incentives are unambiguously for higher APRs. The only constraint on APRs has hitherto been provided by retailers' concern not to have what is regarded as an excessive APR, relative to other store cards. However, this same concern has not, until very recently, led to pressure to reduce APRs. We found that the only, weak, pressure on APR levels came from a few retailers with significantly lower store card APRs; this pressure, such as it was, proved insufficient to bring about a general reduction in APRs for the great majority of store card programmes. We also found that providers who run store card programmes for a number of different retailers had an additional disincentive to lower the APR on any particular programme, namely that pressure might be exerted by other retailers in that provider's portfolio for a cut in the APRs on their programmes as well.
16. We found that Creation (with one small exception), GECF and Style charged APRs that, at least until the end of 2003, were higher and within a narrower band of APRs than the rest of the store card sector. However, we found that different kinds and sizes of retailer could, and did, have store card programmes with APRs significantly below the 30 per cent level where they wanted them and that providers were prepared to accommodate requests for such programmes when contracts come up for re-tender. However, we found that there was an insufficient number of retailers with store card APRs low enough to 'embarrass' the remainder and bring about a 'tipping point' at which higher APRs would no longer be sustainable.
17. We found that the increased competition for store card contracts upstream did not translate into lower APRs downstream because (i) of providers' and retailers' incentives (see paragraph 15 above); (ii) most cardholders are insensitive to store card APRs; (iii) each store card is subject to little or no competitive pressure from credit cards; and (iv) each store card is subject to little or no competitive pressure from other store cards. We also found that because of the lack of such competitive pressure on their store cards, retailers have until recently generally chosen to exert their increased negotiating power to obtain larger payments from providers rather than to secure lower APRs for their retail customers. We therefore found little or no competitive pressure on the setting of APRs.
18. We noted that credit card APRs were in general significantly lower than those on store cards, and that the APRs on most store cards had remained unchanged since the mid-1990s, despite falls in funding costs. We found that the store card sector generated net profits in excess of the cost of capital over the period from 1999 to 2004 of around £270 million. GECF, which represents a substantial part of the market, earned profits that were persistently and substantially in excess of the cost of capital during this period. We considered the evidence on profitability to be consistent with, and indicative of, a lack of competitive pressure on store card APRs.
19. During our inquiry, two potentially significant developments took place. First, a few retailers re-negotiated their contracts to provide for significant reductions in their

store card APRs. Second, GECF in September 2005 provided us with details of its launch of new, lower-APR 'combined' programmes involving the offer of both a store card and an SBCC, using ranges of APRs (which we term 'multi-tier APRs') with risk-based pricing (that is, based on customers' credit status) for Debenhams and Mothercare, and of its plan to reduce the APRs on its ASDA combined programme which had been launched in September 2004. GECF also told us that it was conducting trials for lower-APR programmes with other retailers. It said that, on current plans, seven of its major retailers, accounting for 76 per cent of its gross receivables as at June 2005, would each either have launched, or would be conducting trials of, new lower-APR products by the end of 2005.

20. We considered whether the cumulative effect of these developments might be to force down APRs across the store card market as a whole. However, while we acknowledge that some retailers and providers have recently taken steps to reduce store card APRs and that this is a welcome move in the right direction, we are not satisfied that the lower-APR programmes that they have launched are as yet sufficiently widespread, the proportions of customers on lower APRs sufficiently large, or the programmes themselves sufficiently firmly embedded, to allow us to conclude that there is an irreversible downward trend such that a 'tipping point' in the market has been reached. We found that, excluding the historically much lower store card APRs of JLP and Marks & Spencer, more than 90 per cent of store card balances and active accounts are projected to continue to pay APRs of more than 25 per cent at the end of 2006.
21. So far as store card providers' other sources of revenue are concerned, we found that the level of late payment fees and the policy on the charging of those fees are generally matters decided by the provider. We also found that such information is generally not brought to cardholders' attention when they receive their monthly statement, and that awareness of the amounts charged by way of late payment fees is low among store cardholders. We concluded that there is little or no competitive pressure on the levels of late payment fees from either retailers or cardholders. As regards insurance sold with store cards, we found that retailers appear generally content to surrender responsibility for such insurance entirely to their provider and that there is little or no competitive pressure on the pricing of cardholder premiums. To the extent that payment insurance and either or both of purchase and price insurance are packaged together and are not individually available, cardholders have no choice but to purchase the two or three products together even if they want or need only one or two of them; and some customers who revolve their store card balance will continue to pay for elements of the package (purchase and/or price) that they no longer require or which no longer offer them cover. We found from survey evidence that purchasers of store card-related insurance have a weak understanding of why they buy it and the nature and extent of the cover it provides; therefore, little pressure is brought to bear on the level of store card insurance premiums by cardholders.
22. Finally, we considered the amount and type of information that providers include on the regular statements they send to store cardholders, and whether a lack of information on statements might contribute to, or reinforce, cardholders' lack of sensitivity to APRs, late payment fees and insurance costs and hence to the total costs of revolving on a store card. We found that providers do not include sufficient information on their store card statements, leading to a lack of transparency in the provision of store card credit and card-related insurance, and thereby to cardholders taking credit or insurance on terms which are not clear to them.
23. Taking all the evidence together, we found that:

- (a) There is little or no competitive pressure on the setting of APRs and that APRs are above competitive levels. These findings have led us to conclude that store card APRs are insulated from the competitive pressures that would otherwise be brought to bear on them from general credit cards and, in particular, SBCCs.
- (b) There is little or no competitive pressure on the levels of late payment fees from either retailers or cardholders.
- (c) Little or no competitive pressure is brought to bear on the elements, or the pricing, of insurance sold with store cards.
- (d) Providers do not include sufficient information on their store card statements, leading to a lack of transparency in the provision of store card credit and card-related insurance, and thereby to cardholders taking credit or insurance on terms which are not clear to them.

Features that prevent, restrict or distort competition

24. We concluded that the features of the downstream market (the relevant market) set out in the paragraph 25 below have the effect, when taken in combination, of:

- (a) insulating consumer credit services provided through store cards from the competitive pressures that would otherwise be brought to bear on them from credit cards, including SBCCs (which we regard as the closest potential substitutes for some store cards); and
- (b) insulating insurance purchased in association with the provision and use of store cards from the competitive pressures that would otherwise be brought to bear on such insurance.

We therefore concluded that, by insulating these credit and insurance services in the relevant market, the combination of features prevents, restricts or distorts competition. Accordingly, we find that there is an adverse effect on competition within the meaning of section 134(2) of the Act.

25. The following are the features of the relevant market which we have concluded, when taken in combination, have the effects specified in paragraph 24 above:

- (a) providers and retailers structure the store card offer in such a way that many store cardholders take out such cards to obtain the retail benefits they offer rather than the credit available on them;
- (b) most retailers offering store cards do not exert competitive pressure on store card APRs;
- (c) most retailers' customers do not exert competitive pressure on store card APRs (either at the take up stage or when they take credit) because their sensitivity to them is low;
- (d) most retailers offering store cards do not exert competitive pressure on the level of, or the provider's policy in relation to the levying of, late payment fees;
- (e) most retailers' customers do not exert competitive pressure on the level of late payment fees levied on store cards because their sensitivity to them is low;

- (f) many providers combine different insurance products into packages (that is, payment protection insurance with one or both of purchase protection insurance and price protection insurance) which they sell in association with store cards;
- (g) most retailers offering store cards do not exert competitive pressure on providers to lower their insurance premiums to cardholders, or to offer the components of their insurance package separately;
- (h) most retailers' customers do not exert competitive pressure on premiums for insurance purchased in association with the provision and use of store cards because their sensitivity to the price of such insurance cover is low and they have a poor understanding of the terms of the cover they are purchasing; and
- (i) providers do not include sufficient information on their store card statements, leading to a lack of transparency in the provision of store card credit and card-related insurance.

Detrimental effects on customers

26. We identified the following detrimental effects on customers which have resulted from or may be expected to result from the adverse effect on competition identified in paragraph 24 above:
- (a) most store cardholders who take credit pay higher prices for that credit than would be expected in a competitive market;
 - (b) most store cardholders have less choice in relation to the individual elements of insurance cover sold in association with the provision and use of store cards than would be expected in a competitive market;
 - (c) some customers who revolve their store card balance will continue to pay for elements of the insurance package (purchase and/or price protection) that they no longer require or which no longer provide them with cover; and
 - (d) lack of transparency in the provision of store card credit and insurance leads to cardholders taking credit or insurance on terms which are not clear to them.
27. We sought to estimate in broad terms the scale of the consumer detriment. Based on all the evidence, we found that the detriment to customers in terms of the excess prices paid has been substantial: over the period since 1999, the customer detriment has been at least £55 million a year and possibly significantly more.

The need for remedial action

28. We considered that recent and prospective developments in the store card market are unlikely in themselves to bring about change in the competitive environment over the next 12 to 24 months sufficient to remove the features that together have combined to give rise to the adverse effect on competition that we have identified. Many of the changes in the market that we have noted, in particular the introduction of programmes either with lower single store card APRs or (by GECF) multi-tier APRs with risk-based pricing, have been relatively recent; and the trialling of programmes with lower APRs by one provider GECF with some of its retailers is not yet complete. Indeed, many of the changes have taken place either shortly before our inquiry (some possibly reflecting adverse publicity following the TSC report) or during the course of our inquiry, and that report and our inquiry are likely to have

been factors in bringing certain matters into sharper focus for both the retailers and the providers. Accordingly, it is too soon to know what the consequences of such changes might be, even in the next 12 to 24 months, let alone thereafter, even assuming that those changes already introduced are continued and those which are planned but are not yet in place are fully implemented. Further, we believe that neither current and prospective statutory and self-regulatory measures that would increase transparency for credit cardholders, including store cardholders, nor the regulation of the sale of insurance in connection with store cards that was introduced early in 2005, although bringing benefits to the relevant markets, would fully address the adverse effect on competition that we have identified even when taken together with the changes and potential changes referred to in paragraph 19 above.

29. We therefore considered measures to remedy the adverse effect on competition identified in paragraph 24 above. We consulted on possible measures in a Remedies Notice issue on 14 September 2005. Taking into account the evidence received in response to that notice, we issued a Statement of Provisional Decisions on Remedies on 20 December 2005, which elicited further views from interested parties. In the light of all the evidence and consultations, our decisions on remedies are set out below.²

Decisions on remedies

Full information on statements

30. Certain key items of information must be prominently displayed on the front page of store card statements and the font size employed for these details must not be less than the largest font size used for transaction and balance details. These items are as follows:
- (a) the current annual percentage rate (APR) applicable to purchases (shown in bold);
 - (b) an estimate of interest payable next month in the event that the cardholder only makes a minimum payment;
 - (c) a 'wealth warning' outlining the consequences of only making minimum payments;
 - (d) the basis of insurance charges shown alongside each insurance charge appearing in the transaction box; and
 - (e) a reference to the reverse side of the statement for details of how to pay and contact details to amend or check insurance cover.

If providers wish to show a monthly interest rate on the front of a statement in addition to an APR, then we require that this must not be shown in a greater font size than the APR and must not be in bold type.

31. Other details that must be shown on the statement (but may be displayed on the reverse side either in a summary box format or elsewhere) are as follows:
- (a) late payment or default charges and the policy for levying these charges;

²But these should be read in conjunction with the more extended description of our proposals in Section 10.

- (b) the basic assumptions used in calculating the estimate of interest payable next month;
- (c) other interest rates, if applicable, for example, rates chargeable on cash withdrawals;
- (d) a 'how to pay' section and contact details for setting up or amending a direct debit, prominently displayed within the 'how to pay' section; and
- (e) contact details for amending or cancelling insurance cover sold with the store card and a brief summary of insurance cover. The said summary must inform customers that they should refer to their policy of insurance for full details of their insurance protection and of any applicable exclusions.

APR warning on store card statements

- 32. An APR warning must be prominently displayed on the front page of each monthly statement for store card programmes using a single APR for purchases where the APR is 25 per cent or more. An APR warning is not required where the APR is less than 25 per cent.
- 33. For store card risk-based programmes using multi-tier APRs, the APR warning is required on all statements for tiers where the APR is 25 per cent or more if the average APR for the store card programme as a whole is also 25 per cent or more. An APR warning is not required on a store card programme with multiple APR tiers if the average APR for the store card programme as a whole is less than 25 per cent. The average APR for a store card programme with multi-tier APRs will be calculated by weighting each APR tier by the aggregate interest-bearing balances within that tier in relation to the total interest-bearing balances for the store card programme. This average must be calculated at regular intervals of no more than three months and undertaken on a consistent basis on each occasion, using the most recent available data on interest-bearing balances.
- 34. The required wording of the APR warning is as follows: **'The rate of interest charged on your account may be higher than on other sources of credit available to you. It may be costly for you to leave balances owing on your account after the interest free period'**. The warning must be displayed on the front page of the statement above the transaction box in bold lettering and in a font size no smaller than the largest font size used for transaction and balance details. The APR warning remedy will remain in force for three years from the date of the applicable order. We recommend that at the end of this period, its continuance should be reviewed by the OFT during which time it would remain in force. Following this review, the OFT would advise the CC on whether to remove it or keep it in place for a further period, at the end of which period we recommend that there should be a further review by the OFT.

Provision and prominent display of facility to pay by direct debit

- 35. Store card providers must provide an option for all store cardholders to pay the account balance on their cards by direct debit. This option should be displayed in monthly statements.
- 36. Customers should also be provided with documentation to set up a direct debit with initial contractual information. This requirement may be satisfied by providing a direct debit mandate either with the initial store card application form or in a welcome pack

sent to each new store card customer. However, in the latter case, the card application form must prominently display the question 'Do you want the option of paying amounts owing on your card by direct debit?' which must be ticked 'yes' or 'no' by the customer to ensure that this possibility has been brought to the customer's attention. In this case the application form must also inform the customer that a direct debit mandate will be available in their welcome pack or can be set up by phone. The 'wealth warning' regarding minimum payments should be provided with direct debit mandates and also communicated to customers when they set up a direct debit by phone.

Separate offer of payment, purchase and price protection insurance

37. Where store card providers offer insurance packages containing payment, price and purchase protection, they must also offer, as separate items, (a) payment protection cover alone and (b) a package of price and purchase protection. Where store card providers offer a package of payment and price protection or payment and purchase protection, they must offer payment protection alone as a separate item. There will be no requirement, in those circumstances, to offer either price or purchase protection as separate elements.

Implementation

38. The Group intends to pursue implementation of the measures by order rather than undertakings. Parties to the inquiry have indicated timescales of between six months to one year to implement most of the various measures outlined above. Having considered the arguments put forward, the Group has concluded that an implementation period of nine months is reasonable for all the above measures from the date when an order is made. The Group expects that the period between publication of this report and the date of making an order may be in the region of three to four months. This period will be available to parties to prepare for implementation of the CC's requirements.

Findings

1. Introduction

1.1 On 18 March 2004, the OFT referred to the CC for investigation and report the supply of the following services (the reference services) in the UK:

(a) store card credit services to retailers and services related thereto (store card credit services); and

(b) consumer credit through store cards.

The reference was made under section 131 of the Enterprise Act 2002 (the Act), which empowers the OFT to make market investigation references. The CC is required, by virtue of section 137 of the Act, to prepare and publish its report within a period of two years, that is, by 17 March 2006.

1.2 On 5 November 2004, the CC wrote to the OFT requesting a variation of the terms of reference. Following a period of consultation with interested parties, the OFT announced on 3 March 2005 that it had varied the terms of reference in accordance with section 135 of the Act. The varied terms refer to the supply of the following services (the reference services) in the UK:

(a) store card credit services to retailers and services, including insurance services, related thereto (store card credit services); and

(b) consumer credit through store cards and insurance purchased in association with the provision and use of those store cards.

1.3 The full original terms of reference are set out in Appendix 1.1, and the full varied terms of reference in Appendix 1.2. In these findings, when we refer to 'the (or our) terms of reference', we mean the terms of reference as varied and published on 3 March 2005.

1.4 The varied terms of reference made it explicit that insurance services were included within the supply of both (a) and (b) in paragraph 1.2. They also clarified the definition of store cards, specifically stating that the definition embraced payment cards issued for use in retailers belonging to a store card network (as defined) and specified that store cards were associated with retail benefits, for example discounts.³ A description of the nature, purpose and effects of the variation is given in Appendix 1.3.

1.5 This report, together with its appendices, constitutes the findings and conclusions on the statutory questions that the CC, working through the Group established to investigate the store cards market, has to decide under section 134 of the Act (see Section 5 below). The way our inquiry was conducted is explained in Appendix 1.4. Further information can be found on the CC's website.⁴ This comprises:

- the reports of two consumer surveys carried out by the CC; one such survey carried out by the OFT; and a survey of its store cardholders by GECF;

³The implications of clarifying the definition of store cards in this way are discussed in Section 3.

⁴<http://www.competition-commission.org.uk/inquiries/current/storecard/index.htm>.

- non-sensitive versions of interested parties' written submissions and in some cases oral evidence;
- notes on the open hearing;
- the CC's Issues Statement, Emerging Thinking and Provisional Findings (together with their non-confidential annexes) and responses of parties to the Emerging Thinking and Provisional Findings;
- the Notice of Possible Remedies and parties' responses to this; and
- the Statement of Provisional Decisions on Remedies and parties' responses to this.

We cross-refer to these documents as appropriate. A list of evidence appearing on the CC's website is at Appendix 1.5.

- 1.6 We conducted our investigation having regard to the procedures published in the CC guidelines on market investigations⁵ and other published guidance. The investigation, which was the first market investigation under the Act to be referred to the CC, followed broadly the procedures adopted on earlier monopoly investigations, but a new stage was introduced after the Issues Statement stage, namely Emerging Thinking. The Emerging Thinking document, together with a number of supporting evidential annexes, set out our then current thinking on the central issues of the inquiry that appeared to merit consideration under the provisions of the Act. It was intended both to assist the parties in understanding our concerns at that stage of the inquiry and to aid wider transparency. More generally, we sought the parties' views on the issues as they emerged, gave them the opportunity to give evidence orally and in writing throughout the inquiry, and sought their comments on the evidence as the inquiry progressed.
- 1.7 In the early stages of our investigation we considered data for the period 1999 to 2003. As the inquiry progressed we added relevant data for 2004. Subsequently, we sought projections for 2005 and 2006 from the relevant parties in the inquiry. Naturally, from the beginning, we recognised that, given the expected length of the inquiry, there would be changes and developments in the store card market. We have taken these into account in our analysis and interpretation of the data we have received.
- 1.8 Some 110 companies and organizations provided substantive written and/or oral evidence throughout the different stages of the inquiry. Their names are listed at Appendix 1.6. Many other parties, including credit card companies and retailers not operating store cards, provided help in response to CC questionnaires. We held 60 hearings, including an open hearing on 21 July 2004.
- 1.9 Section 2 of this report outlines the background to the investigation and referral to the CC. Section 3 provides an overview of the store card market, including significant developments within the market during the timeframe of the investigation. In Section 4 we outline the wider regulatory and self-regulatory framework in which store cards operate. Section 5 sets out the statutory questions we were required to address. The economic markets within which store cards operate are defined in Section 6. Sections 7 and 8 discuss, respectively, competition for store card credit services to retailers and competition for consumer credit through store cards. Section 9 presents

⁵Market Investigation References: *Competition Guidelines*, June 2003—CC3, available on the CC's website.

our findings and conclusions and discusses the need for remedies. Section 10 sets out our decisions on remedies and our reasons for each of them.

2. Background to the reference

- 2.1 In December 2003, the Treasury Select Committee of the House of Commons (the TSC) published a report⁶ on the transparency of credit card charges. The report also addressed store cards, about which the Consumers' Association,⁷ the National Consumer Council and Citizens Advice had specifically highlighted concerns during the TSC's inquiry. In particular, the report expressed concern about the lack of transparency as regards the interest rates charged for store card credit, the level of those interest rates (particularly by comparison with rates for credit cards), the apparent lack of control by retailers over the level of the interest rate on their own store cards and certain point of sale practices.
- 2.2 In the course of its inquiry, the TSC also took evidence from the OFT. Although the OFT had previously received few complaints about store cards from consumers or the bodies representing their interests, the Chairman of the OFT undertook to look into the store card sector and announced the start of the OFT's own preliminary examination in September 2003. The OFT's subsequent report on store cards⁸ identified some features that appeared to prevent, restrict or distort competition in the way that store card credit and related services were made available to retailers, and in the provision of consumer credit through store cards, which in its view required further investigation. The OFT accordingly made a reference to the CC on 18 March 2004, the day on which its own report was published.
- 2.3 In December 2003, the Secretary of State for Trade and Industry published a White Paper⁹ containing proposals for a wide-ranging reform of the current legislation governing the credit market (principally enshrined in the Consumer Credit Act 1974 and subordinate legislation made under it). Some of these proposals have been, or are to be, implemented through changes to subordinate legislation, while others require primary legislation. We briefly describe these reforms, in so far as they might be expected to have an impact on store cards, and the wider regulatory framework in which store cards operate, in Section 4.

⁶House of Commons Treasury Select Committee report *Transparency of Credit Card Charges*, published 17 December 2003.

⁷This body has since changed its name to 'Which?'

⁸Office of Fair Trading: *Store Cards—Report of the OFT's inquiry*, March 2004 (OFT706).

⁹*Fair, Clear and Competitive: The Consumer Credit Market in the 21st Century*, 18 March 2004.

3. The store card sector

Introduction

3.1 In this section, we provide an overview of the store card sector. We begin by describing the nature and purpose of store cards in comparison to other plastic cards. We then consider some key data for the store cards sector and discuss SBCCs. We go on to describe the characteristics of store cardholders (cardholders), the retailers who offer store cards and the companies that provide the credit and run the programmes (the providers). We next describe how store card services are provided, including the relationships between retailers, providers and cardholders, and the types of insurance offered to customers when they take out a store card. We then summarize some differences between the store card and general credit card business models and end by noting some recent developments that have taken place in the sector.

Characteristics of store cards

3.2 Store cards are usually defined as plastic cards, branded with a retailer's name or trademark,¹⁰ which can be used for payment or credit only in that retailer's outlets and, in the case of co-branded store cards, other 'accepting' retailers. Co-branded store cards such as Duet and Style have a network of accepting retailers and bear an issuer's, as well as a retailer's, brand,¹¹ some non co-branded store cards are also accepted by other retailers (for example, Debenhams' store card is accepted in Arcadia's stores). Store cards are not part of any of the international payments networks such as MasterCard, Visa, American Express, Maestro or Cirrus.

3.3 Store cards developed as a means by which a retailer's regular customers could be recognized in all its stores and gain access to both a means of payment and an instrument of credit, thereby encouraging customer loyalty and repeat purchases. Cardholders pay for their goods or services with the store card and later receive a statement. Store card statements are issued monthly for accounts with a positive balance and cardholders are required to make a minimum payment (usually 3 to 5 per cent of the outstanding balance on the statement) within a set period (often 25 days from the statement date), although they may opt to settle the outstanding balance in full or pay an amount between the minimum payment and the full amount. The card may be used for multiple purchases on the same or different dates (subject to the cardholder's credit limit not being exceeded). Incentives to take out a store card have traditionally been offered at the point of sale, typically in the form of a discount on purchases made at the time, or shortly after, the store card is taken out. More recently, some retailers have replaced or supplemented the initial discount with reward schemes—these are loyalty schemes that reward cardholders with vouchers which can be redeemed in-store (the greater the store card spend the greater the value of the vouchers)—or with other benefits such as invitations to special events. In both cases, the store card may offer additional ongoing privileges of various kinds, such as invitations to the retailer's special events and sales previews, or entitlement to a free copy of the in-house magazine. Some store cards can be used to withdraw cash from automated teller machines (ATMs).

¹⁰Some store cards are co-branded with a generic name (for example, Duet and Style) and are part of a multi-retailer network.

¹¹There are also some generic Duet and Style cards which are not co-branded with the retailer's brand. These are outside our terms of reference.

- 3.4 In essence, therefore, store cards are used by retailers¹² primarily as a means of generating customer loyalty. They offer benefits to cardholders, as described in paragraph 3.3, and have flexible repayment terms subject to a minimum repayment which is usually 3 to 5 per cent of the amount outstanding. We list the main store cards in Appendix 3.1, and in the next sub-section describe briefly how they differ from other types of plastic card offered by retailers.
- 3.5 Providers¹³ issue store cards only to customers who satisfy their credit assessment criteria. It is usual for the credit assessment to be carried out while the customer is in the store: the customer provides the relevant information to the retailer, who passes it on to the provider for a decision to be made. In-store application enables the customer to obtain any retail benefits immediately, but other application methods, for example online or by post, may be possible. Acceptance rates for store cards—usually over 65 per cent and often significantly more—tend to be higher than those for general credit cards, including SBCCs, as retailers want as many of their customers as possible to take up their store card; moreover, the business models are different, with average credit limits being very much higher on general credit cards than on store cards. Providers aim to set the acceptance rate at the level that includes all profitable cardholders and excludes only those for whom the likelihood of default is such that expected losses exceed expected income net of costs. The acceptance rate accordingly varies from programme to programme, and depends on the customer profile of the respective retailer. In contrast, our survey of credit card providers (see paragraph 3.57) suggested a lower average acceptance rate of about 50 per cent in 2003. However, acceptance rates for applications in response to credit card mailings may not be comparable with acceptance rates for in store applications.
- 3.6 Credit limits on store cards are typically much lower than those on general credit cards. Initial credit limits for store cards range from about £150 to £1,500 depending on the creditworthiness of the applicant and the type of store, whereas initial credit limits on credit cards are typically £1,000 to £10,000 depending on the applicant.

Other plastic cards

Budget cards

- 3.7 Some retailers issue plastic cards designed primarily to encourage and help customers to purchase particular types of goods (often higher-value items such as kitchens, large electrical goods or furniture). They typically have fixed payment periods and offer promotional credit: either simple interest-free credit for an extended period, typically three, six, 12 or 24 months; or Buy Now Pay Later, where no interest is charged and/or no repayments need be made during the promotional period. Holders of this type of card typically do not use it to make additional purchases, although additional purchases on the card are possible. This type of card, which we refer to as a budget card, therefore offers benefits more akin to instalment or promotional credit, but usually does not offer discounts or loyalty points over and above any promotional credit.
- 3.8 The relevant section of our terms of reference defines a store card as a payment card which:

¹²We describe the types of retailer offering store cards in paragraphs 3.32 to 3.36. The main retailers that participated in our inquiry are listed in the Company Directory at the back of this report.

¹³We describe the main store card providers in paragraphs 3.37 and 3.38. The main providers that participated in our inquiry are listed in the Company Directory at the back of this report.

has both associated retail benefits (for example, discounts) and permits the holder of the payment card under his contract with the issuer of the card to discharge less than the whole of any outstanding balance on his payment card account on or before the expiry of a specified period (subject to any contractual requirements with respect to minimum or fixed amounts of payment).

- 3.9 Our terms of reference therefore cover only those cards that have associated retail benefits (benefits that the cardholder receives from the retailer). We consider that initial discounts, reward schemes and privileges are examples of retail benefits. We do not consider that interest-free and other promotional credit in itself is a retail benefit, as the offer of promotional credit merely changes the terms of the credit offer, lowering the effective interest rate charged to cardholders. Accordingly, we exclude budget cards from the ambit of our investigation.

Loyalty cards

- 3.10 Loyalty cards offer discounts or points but can be used neither as a means of payment nor a source of credit. They accordingly differ from store cards which can be used to pay for goods or services and to obtain credit.

General debit and credit cards

- 3.11 General credit and debit cards do not bear a retailer's brand and generally do not offer retail benefits—they may offer incentives to encourage use, such as cash-back, Air Miles or vouchers entitling the cardholder to discounts at various retailers, but such benefits are not usually limited to a single retailer. Unlike store cards, they are widely accepted as a means of payment and a source of credit.

Store-branded credit cards

- 3.12 We define SBCCs as credit cards that belong to one of the international payments networks referred to in paragraph 3.2; that are marketed by the retailer; that are branded with the retailer's name and logo and that usually entitle the holder to benefits, such as discounts and vouchers. SBCCs are widely accepted as a means of payment and source of credit. Some retailers have programmes which make a single offer to prospective cardholders of either a store card or an SBCC—we refer to such programmes as 'combined programmes' and describe them further in paragraphs 3.63 to 3.69 and paragraphs 8.38 to 8.42.

Summary

- 3.13 In summary, store cards are cards which are retailer-branded; offer retail benefits such as discounts, rewards and privileges; are accepted only in the retailer's outlet or network of accepting retailers; are not part of any of the international payments networks and hence have less wide utility than general credit cards. They are distinct from budget cards, loyalty cards and credit cards, including SBCCs, which are outside our terms of reference.

Key store card sector data and trends

- 3.14 To put our inquiry into perspective, we summarize in the following paragraphs the key sector data that we have taken into account in reaching our findings and conclusions. In particular we note that the size of the store card sector, measured by

total store card debt, remained broadly constant until the end of 2002, since when¹⁴ it has declined. During the same period, consumer debt on credit cards and in total (ie including loans, overdrafts etc) has risen very considerably. Even so, store cards continue to be important: at the end of 2005 there were 11.4 million active store card accounts¹⁵ with outstanding balances of about £2,300 million.

Data for 1999 to 2004

3.15 Table 3.1 summarizes some key data on the store card sector. At the end of 2004, there were around 13.9 million active store card accounts. The total value of retail sales on these store cards during 2004 was about £3,700 million and total balances at the end of the year around £2,500 million. Total revenue from cardholders (interest and other payments) was about £680 million. Store card providers may also obtain revenue from retailers (eg merchant fees), but for store cards in aggregate, any such revenue was more than offset by commission and other payments in the opposite direction.

TABLE 3.1 Summary data on store cards and store-branded credit cards, 1999 to 2004

	<i>£ million unless otherwise specified</i>					
	1999*	2000*	2001	2002	2003	2004
<i>Store cards</i>						
Number of active accounts at end year†	N/A~	17.1	17.5	17.5	15.5	13.9
Sales using store cards	N/A~	4,801	4,953	5,043	4,535	3,672
Total balances at end year	2,705	2,725	2,818	2,842	2,540	2,492
Total balances: average through year	2,481	2,551	2,616	2,728	2,526	2,347
Total revenue from cardholders‡	609	618	635	673	690	683
Net payments from providers to retailers§	1	2	3	14	46	43
<i>Store-branded credit cards¶</i>						
Number of active accounts at end year†	0	0	0	0	1.8	2.4
Total balances at end year	0	0	0	20	983	1,693

Source: CC estimates based on questionnaire responses by major providers for store cards. In two cases, data relates to year ending 31 March of the following year. In one of these cases, the financial year end was changed to 31 December in 2004: sales, cardholder revenue and net transfers of this provider for the nine months to 31 December 2004 have been prorated to a 12-month period.

*Number of accounts and balances not available for two providers—based on CC estimates.

†Million. Active accounts are defined as those where the card has been used to pay for a retail transaction in the last 12 months.

‡Interest income, insurance revenue, charges and other revenue.

§Payments by providers to retailers (including commission, profit sharing and marketing support payments) less merchant and other fees paid by retailers to providers. Excludes internal transfers by self-providing retailers.

¶Includes only store-branded credit cards offered by retailers who also offer, or previously offered, store cards. Excludes credit cards offered by other retailers such as Tesco.

~Not available.

3.16 Table 3.1 shows that in the period up to the end of 2002, there was a small increase in the number of active store card accounts and balances. The number of active store card accounts fell sharply during 2003 and 2004. Part of this decline in active account numbers was due to the conversion of store card accounts to SBCC

¹⁴The latest available figures are for 1999 to 2004. We consider projections for 2005 and 2006 in paragraphs 3.19 and 3.20.

¹⁵Active accounts are defined as those with a retail transaction within the last 12 months. In practice, it is likely that some such accounts were opened specifically for a single transaction which was paid for at the first opportunity and thus are no longer active. The number of cards is greater than the number of active accounts as more than one card may be issued against a single account and there are also many cards issued against accounts that are no longer active.

accounts, principally by Marks & Spencer.¹⁶ By the end of 2004, active SBCC accounts of Marks & Spencer and other retailers with store card programmes totalled 2.4 million although not all of these necessarily represented conversions from store cards or were by account holders who would otherwise have held a store card. However, during 2004 most store card programmes (even those not converting to SBCCs) showed a decline in the number of active accounts. Retail sales using store cards also declined sharply.

- 3.17 Store card balances declined between the end of 2002 and 2004, albeit less rapidly. It was suggested to us that amongst the reasons for the less rapid decline in balances than in active account numbers and retail sales was a growth in the balances of less creditworthy cardholders (which is reflected also in the growth in bad debts, see Appendix 8.1).
- 3.18 The level of revenue that store card providers received from cardholders was similar in 2002 and 2004, having risen slightly in 2003. The fact that cardholder revenue did not decline, despite the decline in balances, appears to be explained by two main factors. First, aggregate revenue from insurance and charges on store card accounts continued to increase and offset the reduction in aggregate interest income associated with the reduction in balances. Second, the interest rates on the most significant programmes introducing SBCCs (Marks & Spencer and JLP) were, and remain, below the store card average; consequently the percentage reduction in aggregate store card interest income on conversion to SBCCs was less than the percentage reduction in aggregate store card active accounts and balances. Net payments from providers to retailers increased between 1999 and 2003, principally because of some retailers obtaining more favourable terms (see paragraph 7.54 to 7.63) on new or renegotiated contracts.

Projections for 2005 and 2006

- 3.19 We asked all the providers for their projections for 2005 and 2006¹⁷: these suggested a continuation of the trends shown in 2004—a decline in the number of active store card accounts and balances and an increase in the number of active SBCCs. The total number of active store card accounts was projected to decrease to 11.4 million by the end of 2005 (2004:13.9 million) and 10.7 million by the end of 2006, while the total number of active SBCC accounts was projected to increase to 3.1 million at the end of 2005 (2004: 2.4 million) and 4.3 million at the end of 2006.
- 3.20 On the basis of these projections, the three years to the end of 2005 show a decline of 6.3 million in the number of active store card accounts and an increase of 3.0 million in the number of active SBCC accounts. The introduction of SBCCs therefore accounts for no more than half of the reduction in active store card accounts. Data supplied by one store card provider, GECF, suggest that on programmes where SBCCs are not a factor, the decline in active store card accounts is attributable to attrition (accounts ceasing to be active) rather than fewer new accounts being opened. This provider attributed the high level of attrition to adverse media attention and other credit providers targeting store card borrowing for balance transfers, for example through promotional leaflets. Projected store card balances for 2005 and 2006 show similar trends to active accounts although the proportionate decrease is somewhat smaller, and we note that the projected value of cardholders'

¹⁶Marks & Spencer acquired a large number of store cardholders during the period before 2000, when it had a policy of not accepting general credit or debit cards in its stores. This encouraged a high take-up of the Marks & Spencer store card. Numbers began to fall away when, from 2000, Marks & Spencer began to accept other credit cards and debit cards.

¹⁷These were submitted in December 2005 and should therefore already reflect the main trends experienced during 2005.

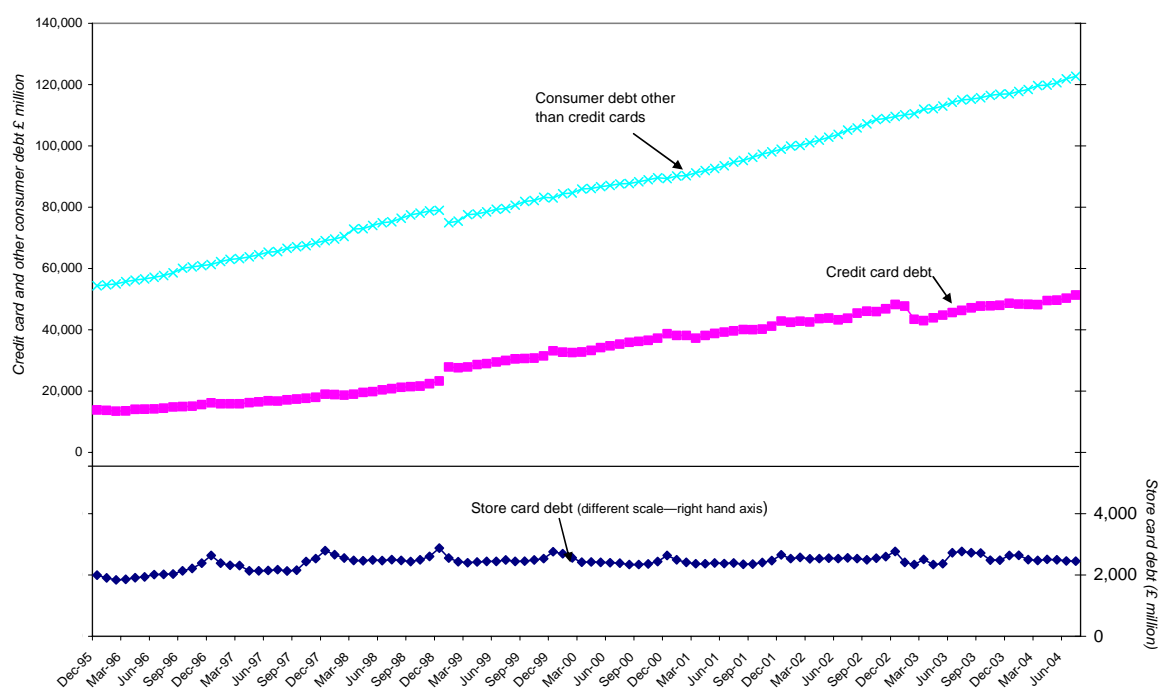
balances at the end of 2006, at about £1,900 million, remains considerable (see Table 3.7 below). Providers' projections also suggested a continuation of the higher levels of bad debt experienced in 2004 (see Appendix 8.1).

Longer-term trends

3.21 Some data on store card balances in the ten years from 1995 is shown in Figure 3.1 (referred to as store card debt). It shows little change over the period.¹⁸ By comparison, there was a rapid rise in debt on general credit cards and other types of consumer lending.¹⁹ Store card debt as at December 2005 accounted for about 3.9 per cent of credit card debt and 1.2 per cent of total consumer debt. This compares to about 14 per cent of credit card debt and 3 per cent of total consumer debt at the end of 1995, and about 7 per cent of credit card debt and 2 per cent of total consumer debt at the end of 2000.

FIGURE 3.1

Consumer debt



Source: CC estimates based on data from Bank of England and FLA.

The emergence of SBCCs

3.22 We have already noted (paragraph 3.16) the introduction of SBCCs by retailers with existing store card programmes, in particular by Marks and Spencer.²⁰ In the case of Marks & Spencer and JLP, the introduction of SBCCs was designed to reverse the declining trends in the use of their store cards. For other providers, it was a response

¹⁸Source: Finance and Leasing Association (FLA). The FLA's definition of store cards is not the same as ours and hence the data shown in Figure 1 is not fully consistent with our data in Table 1. Nevertheless we consider the FLA data shown in Figure 1 is useful as a guide to longer term trends in store cards.

¹⁹Source: Bank of England. Other consumer debt represents overdrafts and personal loans and, prior to January 1999, also includes credit card lending by institutions other than banks and building societies (hence the discontinuity in the series at this point). A further major revision to the credit card series affects the data from February 2003.

²⁰We are primarily interested in our investigation in store-branded credit cards that are offered by retailers who also offer a store card, as opposed to SBCCs offered by other retailers such as Tesco.

to retailers' desire for a broader range of credit products and to the increased interest of general credit card providers in retail partnerships. One provider [X] said it introduced SBCCs in order to offer a lower APR product in response to credit card competition. For general credit card providers, SBCCs offered the opportunity to develop new distribution channels and grow outstanding balances both by migrating retailers' existing store cardholders to the new type of card and by enrolling new cardholders in the SBCC programme.

3.23 We set out in Table 3.2 below details of the SBCC programmes that had been introduced by December 2005. In addition to the programmes shown in Table 3.2, we were told of plans to introduce two further SBCC programmes [X]. We were also informed of trials involving SBCC programmes for three retailers [X].

TABLE 3.2 SBCCs introduced by retailers which offer, or previously offered, store cards as at December 2005

Retailer	Sector	Provider and date of introduction	Store card APR %*	SBCC APR*†	Comments
Adams	Childrens clothing	Creation May 2004 (trial May 2003)	30.9	18.9	Only SBCCs are issued to new cardholders
ASDA	Grocery/supermarket	GECF May 2004	19.7, [X] and 28.8‡	14.8, [X] and 19.7	Combined programme: benefits (reward scheme) similar for both store cards and SBCCs.
Austin Reed	Clothing	Ikano Aug 2005	26.8 (not accepted for payment from March 2006)	18.9 and 24.6	Only SBCCs are issued to new cardholders. Store card balances remain with Austin Reed (in-house store card provider).
Country Casuals	Clothing	Ikano Aug 2005	Not accepted for payment from August 2005	18.9 and 24.6	Only SBCCs are issued to new cardholders. Store card balances remain with previous provider (GECF)
Debenhams	Department store	GECF Sept 2005 (trial from 2003)	18.9, [X] and 29.9‡	13.9, [X] and 18.9	Combined programme: benefits similar except that store card gives rewards (1.25 per cent) through Nectar points and SBCC gives rewards (1 per cent) through Debenhams points.
Harrods	Department store	GECF Sept 2003	28.9	13.9, [X],[X] and 22.9	Benefits (rewards scheme, privileges) similar for both cards.
JJB Sports	Sports goods/clothing/shoes	Creation Sep 2005 (trial May 2004)	30.9	18.9	Only SBCCs are issued to new cardholders
JLP	Department store/Supermarket	HSBC March 2004	14.0	14.0	Benefits differ between store card and SBCC: store card offers privileges and SBCC also offers reward scheme.
Mark One	Clothing	Creation (trial May 2004)	30.9	18.9	Only SBCCs are issued to new cardholders
Marks & Spencer	Clothing/furniture/grocery/supermarket	HSBC Oct 2003	18.9	15.9	Reward scheme similar for both cards.
Mothercare	Clothing and other goods for expectant mothers and infants	GECF Oct 2005	19.9 and 24.9	14.9, [X] and 19.9	Combined programme: benefits (reward scheme) similar for both cards.

Source: CC based on information from providers.

*APRs offered to new cardholders at December 2005. Where more than one APR is shown, applicants are allocated APRs on the basis of their credit score (referred to as risk-based pricing – see paragraph 3.61). Cardholders accepted prior to December 2005 may pay different APRs.

†In some cases a lower APR may be offered for an introductory period on balance transfers and/or purchases.

‡Lower rates may be offered to applicants who qualify for a store-branded credit card but prefer a store card.

- 3.24 As already noted, SBCCs have a wide utility (for example, Visa is accepted in 20 million merchant locations in 150 countries throughout the world) and, in addition, has higher credit limits than store cards; however, the loyalty rewards offered are often similar to those on store cards (see Table 3.2). As already noted in paragraph 3.5, acceptance rates tend to be higher for store cards than for general credit cards, including SBCCs, and it follows that not all customers who are eligible for a store card would necessarily be eligible for an SBCC. Moreover, not all customers who already have a store card wish to transfer to an SBCC, and in some cases SBCCs have not been offered to all, or even most, existing store cardholders.
- 3.25 Several retailers who submitted evidence to us, however, told us that they had no plans to introduce an SBCC, some stating that they did not believe that such a card would be as successful as their current store card in terms of customer take up and usage.

Characteristics of store cardholders

- 3.26 Store cards are held by all sectors of the adult population.²¹ They are much more likely to be held by women (25 to 35 per cent of whom have one or more store cards) than men (10 to 15 per cent of whom have one or more store cards), and they are slightly more likely to be held by those on higher incomes. We estimate that, on average, those holding store cards hold 1.6 store cards. Our survey evidence suggests that about 90 per cent of store cardholders also hold a general credit card and 99 per cent have a current bank account.
- 3.27 Cardholders vary in the use of their cards; for example, some take out a store card for a single purchase, receive any initial discount, pay off the balance before the end of the interest-free period and never use the card again. This is often termed 'hit-and-run' behaviour by the industry. Others use it more than once; on each occasion, they might either pay off the balance or take credit by paying the minimum contractual amount or an amount between that and the full balance, thereby incurring interest charges.²² The industry refers to those who generally pay off their balance in full each month as 'transactors' and those who generally incur interest as 'revolvers'. Cardholders may of course alternate between transacting and revolving. From the data supplied to us by a number of providers, we found that 43 per cent of cardholders, who use their card in a particular month, pay their balance in full and do not incur interest charges; the remaining 57 per cent do incur interest charges (of which 44 per cent made more than the minimum monthly payment and 13 per cent paid the minimum or less). Providers are interested in the number and value of balances on which interest is due. The term 'revolve rate' is used to describe the percentage of the total balance across all cardholders on which interest is payable.²³
- 3.28 We did not find evidence that the majority of revolvers found it difficult to access other sources of credit. About 80 per cent to 85 per cent of revolvers have at least one credit card (although the percentage for transactors is slightly higher at over

²¹Source: CC estimates based on surveys carried out by NOP for the OFT and ORC for the CC. These surveys are available on the CC website.

²²Store cardholders not paying off their balance in full by the due date are charged interest from the date the payment was debited to the account, or in some cases, from the date of the transaction. Under consumer credit regulations (see paragraph 4.4), credit charges are summarized in the APR, which includes both interest and any other unavoidable charges, for example an annual fee. As store cards do not have such unavoidable charges, the APR is simply a measure of the interest rate (it is the store card's monthly interest rate compounded over 12 months). Avoidable charges, such as fees for late payment and cash withdrawals and insurance charges, are excluded from the APR.

²³The term 'interest driver' is also used by one or more store card credit providers and is defined by one provider (Ikano) as 'the proportion of balances that are eligible for interest'.

90 per cent).²⁴ Relatively few (about 9 per cent) of those revolvers who did not have a credit card said that they had ever been refused such a card.²⁵ The main reasons given by respondents for not having a credit card were that they did not like credit cards and that they did not want to get into debt.²⁶ A majority of revolvers (about 60 per cent) were in socio-economic groupings ABC1, although the proportion of transactors in grouping ABC1 was slightly higher at about 70 per cent.²⁷

- 3.29 Nor did it appear to be the case that most revolvers used their store cards because they were constrained by lack of funds or available credit. When asked about their most recent purchase on their store card, only 15 per cent of revolvers (and 7 per cent of transactors) said they used a store card rather than a debit card because they did not have enough funds in the bank; the other reasons revolvers used a store card instead of a debit card included convenience (21 per cent), discounts and/or rewards (17 per cent), spreading the cost of goods (10 per cent) and having no debit card available at the time (9 per cent).²⁸ Responses to a similar question about why cardholders used their store card instead of a credit card showed that only 3 per cent of those revolvers who had a credit card used their store card because they had no credit available on their credit card.²⁹ When asked about their purchases more generally, only 4 per cent of revolvers (and 2 per cent of transactors) said they had often used their store card because they had no other way of paying for something they wanted to buy (although 22 per cent of revolvers and 12 per cent of transactors indicated they had, on occasion but not often, used their store card because they had no other way of paying for something).³⁰
- 3.30 When revolvers were asked why they borrowed on their store card, the main reasons given related to spreading the cost and budgeting rather than unavailability or expense of other credit sources. In our survey, revolvers were asked to choose one or more of four stated reasons for not paying off their balance in full: 57 per cent said they preferred to spread the cost over several months and 42 per cent said revolving helped to manage their overall budget. This compared to 26 per cent who said they had no funds available at the time and 13 per cent who said the cost of the store card was lower than other sources of credit.³¹ In a survey of its own cardholders commissioned by GECF, revolvers were asked an open-ended question about why they used their store card for credit rather than paying off the balance in full: 45 per cent said budgeting, 18 per cent convenience, 6 per cent habit and 5 per cent to buy expensive items, while 24 per cent said no particular reason applied. A negligible proportion gave reasons related to unavailability or expense of other credit sources, such as having a good APR on their store card.³²
- 3.31 The average balance across all store cards was about £150 per active account (using the definition of active account we have adopted throughout this report—see footnote 15 earlier in this section). Average balances vary with repayment behaviour: an analysis based on accounts with a retail transaction within the month showed average balances were about £80 for those paying in full (who accounted for about

²⁴Source: CC estimates based on surveys carried out by NOP for the OFT and ORC for the CC. The McCallum-Layton survey for GECF of holders of GECF store cards suggested a similar proportion of revolvers (83 per cent), but a slightly lower proportion of transactors (88 per cent), had a credit card. These surveys are available on the CC website.

²⁵Source: ORC survey for CC, available on the CC website. The sample size of revolvers without a credit card was 123.

²⁶Source: McCallum Layton survey for GECF, available on the CC website. The sample size of revolvers without a credit card was [X].

²⁷Source: CC estimates based on surveys carried out by NOP for the OFT and ORC for the CC.

²⁸Source: ORC survey for CC, available on the CC website. Respondents were also asked why they used their store card instead of cash and cheques: the proportion responding they did not have sufficient funds in the bank was lower than for debit cards probably because respondents did not have sufficient cash or a cheque book on the relevant shopping trip.

²⁹Source: ORC survey for CC, available on the CC website.

³⁰Source: NOP survey for OFT, available on the CC website.

³¹Source: ORC survey for CC, available on CC website. 8 per cent said none of these four reasons applied.

³²Source: McCallum Layton survey for GECF, available on the CC website.

57 per cent of such accounts and 15 per cent of the balances of such accounts), £250 for those paying more than the minimum but less than the full amount (30 per cent of accounts and 46 per cent of balances), and £800 for those paying the minimum, or less (13 per cent of accounts and 39 per cent of balances).³³ These figures show that transactors account for a higher proportion of active accounts than balances as they have a low average balance per account. As well as varying with repayment behaviour, average balances also vary significantly between retailers (see paragraph 3.36).

The retailers offering store cards

- 3.32 Department stores and clothing retailers account for the bulk of retail sales paid for with a store card. We obtained data from 54 retail groups with store card programmes in 2003.³⁴ Of these 54 retail groups, 22 (41 per cent) classified themselves as clothing retailers and accounted for about 13 per cent of store card sales; 20 (37 per cent) classified themselves as department stores and accounted for 70 per cent of store card sales.
- 3.33 Across all the 54 retail groups, most sales in 2003 were made by debit or credit card, cash or cheque: store card sales accounted for about 12 per cent of total sales. Store cards were a slightly more important means of payment in department stores, accounting for 15 per cent of total sales. Figures for individual retailers vary substantially—from less than 1 per cent to about 50 per cent of sales paid for by store cards.
- 3.34 The OFT noted in its report (see paragraph 2.2 of that report) that, prompted by concern expressed by the TSC, it had enquired into whether inducements were offered to sales assistants to put pressure on customers to sign up to store card agreements. The OFT stated that it had found that incentives were offered to retail staff in most cases. However, the OFT's consumer survey showed that little pressure was put on consumers. According to the OFT report, providers claimed that they trained staff so as to enable them to answer financial questions, and OFT said that its mystery shopping exercise lent some support to this claim. We received no evidence that inappropriate influence was exerted by sales staff on their customers to take out a store card.
- 3.35 In 2004, the four largest store card programmes, by number of active accounts, were (in alphabetical order) Arcadia, Argos, Debenhams, and Marks & Spencer.³⁵ These groups between them accounted for about 50 per cent of all active store card accounts and balances.³⁶ Other retailers with significant store card programmes include ASDA³⁷, Bhs, House of Fraser, JJB Sports, JLP, Laura Ashley, Mothercare and New Look.
- 3.36 Average balances on each active store card account depend on the characteristics of the retailer. As noted above, department and clothing stores account for the bulk of

³³Source: CC analysis of data supplied by some store card providers for 12 months to March or June 2003. The figures are based on the average of the monthly figures for cardholders who made a retail transaction in the month. The average balance across all accounts making a retail transaction in the month was about £240: this is higher than the £150 average balance per active account quoted above as accounts making a retail transaction in the month had a higher average balance than other active accounts (accounts which had not made a retail transaction in the last month but had made one in the last 12 months).

³⁴Two of these retail groups (Arcadia and Rubicon) have more than one retail brand. Arcadia includes Burton, Dorothy Perkins, Evans, Outfit, Miss Selfridge, Topshop/Topman and Wallis. Rubicon includes Principles and Warehouse.

³⁵As noted above, Marks & Spencer has converted many of its store card accounts to SBCC accounts. Nevertheless, it remains one of the four largest store card programmes.

³⁶Source: information from store card credit providers.

³⁷Other large supermarkets do not feature in our inquiry; thus, for example, Tesco operates a credit card and, separately, a loyalty card, but not a store card.

sales to cardholders: at the end of 2003, typical average balances on department store cards were £200 or more, while those for clothing stores were only just over £100.

The store card providers

3.37 The main providers in 2004 were, by number of active accounts: GECF, Creation, HSBC, Arg Card Services,³⁸ Ikano and Style. The provision of store cards is currently highly concentrated: the four largest providers in 2004 accounted for 90 per cent or more of total supply (measured by the number of active accounts and by the total value of balances, retail sales and cardholder revenue (see Table 3.3). This high concentration is also reflected in the Herfindahl-Hirschmann index (HHI) of concentration (HHI)³⁹ which in 2004 was between 3,400 and 4,500 depending on the measure used. Projections of active account numbers and balances suggest the position in 2005 and 2006 is broadly similar to that shown in Table 3.3.⁴⁰ Appendix 3.2 discusses the calculation of market shares and shows providers' shares over a longer period of time.

TABLE 3.3 **Providers' shares of store cards 2004**

	<i>per cent</i>			
	<i>Active accounts end year</i>	<i>Balances end year</i>	<i>Retail sales</i>	<i>Cardholder revenue*</i>
GECF	60–70	50–60	50–60	60–70
Creation	10–20	5–10	5–10	5–10
HSBC†	10–20	10–20	20–30	5–10
Argos	5–10	10–20	5–10	5–10
Style	<5	<5	<5	5–10
Ikano	<5	<5	<5	<5
Total	100	100	100	100
<i>HHI</i>				
2004	4,343	3,807	3,446	4,452

Source: CC calculations based on information from major providers. See notes to Table 1 and Appendix 3.2. The sum of individual market shares does not necessarily equal 100 due to the use of ranges.

*Revenue from interest charges, APRs, fees and charges.

†Including JLP store card programme (acquired during 2003) and Marks & Spencer store card programme (acquired during 2004).

3.38 GECF is the largest provider by some distance on all measures we looked at—that is, by active accounts, credit balances, sales or cardholder revenue. HSBC, which acquired the JLP portfolio in 2003 and Marks & Spencer's financial services business (of which its store card business formed a part) in 2004, is the second-largest on the basis of balances or store card sales. HSBC's two main programmes (JLP and Marks & Spencer) have converted substantial numbers of store card accounts to SBCC accounts. None of the other providers had more than a 13 per cent share of the market on any of the above measures in 2004.

³⁸Arg Card Services Ltd is part of the Argos Retail Group, including Argos and Homebase, for which it provides store cards as an in-house provider. It also provides the store card for Jaeger.

³⁹The HHI is an index of concentration calculated by summing the squared market shares. In its guidelines, the OFT states that it is likely to regard any market with a HHI in excess of 1,800 as highly concentrated.

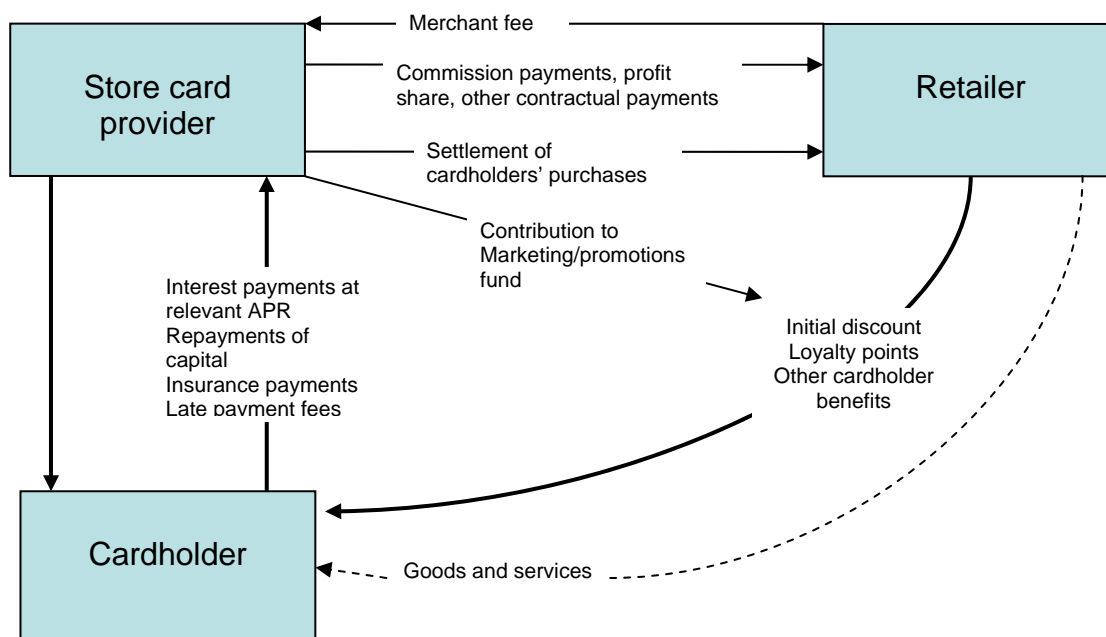
⁴⁰Shares of balances are similar to the ranges shown in Table 3.3 and shares of active accounts are broadly similar although HSBC's share has declined (due to conversion from store cards to SBCCs) and Argos's and Ikano's share has increased.

The provision of store card services

- 3.39 Until the 1990s, retailers financed and operated their own store card programmes. A few still do so, including Argos, Beales, Fenwicks, Fortnum & Mason and Jenners. But most retailers now contract with providers who finance and administer the store card on their behalf. In 2003 and 2004, JLP and Marks & Spencer, two large multiple retailers who previously had large self-provided store card programmes, contracted them out to HSBC who finances and operates the store card on their behalf. In the case of some large multiple retailers, including JLP and Marks & Spencer, these arrangements are conducted within a joint venture structure.
- 3.40 The core functions of the provider include credit risk management, account processing, the provision of capital and marketing. The retailer provides the distribution channel—that is, access to its customers—and is often jointly responsible for marketing the store card. The retailer also funds cardholder discounts and other promotional or loyalty benefits. By taking out a store card, a cardholder enters into a direct contractual relationship with the provider, not with the retailer (except of course where the retailer finances and operates its own store card programme).
- 3.41 Figure 3.2 illustrates the nature of the transactions between the three parties involved (provider, retailer, and store cardholder). The cardholder buys goods or services from the retailer and, when paying with a store card, receives present or future benefits from the retailer. The cardholder may obtain an initial discount when opening a store card account and using it immediately, or may receive other benefits (see paragraph 3.3). The provider pays the retailer for the goods. The amount paid may be less than the face value, in which case the retailer is said to pay a merchant fee, or the provider may pay the full value plus commission. The provider may also make other payments to the retailer, for example a fee for each account opened, payments for marketing the store card or a share of store card profits, or some combination of these (as mentioned in paragraph 3.18, recent years have seen an increase in net payments by providers to retailers). Every month during which a store card has been used to make a purchase or there is still an outstanding balance from the previous month, the provider sends a statement to the cardholder, who makes the desired payment to the provider (the cardholder may opt to pay any amount between the minimum and settling the balance in full, see paragraph 3.3).

FIGURE 3.2

The nature of the transactions between provider, retailer and store cardholder



Source: CC from data provided by the parties.

3.42 The key sources of income for providers include some or all of the following:

- (a) interest income on balances not settled in full within the interest free period;
- (b) card-related insurance income, including one or more of payment, purchase, price and card protection insurance (this income represents the value of premiums collected from cardholders net of payments to insurance underwriters);
- (c) late payment fees and other cardholder charges, including copy statement charges and fees for ATM withdrawals; and
- (d) other income, including merchant fees from certain retailers.

In addition to such income derived from the supply of the store card itself, providers may benefit from opportunities to cross-sell other products and services to cardholders, most notably other financial services such as life insurance. The extent to which cross-selling is undertaken will depend on the contractual terms agreed between the retailer and the provider.

3.43 Figure 3.3 illustrates the various elements affecting a provider's operating profit. In addition to the revenue sources described above, the highlighted boxes represent cost elements of one type or another. These cost elements can broadly be grouped into:

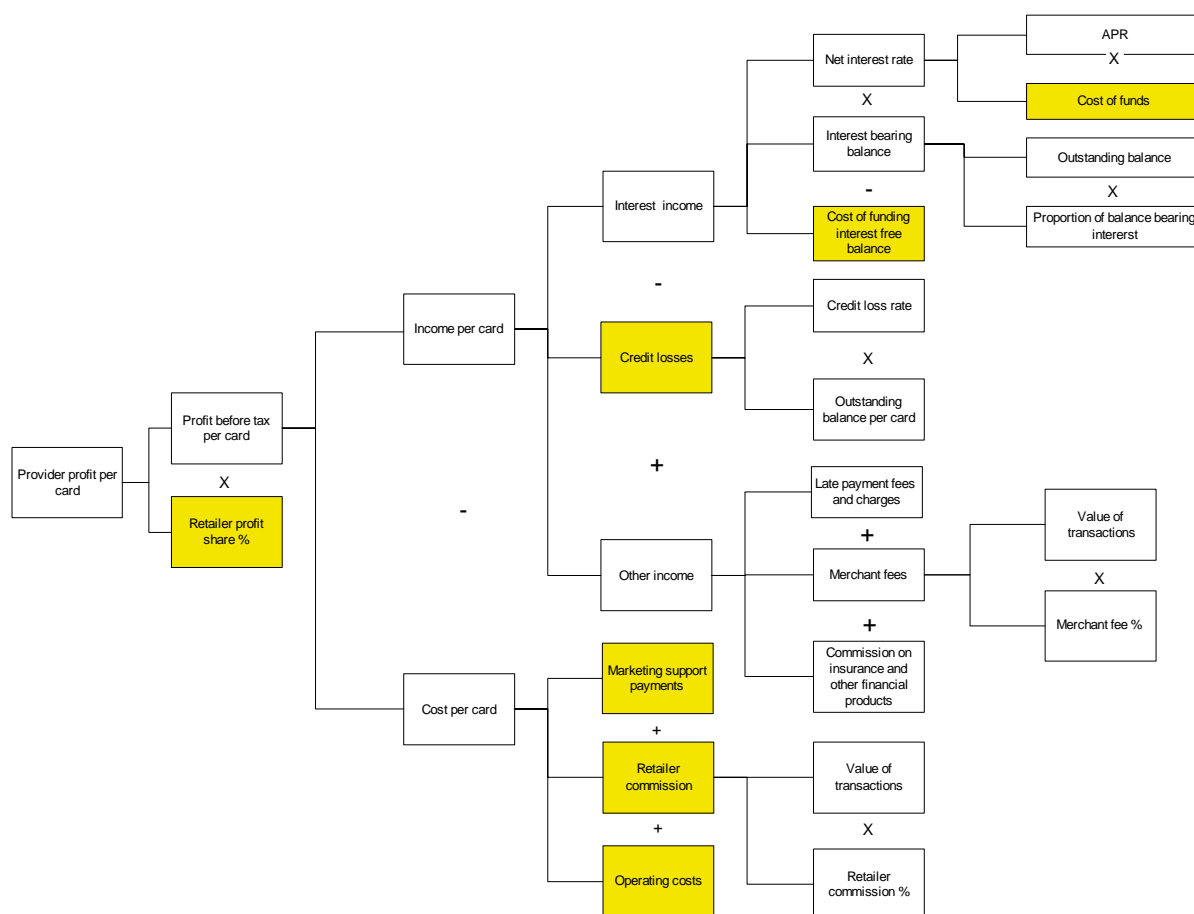
- funding and bad debt costs (including the costs of funding interest-bearing and non-interest-bearing balances, and bad debts);

- payments to retailers (including profit share, commission payments and other payments, for example to support retailers' marketing of the store card); and
- operating costs (including all other costs of running the store card portfolio).

Further detail on the nature of these costs can be found in Appendix 8.1.

FIGURE 3.3

Drivers of profit for store card providers



3.44 Retailers and providers will, in most cases, share the incentive to maximize continuing use of the store card and to discourage ‘hit-and-run’ behaviour (see paragraph 3.27). These shared incentives will be particularly strong where longer-term contract features such as profit-sharing are present. Providers and retailers also derive similar benefits from having access to the database of the names and addresses of cardholders: providers may (subject to any contractual restrictions) use these lists as an additional distribution channel through which to cross-sell other financial products, while retailers use them for their own marketing purposes. However, the two parties have somewhat different short-term incentives: for retailers, it is to maximize incremental purchases on the card (since it is this that generates an additional contribution to retail profit), and for providers it is to maximize borrowing and the take up of store card insurance (see next section), since it is these that generate their income and profits.

Store card insurance

3.45 Our terms of reference require us to investigate store card credit services to retailers and services, including insurance services, related thereto; and insurance purchased in association with the provision and use of store cards by cardholders.

3.46 Payment protection insurance is offered on almost all store cards and covers card repayments in the event of accident, illness, unemployment or the death of the store cardholder. This insurance is often sold as part of a package of insurance that

includes purchase protection, under which purchases that are damaged, lost or stolen within a given period are replaced, and/or price protection, under which cardholders are refunded the difference when purchases are reduced in price within a given period. For some retailers, for example those selling only perishable goods, the offer of purchase or price protection will be inappropriate and so payment protection insurance may be offered alone. We refer to payment protection insurance, whether offered with or without purchase and/or price protection insurance, as PPI. Cardholders may be offered PPI when opening a new store card account in-store or may be contacted by providers and offered insurance at a later stage (by telemarketing or mail).

- 3.47 A second category of insurance that is offered by most providers is card protection insurance (CPI), which covers store cards (and other credit cards the holder may own) against loss or theft. Providers who offer CPI in most cases do not market this type of insurance actively in-store but prefer to promote it through telemarketing or by mail. CPI is generally not bundled with other insurance products, and comparable (and potentially competitive) cover is available elsewhere in the market, for example, for general credit cards. We do not, therefore, consider CPI further in our inquiry.
- 3.48 At least until the end of 2004, most providers and retailers offered PPI in-store. Some providers, however, for example [X], did not offer PPI in store—in such cases, cardholders were typically offered PPI later, usually when they called to activate their cards. Rules introduced by the Financial Services Authority (FSA) under new legislation in January 2005 (the Insurance Conduct of Business (ICOB) rules) apply to all companies selling non-investment insurance (see paragraph 4.13). These rules have resulted in most providers and/or retailers deciding not to offer insurance in-store and, to the extent that uptake through telephone sales is less than in-store uptake or the new rules have other effects, may lead to a lower penetration of store card insurance overall. It is too early to judge what effect the new rules will have on PPI penetration rates, and the evidence we received from parties was mixed. Two providers [X] told us that take-up of PPI had already fallen; however, an insurance underwriter [X] told us that experience in one country overseas suggested that regulation needed time to become entrenched in the selling process and while there might be an initial reduction in the penetration levels of certain distribution channels, they did revert back to original levels once processes became established. A provider [X] told us it expected those providers and retailers who had stopped offering insurance in-store to reintroduce it once they had fully assessed the regulatory changes. The Finance and Leasing Association (FLA) told us that it did not share the view that the effect of regulation would be a fall in store card insurance penetration rates.
- 3.49 Customers offered insurance in-store, who decide to take up the insurance offer, indicate their wish to do so by either ticking a box on the store card credit agreement form or signing that section of the agreement form which deals with the offer of insurance. The Consumer Credit (Agreements) (Amendment) Regulations introduced in June 2004 make it mandatory, from 31 May 2005, to have a separate signature box on the credit agreement for customers to sign if they are purchasing any optional insurance products, and for both agreements and pre-contract information to disclose the costs and other terms of the insurance. The full insurance policy is subsequently sent to the cardholder by post; this contains such details as eligibility criteria for insurance cover, what is not covered by the insurance, cancellation rights, cancellation procedures and complaints procedures.
- 3.50 Cardholders may cancel the insurance contract at any time by giving notice to the provider, and then need pay no further premium. Most providers also offer a cooling-

off period of 30 days, within which the policy may be cancelled and any premium already paid refunded.

- 3.51 The take up of PPI can be measured by the proportion of insured balances, which is known as the insured debt penetration rate. The insured debt penetration rate in 2004 averaged about 32 per cent but varied considerably between providers, from less than 10 per cent to 47 per cent (details are set out in Table 3 of Appendix 3.3).
- 3.52 In terms of the numbers of customers taking out PPI, the NOP World (NOP) survey carried out for OFT suggested an average uptake across the market of 27 per cent (35 per cent for revolvers, and 22 per cent for transactors). Information collected by the CC showed that most store cardholders who took out PPI did so at the point of sale, (although this information pre-dated the introduction of the new rules on the selling of non-investment insurance referred to in paragraph 3.48).
- 3.53 In 2004, total revenue from card-related insurance amounted to about £135 million. Total insured balances were about £775 million, covering around one third of total store card balances. Insurance revenue represented about 20 per cent of total 2004 cardholder revenue although there was considerable variation across the different providers (from about 4 per cent to 25 per cent). The share of insurance in total cardholder revenue increased from about 14 per cent in 2002 to 20 per cent in 2004. This principally reflected increases in price rather than in the insured debt penetration, which remained broadly constant³²: during 2003, two of the providers (GECF and Style) increased their monthly PPI premiums for many of their programmes by 50 per cent, from 1 per cent to 1.5 per cent (one further provider (Creation) increased its premium from 0.99 per cent to 1.5 per cent during 2005). Increases in price were generally accompanied by an increase in the extent of insurance cover.
- 3.54 In Appendix 3.3, we describe in more detail how providers arrange and price store card insurance, and the premium levels and benefits offered to cardholders, while Appendix 3.4 provides summaries of the store card insurance cover each provider offered in 2005.

Store card and credit card income analysis

- 3.55 Both providers and retailers suggested to us that the provision of store cards should be considered as part of the same market as the provision of other forms of credit, including general credit cards. However, some drew particular attention to the differences between the business models for store cards and credit cards, arguing that these explained and justified the high APRs on store cards. We examine these arguments in detail in Section 6.
- 3.56 By way of background, we considered it useful to understand and compare the sources of income for general credit cards and store cards.
- 3.57 We asked the major credit card providers to give us details of the sources of their card income. During 2004, responses were received from credit card providers that, between them, had approximately 26 million accounts in 2003.³³ We then compared this to store card income data given by store card providers in their responses to our financial questionnaire (see Tables 3.4 and 3.5 below).

³²See Table 3 in Appendix 3.3.

³³Mintel estimates that there were 58.8 million credit cards in issue in 2002.

3.58 The main difference between the revenue model for store cards and that for credit cards is that credit cards have greater amounts spent on them. Table 3.4 shows that average balances and average annual purchases per active account were about ten times greater on credit cards than store cards.

TABLE 3.4 **Weighted average annual purchases, cash withdrawals and account balances for store cards and credit cards**

	<i>£ per active account (2003)</i>	
	<i>Store cards</i>	<i>Credit cards</i>
Annual purchases	220	2,382
Annual cash withdrawal	7	497
Average balance	134	1,281

Source: CC based on information from store card and credit card providers.

Note: figures represent weighted averages of all companies providing information.

3.59 Table 3.5 shows various sources of store card and credit card income per active account and as a percentage of total income. This illustrates that in absolute terms, the total revenue per active account was around five times greater for credit cards than for store cards. In terms of the income structure, store card providers derived a slightly greater percentage of their total income from interest (69 per cent) than did credit card providers (64 per cent). There were greater differences in the respective sources of other income. Store card providers derived a greater proportion of their income from PPI than credit card providers. On the other hand, credit card providers derived a significant proportion of their total income from interchange fees.³⁴ The proportion of income derived from late payment charges was similar for both credit card and store card providers, although credit card providers derived more income from over-limit fees. Although these results relate to 2003, we received no suggestion (for example in response to our provisional findings) that the situation had changed since then.

TABLE 3.5 **Store card and credit card income , 2003**

	<i>£ per active account</i>		<i>Percentage of total</i>	
	<i>Store card average</i>	<i>Credit card average</i>	<i>Store card average %</i>	<i>Credit card average %</i>
Interest	28.55	135.27	69	64
Late payment charges	3.68	18.00	9	8
Over limit fees	0.00	8.61	0	4
PPI	6.59	16.78	16	8
Other insurance	0.84	1.59	2	1
Cash advance fees	0.06	5.37	0	3
Other fees, charges and income	<u>0.18</u>	<u>3.67</u>	<u>0</u>	<u>2</u>
Total income from cardholders	<u>39.89</u>	<u>189.29</u>	96	90
Interchange/merchant fees	<u>1.32</u>	<u>22.88</u>	<u>3</u>	<u>11</u>
Total income	<u>41.21</u>	<u>212.16</u>	100	100

Source: CC based on information from store card and credit card providers.

Note: figures represent weighted averages of all companies providing information.

³⁴Interchange fees are fees—set at a percentage of the purchase price—paid by a retailer's bank to the cardholder's bank for each transaction involving a credit card.

Current state of, and recent developments in, the store card sector

- 3.60 The store card sector is relatively mature in at least two respects. First, the size of the sector remained broadly constant for many years until the end of 2002 since when it has declined (see paragraphs 3.16 to 3.18). Second, there are now far fewer opportunities for the establishment of new store card programmes by retailers of any significant size or for the contracting out of portfolios currently run in-house. Possible new candidates, such as Gap and Woolworths, were mentioned to us during our inquiry, but we were told of no other significant retailer without a store card programme that was currently actively considering introducing one. Of course, new retailers may emerge. One provider suggested there were a number of small retailers possibly interested in new store card programmes, whose programmes aggregated together would produce a considerable turnover. Recent contracting-out of their previous in-house operations by JLP and Marks & Spencer leaves only Argos among the larger retailers that now provides its own store card services in-house—and hence has the potential to offer a new entrant a sizeable contract if outsourced.
- 3.61 Against this background, there have been some potentially significant recent developments. These concern some new entry, changes in the relationship between retailers and providers, conversion of some store cards to SBCCs and, most recently, certain reductions in APRs and the introduction by one provider of programmes under which the APR is determined by each cardholder's credit risk as assessed by the provider at the time of application. This is generally referred to as risk-based pricing.³⁵ We discussed SBCCs in paragraphs 3.22 to 3.25 and those developments that relate to entry and the relations between retailers and providers in Section 7. We now turn to reductions in APRs and risk-based pricing.

Reductions in APRs and risk-based pricing on store cards

- 3.62 During our inquiry, it became apparent that the adverse publicity surrounding the APRs charged on most store cards, which had begun with the report of the TSC and which had continued throughout our investigation, was beginning to have an effect on some parts of the market. Ikano reduced the APR on the Ikea store card to 12.9 per cent in mid-2004. Early in 2005, Monsoon and River Island re-negotiated contracts with GECF providing for a significantly reduced APR of 18.9 per cent and 17.9 per cent, respectively.³⁶ [X].³⁷
- 3.63 Another recent development has been the introduction of risk-based pricing (see paragraph 3.61). This is a feature of three combined programmes, those of ASDA, Debenhams and Mothercare.³⁸ The ASDA programme was launched in 2004 as a combined programme with risk-based pricing, although APRs were modified in October 2005. Risk-based pricing for store cards was introduced on the Debenhams and Mothercare programmes in September 2005 and October 2005 respectively (see Table 3.2). Table 3.6 shows APRs for these three programmes. It also shows the

³⁵As at February 2006, only GECF was operating programmes with such risk-based pricing for store cards, with two or three tiers of APR. We refer to these as multi-tier APRs.

³⁶In the case of Monsoon, the lower rate of 18.9 per cent applies to all balances. In the case of River Island, the lower rate of 17.9 per cent applies to new cardholders and new purchases by existing cardholders.

³⁷At the same time GECF reduced the fee from £18 to £15.

³⁸As noted in paragraph 3.12, combined programmes involve a single offer to prospective cardholders of either a store card or an SBCC.

'typical APR'³⁹ for the combined programme. We consider the changes to each programme below.

Table 3.6 Combined programmes with risk-based pricing

	Store card	SBCC	Typical APR for combined programme (%)
<i>ASDA</i>			
APR up to October 2005 (%)	24.8 and 28.8	13.8, [redacted], [redacted] and 22.7	28.8
APR for existing cardholders from October 2005 (%)	22.7, [redacted] and 28.8	13.8, [redacted], [redacted] and 22.7	
APR for new cardholders from October 2005 (%)	19.7, [redacted] and 28.8*	14.8, [redacted] and 19.7	19.7
<i>Debenhams</i>			
APR up to 29 September 2005 (%)	29.9†	Trial only: [redacted]	29.9
APR for existing cardholders from 29 September 2005 (%)	29.9†	9.9, [redacted], [redacted], [redacted] and 22.9	
APR for new cardholders from 29 September 2005 (%)	18.9, [redacted] and 29.9‡	13.9, [redacted] and 18.9	18.9
<i>Mothercare</i>			
APR up to 3 October 2005 (%)	29.0§	None	29.0
APR for existing cardholders from 3 October 2005 (%)	24.9 and 29.0§	14.9, [redacted], [redacted] and 22.9	
APR for new cardholders from 3 October 2005 (%)	19.9 and 24.9	14.9, [redacted], and 19.9	19.9

Source: CC based on information from GECF.

*[redacted]

†28.0 per cent, not 29.9 per cent, for direct debit payments.

‡[redacted]

§26.0 per cent, not 29.0 per cent, for direct debit payments.

ASDA

3.64 ASDA's combined programme, which is provided by GECF, was launched in 2004 with two store card APRs (24.8 and 28.8 per cent), as well as four SBCC APRs. The typical APR stood at 28.8 per cent in view of the fact that most customers were supplied with cards at the highest APR tier. We were told that around [redacted] per cent of those applying for an ASDA card did not specify a preference between the SBCC and the store card and [redacted] per cent specifically requested the store card. SBCCs are allocated to the more creditworthy applicants who have not specified a preference regarding type of card, with store cards allocated to creditworthy applicants who have lower credit scores. Up to October 2005, about [redacted] per cent of successful applicants for the ASDA card received an SBCC and [redacted] per cent a store card, with [redacted] of store cardholders receiving the lower APR of 24.8 per cent and the remainder receiving 28.8 per cent. The ASDA programme was modified in October 2005: a new lower store card APR of 19.7 per cent was introduced and we were told that this was expected to be offered to [redacted] of new store cardholders, with the 24.8 per cent APR offered to [redacted] and the 28.8 per cent APR offered to the remainder.⁴⁰ The expected typical APR on ASDA's combined programme was reduced to 19.7 per cent, reflecting the fact that more than 66 per cent of all successful applicants in the

³⁹The 'typical APR' is the APR that must be quoted in any advertisement. It is required to be the highest rate that is expected to be offered to at least 66 per cent of borrowers who are given the credit as a result of the advertisement. For the programmes set out in the table, the typical APR is calculated using the APR levels of both the store cards and the SBCCs in the programme.

⁴⁰We were also told that lower APRs of [redacted] per cent could be offered to applicants who qualified for an SBCC but preferred a store card. However, GECF's projections showed [redacted] cardholders receiving these lower APR rates.

combined programme (ie including those offered an SBCC as well as a store card) were expected to be offered an APR of 19.7 per cent or lower.⁴¹ Additionally, ASDA and GECF told us that they had reduced the APRs charged to around [redacted] per cent of existing active accounts and that they expected to carry out further such APR reductions in future. As a result of these changes, GECF estimated that the proportion of active store card accounts and balances paying the 28.8 per cent APR would reduce to about [redacted] per cent by the end of 2005 and [redacted] per cent by the end of 2006.

- 3.65 We note in particular, first that the new typical APR of 19.7 per cent for ASDA's combined programme reflects the rate offered to new holders of store cards and SBCCs taken together as a single group. Second, the new typical APR is the expected rate based on GECF's expectations of the numbers of ASDA customers who might take up each of the two types of card and their creditworthiness (which determines to which APR tier they will be allocated). The actual APRs received by new cardholders will not be known until there is some historical data. And third, [redacted] new store cardholders are expected to continue to be offered 28.8 per cent and most existing store cardholders will remain on their previous APRs.

Debenhams

- 3.66 In September 2005, following a lengthy trial, the Debenhams programme was re-launched as a combined programme, with three store card APRs (18.9, [redacted] and 29.9 per cent) and three SBCC APRs offered to new cardholders, the lowest being 13.9 per cent and the highest being 18.9 per cent, instead of the single previous store card rate of 29.9 per cent. The combined programme operates in a similar way to the ASDA programme, with applicants receiving a store card either because they specifically request it or because their credit scores are too low for an SBCC. The typical APR on the new combined programme is 18.9 per cent, reflecting the expectation that more than 66 per cent of all successful applicants will be offered an APR of 18.9 per cent or less. GECF (the provider of the Debenhams card) told us it expected that around [redacted] per cent of new Debenhams store cardholders would receive the typical APR of 18.9 per cent⁴² with [redacted] per cent receiving the middle APR of [redacted] per cent and the remaining [redacted] per cent of new cardholders receiving the highest APR of 29.9 per cent. GECF also told us that it anticipated offering an SBCC with a lower APR to around [redacted] existing Debenhams store cardholders in 2005 and a further [redacted] in 2006. Nevertheless, GECF expected the bulk of existing active Debenhams cardholders ([redacted]) to remain on the 29.9 per cent APR at the end of 2006, because they had refused the offer of an SBCC; because they were ineligible on a behavioural basis;⁴³ because they did not meet the credit score criteria for an SBCC; or because they tended not to use their store card for credit. [redacted]. But (in December 2005), GECF considered it was too early to predict this impact with any certainty.
- 3.67 We note in particular two things: first that the new typical APR of 19.7 per cent for the Debenhams combined programme reflects the rate offered to new holders of store cards and SBCCs taken as a single group; and second, that the new typical APR is the expected rate based on GECF's expectations of the numbers of Debenhams customers who might take up each of the two types of card and their creditworthiness (which determines to which APR tier they will be allocated). The actual APRs

⁴¹Paragraph 4.5 explains the concept of the typical APR.

⁴²We were also told that lower APRs of [redacted] per cent could be offered to applicants who qualified for an SBCC but preferred a store card. However, GECF's projections showed [redacted] cardholders receiving these lower APR rates.

⁴³[redacted]

received by new cardholders will not be known until there is some historical data. Third, many [redacted] new store cardholders are expected to continue to be offered an APR of 29.9 per cent and all existing store cardholders will remain on an APR of 29.9 per cent. Furthermore, GECF's projections suggest that [redacted] existing store cardholders will convert to SBCCs, with the result that the bulk of existing cardholders will remain on an APR of 29.9 per cent.

Mothercare

- 3.68 The Mothercare programme was also re-launched as a combined programme in December 2005, with two store card APRs (19.9 and 24.9 per cent) and three SBCC APRs offered to new cardholders, instead of the single previous store card APR of 29.0 per cent. The programme operates in a similar way to the ASDA and Debenhams combined programmes and has a typical APR of 19.9 per cent. GECF's projections show that many [redacted] new store cardholders are expected to receive the lower APR of 19.9 per cent, with the remainder expected to receive 24.9 per cent. [redacted]. As a result of these changes, GECF's projections show a rapid reduction in the proportion of active Mothercare accounts paying an APR of 29.0 per cent: the proportion of all accounts (including both store cards and SBCCs) is projected to decline from 100 per cent in mid-2005 to [redacted] per cent at the end of 2005 and [redacted] per cent at the end of 2006. For store card accounts only, the proportion of active Mothercare accounts paying an APR of 29 per cent is projected to decline to [redacted] per cent at the end of 2005 and [redacted] per cent at the end of 2006.
- 3.69 We note in particular, first that the new typical APRs received by new cardholders of 19.9 per cent for the Mothercare combined programme reflects the rate offered to new store card and SBCC-holders taken together as a single group; and second, that the new typical APR is the expected rate based on GECF's expectations of the numbers of Mothercare customers who might take up each of the two types of card and their creditworthiness (which determines to which APR tier they will be allocated). The actual APRs received by new cardholders will not be known until there is some historical data. However, the majority of new store cardholders are expected to receive the typical APR of 19.9 per cent and most existing store cardholders will benefit from an APR reduction.

Other programmes

- 3.70 In addition to the above programme changes, [redacted] told us that it was [redacted]. We are not aware of any similar developments by other providers. We discuss APR developments further in Section 8.

Store card projections, taking account of recent developments

- 3.71 Table 3.7 shows the historic and projected trend in total store card balances and active accounts at different tiers of APR, taking account of the developments described above. The table suggests that the bulk of store card balances and active accounts pay APRs above 25 per cent and are expected to continue to do so at least up to the end of 2006. Excluding JLP and Marks & Spencer, which have historically had low APRs, more than 90 per cent of store card balances and active accounts are projected to continue to pay APRs of more than 25 per cent at the end of 2006. As we discussed above, some store cardholders have converted or are expected to convert their accounts to SBCCs. Although all of these SBCCs have APRs below 25 per cent, Table 3.7 also shows that, even making full allowance for these conversions (the rate of which is uncertain) and again excluding JLP and Marks &

Spencer, over 75 per cent of store card and SBCC active accounts are projected to continue to pay APRs of more than 25 per cent at the end of 2006.⁴⁴

TABLE 3.7 Store card balances and active accounts (end of year)

	2002	2003	2004	2005E	2006E
<i>Store card balances (£ million)</i>					
Marks & Spencer and JLP					
Other below 20% APR			✂		
APR of 20% to 25%					
APR above 25%					
Total	2,842	2,540	2,492	2,257	2,117
Total (excluding Marks & Spencer and JLP)	[✂]
<i>Store card active accounts (thousand)</i>					
Marks & Spencer and JLP					
Other below 20% APR			✂		
APR of 20% to 25%					
APR above 25%					
Total	17,481	15,505	13,884	11,376	10,720
Total (excluding Marks & Spencer and JLP)	[✂]
<i>Store-branded credit card active accounts (thousand)</i>					
Marks & Spencer and JLP					
Other below 20% APR			✂		
APR of 20% to 25%					
APR above 25%					
Total	35	1,753	2,388	3,063	4,240
Total (excluding Marks & Spencer and JLP)	[✂]
<i>Store card and store-branded credit card active accounts (thousand)</i>					
Marks & Spencer and JLP					
Other below 20% APR			✂		
APR of 20% to 25%					
APR above 25%					
Total	17,531	17,273	16,272	14,438	14,959
Total (excluding Marks & Spencer and JLP)	[✂]

Source: CC estimates based on December 2005 information from major providers. See notes to Table 3.1.

⁴⁴The proportion of combined store card and SBCC balances paying over 25 per cent is less than this, reflecting the higher average balance on SBCCs.

4. Regulatory and self-regulatory framework

- 4.1 In this section, we first survey the legislation governing the offering of credit through store cards. We consider various amendments to the Consumer Credit Act 1974 (CCA) that are being made through enactment of a Consumer Credit Bill that is expected to receive Royal Assent shortly. Next, we review the new legislation regulating consumer contracts for insurance referred to in paragraph 3.48. We then look at the various regulatory initiatives taken by representative bodies in the private sector; focus is directed particularly to the quality of the information store card providers disclose on monthly cardholder statements, and we describe some research undertaken by the CC in this area. Finally, we note three inquiries by other regulators into issues relevant to store cards.

A. The regulatory framework

The CCA

- 4.2 Store cards are regulated as consumer credit products. The regulatory regime is based on the CCA—which among other matters provides for the OFT to operate a system of licensing of persons concerned with the supply of consumer credit—and on a range of statutory instruments made under it.
- 4.3 An important underlying principle of the regime is the concept of truth in lending. Consumers are to be given an accurate, clear and comprehensive indication of the nature and true cost of the terms being offered. The CCA and its subordinate legislation lay down rules covering the form and content of agreements, credit advertising, the method of calculating the APR, the procedures to be adopted in the event of default, termination or early settlement, and what constitutes an ‘extortionate’ credit bargain.
- 4.4 Part III of the CCA requires most businesses that offer goods or services on credit or lend money to be licensed by the OFT. Retailers that accept credit cards as payment for goods and services do not need to be licensed to do so. Retailers that offer store or credit cards to consumers do need to be licensed, as do those providing the credit facility (the lending institutions). (Some financial institutions wishing to provide credit on SBCCs or general credit cards also choose to obtain authorization from the FSA and become subject to FSA regulation, but they are obliged to do so only if they take deposits.) A Consumer Credit Public Register is maintained by the OFT. It documents traders that hold, or have applied for, a licence, together with any action taken against the former. In 2004, the OFT received 16,418 applications and granted 16,164 licences. Thirty-five applications were refused. The number of current licences is around 157,800 (at present the total number of licence holders cannot be broken down further into different business categories).

Recent regulations under the CCA

- 4.5 In the context of the current reform of consumer credit legislation (see paragraph 2.3), three statutory instruments were made in June 2004 that are relevant to the provision of credit through store cards. Thus, the regulations on consumer credit advertising,⁴⁵ which came into force on 31 October 2004, apply to marketing material for consumer credit products, including store cards. These regulations introduce a new, simplified approach to the advertising of consumer credit that focuses on the

⁴⁵The Consumer Credit (Advertisements) Regulations 2004, SI 2004/1484.

provision of key information to consumers about the costs of the credit. Principal among these is the APR. The regulations introduce a new single set of assumptions for the calculation of the APR. They also revise the concept of the ‘typical APR’—by requiring the APR quoted in any advertisement to be the highest rate that is expected to be offered to at least 66 per cent of borrowers who are given the credit as a result of the advertisement. The inclusion of even a single APR in an advertisement triggers the requirement to show the typical APR. In addition, the regulations set out the circumstances under which the APR must be quoted in an advertisement—for example, where the advertising copy makes claims about the competitiveness of the rates on offer or is targeted at particular groups of borrowers. The regulations also establish a number of further key financial indicators, and require that—where any one of these is included in an advertisement—all must be shown, together and with equal prominence. In such circumstances, the APR must also be shown—at 150 per cent of the prominence of (that is, in a print font-size one-and-a-half times larger than) the other financial information.

- 4.6 From 31 May 2005, store card agreements have also to comply with the regulations governing the provision of pre-contract information⁴⁶ and the form and content of consumer credit agreements.⁴⁷ The rules on pre-contract disclosure are an innovation. They require lenders to give borrowers specific information about the costs and other terms and conditions of the credit before the agreement itself is made. By providing a summary of the key features of the credit—in a form that mimics the information at the start of the agreement itself—the regulations are intended to allow consumers to compare products and to choose the one that best suits their circumstances.
- 4.7 The regulations governing the form and content of consumer credit agreements prescribe the order in which information, statements of protection and other remedies, and signature boxes must be set out in regulated agreements. They distinguish between details that must be highlighted as ‘Key Financial Information’ and ‘Other Financial Information’ and also govern the prominence that must be given to information in the agreement. (For information on ‘Summary Boxes’—an industry initiative—see paragraph 4.18.)

Unfair terms in contracts

- 4.8 The Unfair Terms in Consumer Contracts Regulations 1999⁴⁸ (UTCCRs) are also relevant to our considerations. These protect consumers against unfair standard terms in contracts they enter into with traders. They are enforced by the OFT and by the courts in actions on contracts. The OFT is in the process of investigating contract terms that permit default charges to be levied by credit card companies—see paragraph 4.21. In the OFT’s view, the UTCCRs also apply to the terms and conditions used by store card providers in their contracts with consumers, which would include terms that permit the levying of fees for late payment.

Consumer credit bill

- 4.9 As already noted, the Consumer Credit Bill principally amends the CCA, regulating consumer credit agreements including those governing the provision of credit through store cards. The Bill was first introduced into the House of Commons on

⁴⁶The Consumer Credit (Disclosure of Information) Regulations 2004, SI 2004/1481.

⁴⁷The Consumer Credit (Agreements) (Amendment) Regulations 2004, SI 2004/1482.

⁴⁸SI 1999/2083. Made under section 2(2) of the European Communities Act in implementation of Council Directive 93/13/EEC on unfair terms in consumer contracts (O.J. No L95, 21.4.93, p.29).

16 December 2004, but failed to complete all its stages before the dissolution of Parliament in April 2005 following the announcement of a general election. A new Bill, which does not differ in policy terms from its predecessor, was reintroduced to the House of Commons on 18 May 2005. It is possible that the Bill will receive Royal Assent in the first half of 2006. However, no timetable has yet been set for the implementation of the various provisions of the Bill, some of which will require secondary legislation, but it could extend into 2007 or 2008.

- 4.10 The Bill was the culmination of a review of consumer credit law, and aims (in the words of the Department of Trade and Industry (DTI)) ‘to protect consumers and create a fairer, more competitive credit market’. Among other matters, current legislation includes requirements for lenders to provide regular statements to cardholders and to prescribe what information should be provided on those statements—the aim being to ensure that borrowers know the current state of their accounts, and are made aware of changes to interest rates and the imposition of fees and charges. The Bill proposes an amendment to the CCA to permit the Secretary of State to make regulations specifying the inclusion of warnings in customer statements required in relation to revolving credit (referred to in the CCA as ‘running-account credit’) about the consequences to the debtor of failing to make repayments as required or of only making minimum repayments. There are also other clauses imposing requirements on providers to give debtors information about sums in arrears.⁴⁹ (There are already provisions—section 78 of the CCA—under which consumers can obtain on request a statement of account in respect of running-account credit agreements, such as those relating to credit or store cards.) The Bill also proposes a new ‘unfairness test’ in respect of consumer credit agreements; and new dispute resolution arrangements that are intended to operate through the Financial Ombudsman Service.

OFT recommendations

- 4.11 In relation to post-contractual information, in its report, *Store Cards*, of March 2004, analysing the sector and explaining why it had decided to refer the matter to the CC (see paragraph 2.2), the OFT made recommendations relating to the monthly statements issued by store card providers. In summary, the OFT said: ‘Post contract, we recommend that monthly statements should include:
- a slimmed down version of the summary box (recommended for store card agreements), including crucially, APRs; and
 - a warning about the implications of making only minimum payments, and the consequences of default’.⁵⁰
- 4.12 The OFT report also noted that the Consumer Credit White Paper⁵¹ had proposed the inclusion of wealth warnings⁵² in post-contractual information about the implications of making only minimum payments on credit card debt. The OFT said

⁴⁹See: <http://www.dti.gov.uk/ccp/creditbill/keydocs.htm>.

⁵⁰*Store Cards: Report of the OFT Inquiry*, March 2004 (OFT706), pages 3 and 57.

⁵¹White Paper, *Fair Clear and Competitive: The Consumer Credit Market in the 21st Century*, 8 December 2003.

⁵²White Paper, *Fair, Clear and Competitive: The consumer credit market in the 21st Century* (Chapter 2, Establishing a Transparent Market, page 36) proposed that a statutory wealth warning should be included in credit agreements so as to alert consumers to the responsibilities of entering into such agreements and the consequences if they miss payments. Some credit card providers now include wealth warnings in pre-contractual and other information.

that it would welcome the inclusion of such warnings on store card monthly statements showing the amount in years and the total amount payable.⁵³

The regulation of consumer contracts for insurance

- 4.13 Legislation (made under The Financial Services and Markets Act 2000) governing the sale of non-investment insurance contracts to consumers required insurance intermediaries to be authorized by the FSA from 14 January 2005.⁵⁴ Under this legislation, giving advice on, arranging, acting as agent and assisting in the administration and performance of non-investment insurance contracts are regulated activities, and the FSA has made various rules relating to these activities, the most relevant rules for the purposes of our inquiry being the ICOB rules. The rules impact in particular on the ways insurance on store cards can be sold (see paragraph 3.48). Companies wishing to sell non-investment insurance have two options: to become authorized by the FSA and to become an ‘appointed representative’ of an authorized firm. Under the first of these options, a person would be directly authorized to carry on the selling of general insurance by the FSA and would have, among other things, to meet the requirements in respect of capitalization, ensure that its staff have a proper knowledge of the insurance business and report as required to the FSA. The second option is to become an appointed representative of an authorized firm (which does not have to be an insurer); the firm would then be responsible to the FSA for ensuring that its representative met the standards required by the FSA’s rules. Firms would in these circumstances be expected to require their appointed representatives to meet the standards set by the rules in areas such as training, competence and information to customers, and to assure themselves that their representatives would meet the necessary standards. A company may also become an ‘introducer-appointed representative’ of an authorized firm. Here, an introducer-appointed representative also relies on an authorized firm to accept responsibility for its activities, but these activities are limited to effecting introductions to the authorized firm or distributing non-real time promotions and cannot include the sale of store-card related insurance.
- 4.14 As noted in paragraph 3.48, these rules have resulted in most store card providers deciding not to offer store card-related insurance in-store.

The Unfair Commercial Practices Directive

- 4.15 The Unfair Commercial Practices Directive (UCPD) was adopted by the EU on 11 May 2005. It will harmonize unfair trading laws in all EU member states and introduce for the first time in UK law a general duty on all businesses (including providers and retailers offering store cards) not to trade unfairly with consumers. In particular, it will oblige businesses not to mislead consumers through acts or omissions; or subject them to aggressive commercial practices such as high pressure selling techniques. The Government addressed the question of how the provisions of the Directive should be implemented in the UK in a consultation document published in December 2005. The UCPD must be implemented in UK law by 12 June 2007 and the relevant legislation must come into force by 12 December 2007. We considered whether the UCPD might have a bearing on our inquiry. However, the scope of the UCPD is very broad and the DTI is currently consulting on how to implement it in UK law—in particular, the DTI has noted that it inevitably overlaps with existing UK legislation such as the Trade Descriptions Act 1968 and Part III of the Consumer Protection Act

⁵³Store Cards: Report of the OFT Inquiry, March 2004 (OFT706), page 58.

⁵⁴The Financial Services and Markets Act 2000 (Regulated Activities)(Amendment)(No 2) Order 2003, SI 2003/1476.

1987. These considerations, and the fact that the relevant legislation does not have to be in force until the end of 2007, lead us to the view that we cannot take the UCPD into account in our consideration of current and prospective legislation affecting the store card market and hence any appropriate remedies, were we to conclude that they were required.

B. Sector self-regulation

- 4.16 The store card sector is also subject to self-regulation. The FLA is the biggest UK representative organization for the UK consumer credit and asset finance sectors and acts as regulator and monitor of best practice for the consumer credit industry. The FLA represents virtually the entire store cards sector (although in the case of HSBC it is the two HSBC subsidiaries providing store cards which are FLA members). The FLA's Lending Code 2004—previous forms of which had been in existence since 1992—sets out standards of good practice for the consumer finance industry and is intended to reassure any consumer who applies for finance from full members that they are doing business with reputable organizations. Since 31 March 2004, the Code has required member store card providers to position a 'summary box' prominently on store card adverts, direct mail promotions, leaflets and inserts. The FLA told us that its summary boxes provided detailed information on key features such as APRs and interest-free periods, and were designed to enable consumers to compare store card offers and shop around for the best deal.⁵⁵ The FLA also told us that the Lending Code had proved highly flexible and could be modified at short notice to keep pace with market and regulatory developments.
- 4.17 The Association for Payment Clearing Services (APACS) is a trade association for institutions delivering payments services to end-customers, and membership is open to any member of a payment scheme which is widely used or significant in the UK. It provides the forum to address cooperative aspects of payments and their development. It is also the main industry voice on issues such as plastic cards, card fraud, cheques, electronic payments and cash. The organization's Card Payment Group plays a major role in policy-making on strategic issues affecting the industry. Its remit covers all types of cards—credit, debit, charge cards as well as ATMs and cheque guarantee cards. While no company specializing in providing store cards is a member, three Groups with subsidiaries or units which operate in the store cards sector—HSBC, the Royal Bank of Scotland and GE Capital Bank—belong.

Post-contractual information

- 4.18 In March 2005, APACS issued Best Practice Guidelines for credit card providers dealing with the provision of post-contractual information to cardholders. These related to a summary box that credit card providers might include on monthly statements so as to present the customer with key features of their credit card. The Guidelines, which APACS suggested should be applied by the end of 2005, provide advice on the content and positioning of the Box. As a minimum, APACS recommended including, in addition to material already carried on the statement, information on the interest-free period, interest charges, allocation of payments (that is, if the total balance was not paid off in full, the payment would be first allocated to lower APR offers), minimum repayments, fees (eg an annual fee), charges (eg for cash advances and foreign exchange transactions) and default charges.

⁵⁵The information provided in the summary box include: APRs, monthly rates, interest free period, allocation of payments (ie, the way payments are allocated if the total balance is not paid in full), minimum repayments, fees, charges and default charges.

- 4.19 We conducted some research in June and July 2005 to establish how much detail was provided on the monthly statements issued by the six major store card providers—ARG Financial Services, Creation, GECF, HSBC, Ikano and Style—asking each whether or not its monthly statements showed: the level of the APR; estimated interest charges if only the minimum amount is repaid; a ‘wealth warning’; the levels of insurance, late payment and other charges; and the customer’s cancellation rights and the ways to cancel the agreement. The results (presented in full in Appendix 4.1) showed that the six providers’ current practices vary widely. Only one of them stated the APR (and two others provided the monthly interest rate). Only two stated the level of interest charged on outstanding debt when only the minimum amount is repaid, one giving a detailed explanation. Three included a ‘wealth warning’. Four included the levels of insurance charges. Only one routinely listed the levels of late payments or other charges, although most of the others indicated that such charges could be payable in principle or showed the level if the charges had been applied.⁵⁶ Finally, none of the providers included information on cancellation rights and methods on their statements, although one provided a telephone number for inquiries.
- 4.20 Two store card providers told us that they already voluntarily applied the APACS Best Practice Guidelines for monthly statements by credit card providers; another said that it was intending to do so. A further two providers indicated that they were reviewing the information carried on their monthly statements. Appendix 4.1 indicates the extent to which providers’ practices as set out in its questionnaire response would be affected if the Guidelines were to be fully applied; the appendix also charts the likely impact of the changes relating to monthly statements mooted by the OFT and the provisions of the Consumer Credit Bill.

C. Investigations into issues relevant to store cards

OFT investigation of default charges on credit cards

- 4.21 In 2003 the OFT, prompted by complaints from members of the public, launched an investigation into the terms and conditions of credit cards, including those covering default charges (imposed if cardholders fail to pay bills on the due date, exceed their credit limits or pay with cheques or direct debits which are not honoured). In late July 2005, the OFT wrote to eight major credit card companies to consult them on its provisional conclusion that the levels of their default charges were excessive. The OFT said it believed that it was unfair for the purposes of the UTCCRs to require a consumer who defaulted (in one of the ways defined above) to pay a disproportionately high charge (see paragraph 4.8). The OFT considered that, in a consumer contract, a default charge was likely to be disproportionately high if it was more than a genuine pre-estimate of the damages that the card issuer would win in court if it sued the cardholder for breach of the contract. The credit card companies were given three months in which to provide suitable undertakings or to otherwise address the OFT’s concerns. The OFT told us in January 2006 that it was now considering the companies’ responses and assessing its position. The OFT has powers to ask a court for an injunction to prevent an unfair term being used, or recommended for use, if it deems this necessary.

⁵⁶In September 2005, GECF told us that since mid-August 2005 the levels of late payment fees had been shown on monthly statements.

OFT market study of the PPI sector

- 4.22 On 8 December 2005, the OFT announced that it was to carry out a market study of the PPI sector, following its consideration of a super-complaint from Citizens Advice. In its press release accompanying the announcement the OFT said that it had decided to carry out a market study because a number of factors—notably, the size of the sector; the complexity of the product, coupled with limited understanding on the part of the customer; and the way in which the product was sold (as a secondary purchase to the credit product)—pointed to a potentially high risk of consumer detriment. The precise timing and scope of the study would, the OFT said, be decided in the first half of 2006 after the CC had reported on store cards and associated insurance.

FSA investigation of PPI

- 4.23 In summer 2005, the FSA carried out a supervision project, looking at different segments of the PPI market and published the outcome in '*The sale of payment protection insurance – results of thematic work*' in November 2005. The FSA followed up this project with a letter to the chief executive officers of all large and medium-sized firms or groups that underwrote or distributed PPI, explaining its findings and requesting their response by 19 December 2005. For small firms, the FSA published a fact sheet communicating similar messages. The FSA is currently assessing the responses to its letter and plans a further round of thematic supervision work on the sale of PPI early next financial year. It is focusing on selling practices and compliance with FSA rules, but is not looking into competition or pricing aspects.

5. The statutory questions

5.1 We are required by section 134(1) of the Act to decide whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK, or a part of the UK, and hence whether there is an adverse effect on competition.⁵⁷ The Act states⁵⁸ that, for the purposes of a market investigation reference, a ‘feature’ shall be construed as:

- the structure of the market concerned or any aspect of that structure;
- any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or
- any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

‘Conduct’ includes any failure to act (whether or not intentional) and any other unintentional conduct.⁵⁹ ‘Relevant market’ means a market for goods or services of a description specified in the reference.⁶⁰

5.2 The Act thus requires us to consider ‘features’ in relation to ‘each relevant market’, and states that ‘relevant market’ for these purposes equates to the market for goods or services specified in the reference. The goods or services specified in the terms of reference and defined as the ‘relevant market’ may or may not correspond to a ‘market’ in the economic sense—that is, a market defined for the purposes of determining within what product and geographical boundaries competitive forces operate, through demand- and supply-side substitution. We consider the economic market or markets for the services specified in the reference in Section 6.

5.3 We are also required to consider whether action should be taken by us for the purpose of remedying, mitigating or preventing the adverse effect on competition or any detrimental effect on customers so far as it has resulted from or may be expected to result from the adverse effect on competition. We therefore need to consider whether any feature or combination of features we may have identified as preventing, restricting or distorting competition has brought about, or may be expected to bring about, a detrimental effect on customers in the shape of higher prices, lower quality or less choice of goods or services in any market, or less innovation in relation to such goods or services.⁶¹

5.4 In addition, pursuant to Article 10 of the EC Treaty and in the light of the Council Regulation (EC) No 1/2003 on the implementation of the rules of competition laid down in Articles 81 and 82 of the EC (that is, the Modernisation Regulation), we need to consider the requirement that the application of national competition law must be consistent with, and must not prejudice, the full and uniform application of EC competition law.

⁵⁷Section 134(2).

⁵⁸Section 131(2).

⁵⁹Section 131(3).

⁶⁰Section 134(3).

⁶¹Section 134(4) and (5).

6. Market definition

Introduction

- 6.1 There are normally two dimensions to the economic definition of a market: a product or service dimension and a geographical dimension. The products or services to be included in the economic market, and the geographic boundaries of that market, are determined by the extent to which customers can readily switch between substitute products, or suppliers can readily switch their facilities from the supply of one product to an alternative product. These substitute products are the most immediate competitive constraints on the behaviour of the undertaking supplying the product in question.
- 6.2 In its published market guidelines,⁶² the CC says that it does not regard market definition as an end in itself, but rather as a useful tool for identifying the competitive constraints present in a market and a framework within which to analyse the effects of market features. There is inevitably an element of judgement involved in defining the market and the CC will adopt the methodology most appropriate in the context of the investigation. The generally-accepted conceptual approach to market definition is the hypothetical monopolist or small but significant non-transitory increase in price (SSNIP) test.⁶³ Based on the principle that a market may be defined as a product or collection of products, the supply of which can, hypothetically, be monopolized profitably, it asks whether a hypothetical monopolist of a certain product or set of products, which might constitute a market, could profitably impose a SSNIP. In addressing the economic market definition in this inquiry, we make use of the SSNIP test to the extent that it appears feasible and helpful to do so.
- 6.3 We consider market definition in relation to the two services referred to us:⁶⁴
- (a) store card credit services to retailers and services, including insurance services, related thereto (store card credit services) (the ‘upstream market’) (paragraphs 6.4 to 6.27); and
 - (b) consumer credit through store cards and insurance purchased in association with the provision and use of those store cards (the ‘downstream market’) (paragraphs 6.28 to 6.186).

The provision of store card credit services to retailers: ‘the upstream market’

- 6.4 Retailers contract with store card providers for store card credit services, including insurance. Retailers do not always directly pay store card providers for these services. Indeed, for many of the larger and more recent contracts, substantial payments flow from the provider to the retailer. However, regardless of the payment flow, the retailer is clearly acting in the role as ‘client’ choosing between providers competing to supply services. We therefore believed that it was appropriate to examine market definition in the normal way for the supply of store card credit services to retailers.⁶⁵ The question was therefore how broad was the pool of potential services (on the demand side) and potential suppliers (on the supply side).

⁶²CC3—*Market Investigation References: Competition Commission Guidelines*, June 2003 (CC3).

⁶³CC3, paragraph 2.2.

⁶⁴See paragraph 1.2 and Appendix 1.2.

⁶⁵In the discussion that follows, a ‘SSNIP’ or a ‘5 per cent price increase’ should be considered to be a change in contract terms that makes the contract more attractive to the provider and less attractive to the retailer. In some circumstances this is simply an increase in the price paid by the retailer but often this could represent a *decreased* payment from provider to the retailer.

- 6.5 We began by examining the narrowest possible market definition: whether each contract should be regarded as a separate market. We then considered whether the possibility of substitution to other card services should lead us to a wider market than 'store card services'.

Is each contract a separate market?

- 6.6 The process of price formation in this market takes place increasingly through formal or informal tenders. We examined whether this implied that we should treat each contract as a separate market, since in a sense price formation is specific to each such contract.
- 6.7 We applied the hypothetical monopolist test to each contract as being its own market, considering whether a 5 per cent rise in the price offered by all bidders for a single contract would be profitable. Supply-side substitution, from store card service providers not currently bidding for any given contract, can be expected to render such a price rise unprofitable. There is a wide variety of providers currently offering store card credit services and it is hard to see how any of them or even any subset of them could monopolize the supply of any single contract—unless they also monopolized the wider market for store card credit services (comprising all such contracts). Consequently, we consider that this wider market is the appropriate market definition for understanding the dimensions within which rivalry occurs. We therefore concluded that supply-side substitution resulted in a market which was wider than a single contract. This conclusion is consistent with our observations that there were common price trends across different contracts, implying that similar competitive conditions apply across a market wider than the individual contract.
- 6.8 We therefore conclude that the relevant market is wider than each individual contract.

Whether the market is wider than 'store card credit services'

- 6.9 Having rejected the narrowest market definition, we widened the proposed market definition to 'store card credit services' across different store card contracts. We tested this market definition by considering whether it is still too narrow. Again, we considered whether a hypothetical monopolist of this market would profitably be able to raise prices above competitive levels, or would be prevented from doing so by demand-side or supply-side substitution.

Demand-side substitution

- 6.10 On the demand side, retailers may be able to choose alternative services. Store card credit services could in principle be substitutes for loyalty card services, for credit services available on credit cards or (especially) for the services provided by an SBCC. These services will often be viewed as alternatives to store card services. The question for us was whether they are sufficiently close substitutes to be in the same economic market.
- 6.11 Many retailers suggested that the loyalty and brand image elements of the service take priority over the credit. Store cards are designed to enable retailers to communicate with and reward their customers, and hence generate loyalty and repeat purchases. Store cards also increase awareness of the retailer's brand. One retailer [X] put it to us this way: 'The importance [of the card] is around the information about our regular shoppers so that we can understand what they want to buy and when they change their habits. ... For us, credit is secondary. The information around the customer is the primary reason to have the card'.

- 6.12 We received mixed views from credit providers on the question of whether these characteristics of store cards meant that there was a distinct market for the supply of store card credit services to retailers. For example, we were told by one provider [X] that retailers' needs could be met by a range of products or combination of products. In particular, all elements offered by a store card programme could be replicated by an SBCC programme.
- 6.13 We accept that loyalty cards are also intended to generate and retain customer loyalty, and SBCCs can also do so. However, as discussed in paragraphs 3.10 to 3.12, both represent significantly different business propositions from store cards. Loyalty cards are entirely funded by the retailer itself. SBCCs may not be suitable for all retailers, particularly if the number of retailers offering these cards increases significantly—as their success depends on the cards having 'front of wallet' status; infrequent usage renders them unprofitable. Several retailers told us that they did not consider such cards to be suitable for their business. In short, both types of card may be attractive to retailers in certain circumstances—often more attractive than store cards—but the choice of such cards can be an important strategic decision.
- 6.14 SBCCs and loyalty cards may in some sense provide alternatives to store card services. However, the test for market definition is whether they are such close substitutes that relative small changes in price would cause them to be preferred to, or rejected over, store cards by a retailer interested in having a card programme.⁶⁶ There are many reasons for retailers to choose an SBCC or a loyalty card over a store card, but a 5 per cent change in price seems unlikely to be one of them—the decision is bigger than that. This view was consistent with all of the evidence we received from providers and retailers and we also noted that bids by providers have varied by considerably more than 5 per cent over the course of a single store card tendering process, without necessarily inducing the tendering retailer to examine switching to other card types.
- 6.15 Considering demand-side substitution therefore leads us to a market defined as being no wider than 'store card credit services'.

Supply-side substitution

- 6.16 Turning to supply-side substitution, we considered whether suppliers of general credit cards and other financial products could readily switch to providing store card services to retailers and so exert a competitive constraint on existing store card providers. We found it helpful to distinguish two sorts of investment required of potential providers: physical investment to provide purely operational capabilities on the one hand, and investment to build credibility and customer relationships on the other.
- 6.17 So far as physical investment required to operate a store card programme is concerned, many of the necessary functions are common to all providers of credit services—in particular, analytic services (for credit and fraud risk); customer information (the maintenance, provision and analysis of databases and the provision of Customer Relations Management (CRM) and data management software); customer contact (including running call centres and issuing statements); cash collection and disbursement to retailers and plastic card production.

⁶⁶This applies only to the 'upstream market'. Cardholders' decisions affecting 'downstream' market definition are considered later in this section.

- 6.18 We were satisfied that it would be technically feasible for a provider of credit services to adapt its systems to supply store card credit services, in some cases at a relatively low incremental cost. Furthermore, potential entrants lacking suitable facilities or know-how would be able to outsource them. (We discuss opportunities for outsourcing further in Section 7.) We therefore considered that suppliers of some other consumer credit products (especially credit card providers) could readily begin to supply store card services without significant physical investment in IT and other infrastructure.
- 6.19 However, there may still be a need to invest in building a credible reputation in the sector. For the retailer, store cards are essentially marketing tools rather than credit instruments; the efficient operation of the store card programme is therefore viewed as crucial in maintaining the brand image of the retailer who offers them. Retailers therefore place a high value on credibility and experience in a store card credit provider. We were told [X] that the credit provider and the retailer needed to work closely together in order to promote the card successfully and that those with a track record in store cards had an advantage over a new entrant with whom the retailer had had no previous relationship, and would generally win a tender, all else being equal. Another provider [X] said that, as one of the key commercial drivers for a retailer in offering a store card was to build brand loyalty by enhancing the value that customers perceived in their brand, it was extremely important to retailers that store cardholders received seamless and consistent customer services of high quality when using their card. Retailers had to feel confident that their brand would not be affected by poor management and administration of their card. A credit card company, [X], which told us that it had put in some unsuccessful tenders for store card contracts with retailers, acknowledged that it would need to invest in the special requirements of retailers in respect of store cards.
- 6.20 Retailers confirmed the advantage conferred by a track record in store cards. (Some retailers, however, noted that a track record in credit cards could be equally useful—for example, the strength of Barclaycard’s brand and Barclaycard’s experience in the credit card market were among the reasons for House of Fraser’s choice of Barclaycard to supply its new store card and SBCC.) For example, when one large retailer’s [X] contract was re-tendered, ‘the concerns focused on UK store card experience and scale and size of operations’ (of the provider), leading it to sum up the advantages of the supplier that it ultimately selected [X] as: ‘safe—size, experience, no need to transfer customers’. Another retailer [X] told us that it was ‘the softer issues’, such as the marketing side and support for store staff, rather than the switching and IT costs, that were most important for it in thinking about an acceptable alternative credit provider. Here, it said, the question was always whether a new provider would do as good a job for its customers [as an existing provider] and preserve and develop its brand. This same retailer commented that, a few years ago, it had explored seriously the possibility of a store card contract with a credit card company that was not yet in the UK store card market; it had not been satisfied, however, that this provider could deliver all the ancillary services (such as customer relations and support) that ‘made the store card business different from the credit card business’. Another retailer [X] told us that it had ruled out certain providers [X] because these did not have a track record in providing store cards to large retailers.
- 6.21 Retailers may therefore regard entrants which lack reputation and experience in providing store card services as ineffective substitutes for incumbent and proven providers. Any new entrant is therefore likely to need to invest in building such a reputation, whether by buying an existing provider or offering an unusually good deal to a retailer. Examples of the former type of entry are Barclaycard and HSBC, which purchased existing providers of store cards or similar financial products. So far as the latter is concerned, we were told by a number of retailers that re-tendered their

contracts [redacted] that they had secured a more favourable deal with their existing provider by inviting tenders from a wide circle of potential entrants, suggesting that new entrants would have had to put in even higher bids to secure those contracts.

- 6.22 We therefore conclude that investment is required to enter the market and therefore that supply-side substitution does not widen the market beyond store card services. However, this conclusion does not imply that any entry barriers to providing store card services are large, merely that they exist to some degree. We discuss entry further in Section 7.

Upstream geographical market

- 6.23 So far as the geographical market is concerned, we considered it possible that retailers could outsource these services to specialist finance companies not currently operating within the UK (in contrast to providers with a UK presence but a parent company outside the UK). However, the provision of cards is usually specific to UK customers, not pan-European or even wider, and the same reputational barriers as restrict the relevant product market to store card services seem likely to restrict the scope for demand-side or supply-side substitution to the existing market within the UK. We saw no evidence that a 5 per cent price rise would induce retailers to seek providers overseas. There was no suggestion that the relevant geographic market should be regarded as regional, or in any other way narrower than the UK. None of the parties argued that store cards should be assessed in a geographic market other than the UK. We conclude that the geographical extent of the market is no wider than the UK. Again, this conclusion should not be taken to imply that we regard new entry from outside the UK as unlikely or difficult, merely that this is not so simple as to create a unified trans-national market.

Upstream insurance market

- 6.24 We considered whether the boundaries of the market for providing insurance services within store card programmes could be different from those for other store card services. Some retailers directly benefit from the sale of insurance to end-customers. We were told of examples where retailers received a proportion of PPI premiums [redacted] or where there is an annual payment to the retailer conditional on a number of targets being met, including insurance penetration rates [redacted]. One provider [redacted] told us that, following retailer demand, it had set up a number of income share arrangements, which was becoming a more frequent feature of store card operations. According to the FLA, commission from the sale of store card insurance would in most cases be shared between the credit provider and the retailer. Retailers with such arrangements therefore benefit from insurance being sold as part of the store card offer and this may represent a disincentive for them to look elsewhere. They may also be concerned about the price of insurance offered to their customers to the extent that this affects their brand image. Style told us that retailers had an interest in ensuring that their store card insurance offering represented good value, as the product reflected upon their brand: it said that most cardholders were only aware of the retailer's brand. Given the benefits that many retailers derive from the insurance arrangements made with their credit provider, we consider that such retailers have little incentive to seek alternative insurance provision with a view to offering their retail customers a significantly better deal, provided that the insurance offer made available by their credit provider is not out of line with that of their retail competitors offering store cards.
- 6.25 However, even when the retailer does not directly share in any profits made from the sale of insurance, such profits make the card programme more profitable overall and

can therefore be expected to result in a better deal for the retailer when contracts are re-tendered than would otherwise be the case. This better deal could show up through any of a range of payments terms (including reduced payments from the retailer to the provider). Thus, it seems likely that most retailers have an interest in the profitability of the sale of insurance.

- 6.26 We heard of some examples where retailers had separated the provision of insurance from the provision of credit services or had arranged insurance directly, but these were all cases involving the offer of insurance in connection with budget card, rather than store card, accounts. And the evidence suggests that these sorts of insurance arrangements are exceptional and that, generally, retailers tend to accept the insurance provider engaged by the card provider and do not reach out to insurers not engaged by card providers. We therefore see little possibility of substitution outside the market for store card services more generally and therefore adopt the same market definition 'upstream' for insurance as for store card credit services more generally.

Conclusion on the market for the provision of store card credit services to retailers

- 6.27 We therefore conclude that there is a market involving the provision of store card credit services, and related services including insurance, to retailers by providers of store card credit services in the UK. (We have set out market shares in Section 3.)

The provision of consumer credit through store cards: 'the downstream market'

- 6.28 We now turn to the question of market definition at the consumer or 'downstream' level. At this level, store cards operate alongside a wide variety of other plastic cards (see, for example, paragraphs 3.7 to 3.12). We begin by considering whether store cards have characteristics which distinguish them from other types of card (paragraphs 6.29 to 6.47). We then consider the analytical process of economic market definition based on the hypothetical monopolist (or SSNIP) test (paragraphs 6.48 to 6.177). Store cards do not directly compete with other store cards (as it is rarely if ever possible for a cardholder with two cards to face a choice of which to use). We therefore consider two possible market definitions: firstly, a wide market for consumer credit in which store cards compete directly with credit cards (paragraphs 6.92 to 6.170); secondly, a market for 'consumer credit through store cards' defined by retailers' concern to protect their brand by not offering a store card which is priced significantly higher than their retail rivals (paragraphs 6.171 to 6.177). We set out our conclusions on market definition in paragraphs 6.187 to 6.189. In paragraph 6.190 we re-state our findings on each of the matters discussed in this section.

Store card characteristics

- 6.29 None of the store card credit providers or retailers who submitted evidence to us argued that store cards formed a separate downstream market. Only Which?, formerly the Consumers' Association, provided a substantial submission that effectively supported the notion of a separate market for store cards 'downstream'. The general view among the parties was that store cards were part of a wider market that included other methods of paying for goods and other sources of credit such as credit cards. GECF said that many consumers used store cards only as a payment mechanism and that these consumers were unlikely to be strongly influenced by borrowing costs. For those consumers who intended to take credit, there was a wide choice of credit products available, including credit and store cards, personal loans or

overdraft facilities, other credit offerings available in store, such as retail loans, and mail order catalogues which had a built-in period of credit reflected in the purchase price. It was also put to us by GECF that store cards were not unique in offering a range of benefits to consumers, who viewed credit cards as an alternative to store cards. Both types of card could offer a similar value and range of benefits to consumers. These benefits, it argued, were often a key selling point for credit cards in the same way that they were for store cards. Many credit providers and retailers told us that the introduction of SBCCs made it even more difficult to distinguish credit cards from store cards.

- 6.30 Some parties, however, despite not claiming that store cards formed a separate downstream market, took the view that store cards had characteristics that distinguished them from other kinds of payment or credit instrument. Creation told us that it considered the key selling point of its store cards for consumers to be the benefits they offered, in particular the discount on the first purchase and subsequent cardholder benefits. The importance of the first purchase discount was, Creation said, demonstrated by the fact that 43 per cent of Creation's cardholders were 'single spenders', who would take advantage of the opening discount (typically 10 or 20 per cent off their first purchase) and then pay off the balance in full or over a number of months, but would make no further purchases on the card. In Creation's view, this indicated that, for many consumers, the key price element in the transaction was the sale price of the relevant product, not the interest rate on the store card. A retailer, Arcadia, told us that the benefits that a store cardholder received were considerably more attractive than those on offer from credit cards.
- 6.31 A number of retailers told us that, in terms of attracting customer loyalty, loyalty cards were substitutes for store cards; but the disadvantage of loyalty cards from the retailers' point of view was the fact that the retailer bore the whole of the associated costs, which could be substantial, while the disadvantage from the customer's point of view was that loyalty cards did not offer a credit facility.
- 6.32 In evaluating the evidence, we begin by noting that store cards have the following characteristics which, taken together, are exhibited by no other payment card (including SBCCs):
- (a) *they have a primary function as marketing tools for retailers:* store cards are designed to encourage loyalty on the part of customers, provide retailers with customer information for marketing purposes, and thereby increase sales. Very few retailers (except those selling high-ticket items like furniture and electrical and electronic goods) appear to view the credit facility provided through store cards as an important element leading to increased retail sales;
 - (b) *they are a distribution channel:* store cards are supplied mainly through the retailer in store;
 - (c) *they have limited usage:* their usage is limited to a single retailer or a small network of retailers;
 - (d) *they provide customer benefits:* customer services and benefits are provided by the retailer in order to induce loyalty. Typically, they include an initial discount or other benefits on taking out the card or loyalty points for repeated usage, privileged access to facilities and events, and other loyalty benefits and programmes;

- (e) *they offer immediate access to credit*: immediate credit is made available at the card sign-up stage to those customers who are judged creditworthy by the store card credit provider, for use only in the particular retailer's stores;
- (f) *they have an affinity value*: store cards have some affinity value for customers, associated with their preference for the particular retailer or its brand; and
- (g) *they have higher acceptance rates than general credit cards*: retailers want as many of their customers as possible to take out their store card. The acceptance rate (generally well over 65 per cent) is therefore typically higher for store cards than for SBCCs or general credit cards. Higher acceptance rates tend to be associated with lower credit limits.

6.33 Loyalty cards typically exhibit most of these characteristics. However, they are neither a credit vehicle (see (e) in the previous paragraph) nor can they be used as a means of payment. For this reason, they also lack characteristic (g)—there are no restrictions on who may be accepted for a loyalty card. General credit cards⁶⁷ typically do not provide *immediate* credit either, in that the application process usually does not allow immediate expenditure on the card. General credit cards are distinguished from store cards principally by virtue of their wide utility (ie they lack characteristic (c)). They also normally lack the characteristics associated with the retailer: notably the distribution channel, the benefits, affinity value and their role as a marketing tool. Most credit cards will offer some benefits and many will act as marketing tools and have affinity value for other organizations, of course, but the specific link between the brand and goods on offer where the card is used and the brand and benefits associated with the card itself is not a characteristic of general credit cards. SBCCs exhibit all of the characteristics above except (c) and (e), and to an extent (g), as their acceptance rates are typically lower than those of store cards. (As discussed later in this section, SBCCs might *replace* store cards, but we do not regard them as directly *competing* with store cards—see paragraph 6.178).

Demand-side characteristics

- 6.34 In assessing whether store cards have distinctive characteristics, we consider first the demand side—that is, whether for consumers there are effective substitutes for store cards. For the purposes of determining this question, it is not necessary, in our view, to consider whether all the alternative means of payment and sources of credit are effective substitutes if we can establish that the closest potential substitutes for store cards are, in fact, ineffective. The closest substitutes for store cards would appear to be credit cards. Although a minority of store cardholders do not hold credit cards, enough do hold credit cards to ensure that substitution from store cards to credit cards could in principle be a significant factor for market definition. More specifically, SBCCs, which share most characteristics with store cards, would appear to be the closest potential substitute where they are available.
- 6.35 The CC commissioned research intended to expose the attitudes and behaviour of store cardholders. This took the form of a large quantitative survey, conducted by telephone, of 1,000 store cardholders, preceded by qualitative research, which involved in-depth face-to-face interviews with some 40 store cardholders.⁶⁸
- 6.36 The CC's quantitative survey asked respondents how important they considered each of seven factors that were put to them as possible reasons for their decision to

⁶⁷'General' as opposed to store-branded.

⁶⁸The survey was discussed in more detail in Section 3 and a summary of the results is available on the CC website.

take out a store card. It should be noted that the most important factor was the discount available on the day. However, the interest-free period, the APR/interest rate and the availability of instant credit were also important to those who said that they did not pay their store card bills in full. The main reasons given as to why respondents used a store card rather than a credit card to purchase particular goods were the discounts (or other benefits) available, and the convenience.

- 6.37 NOP's survey for the OFT⁶⁹ showed that relatively few of those taking out a store card had planned to do so in advance. Furthermore, the interest rate was not a significant driver of this decision, as NOP report 'In fact, during the actual process of taking out the store card, no respondent felt that he or she was influenced by the interest rate, as none had considered this to be important at the time'. The main reasons for the decision to take out a card related to the discounts and benefits offered with the card.
- 6.38 The evidence we received from the 40 in-depth interviews with store cardholders in the CC's qualitative survey suggested that, for many of the respondents, the store card was not taken out primarily for the purpose of obtaining credit.⁷⁰ Most interviewees reported that it had been an impulsive act, taken at the suggestion of the sales assistant and not planned for the purposes of obtaining credit. Another key reason was that an incentive was being offered—for example, 10 per cent off the purchase price on that day. Others took out a store card for convenience. Almost all said that they had taken out the store card without considering what the implications might be; many said they did not consider the information explaining interest rates.
- 6.39 We are satisfied that most customers, when considering taking out a store card, do not view them primarily as a source of credit. It follows from this that the APR is unlikely to have much effect on the take-up of cards, although we recognize that potential revolvers are likely to be more sensitive than the average cardholder to APR at this stage
- 6.40 On the demand side, therefore, we concluded that most customers view store cards as having characteristics that differentiate them from any other card that would be likely to offer competition to them. However, whether these differentiated characteristics are sufficient to place them in a separate market from credit cards depends upon the degree to which substitution would occur in response to changes in the relative price of store cards and credit cards. We examine this question when considering economic market definition (see the discussion beginning at paragraph 6.48).

Supply-side characteristics

- 6.41 Turning to the supply side, although the overwhelming majority of credit providers and retailers took the view that store cards were part of a wider downstream market, we received evidence from those parties, as well as survey evidence, which suggested that store cards had characteristics which, taken as a whole, distinguished them from all other types of payment or credit instrument. Further, these characteristics were important: retailers regard store cards as part of their 'offering', which can be important for them in their competition with other retailers for consumer spending.

⁶⁹Summarized on the CC website.

⁷⁰About half of all store card users at any one time do not regularly take credit, although the proportion varies substantially between different programmes.

- 6.42 Thus, a number of retailers who took the view that store cards formed part of a wider downstream market agreed that these cards were distinctive from the retailer's perspective. As already noted (see paragraph 6.11), a significant number of these retailers told us that by far the most important benefit of store cards from their point of view was the generation of customer loyalty and that store cards were more important to them for this purpose than as a tool of credit provision. The next most important benefit they saw was that store cards attracted new customers, or increased spending by existing customers.
- 6.43 SBCCs provide similar benefits. However, several retailers also regard them as a significantly different proposition from a traditional store card. They might introduce an SBCC as a replacement for a store card, or to run alongside an existing store card as a complementary programme (we refer to these as 'combined programmes'). However, introducing an SBCC appears to be regarded by these retailers as a significant change in their offering (and one that some have considered and explicitly rejected), not simply a switch to an essentially identical product. We also note the observation made by Citi Cards (part of Citigroup), that the store card market in North America had gone through cycles: at one time favouring general purpose credit cards and then becoming interested in establishing or reinvigorating store card programmes once again. These trends were influenced by business cycles, but also reflected a recurrent perception that SBCCs did not elicit the same measure of loyalty as store cards because they could be used anywhere and were not as focused on store merchandising. While issuers might attempt to reward holders of SBCCs according to spend, with higher rewards attached to purchases in the named store, the North American experience suggested that retailers continued to see high value in operating a store card portfolio, frequently alongside an SBCC portfolio.
- 6.44 From the credit provider's point of view, the evidence we received suggested that store cards offered credit providers an additional and distinct distribution channel or 'route to market'. The distribution channel through retailers would be particularly important to those credit providers lacking other retail channels (such as a large network of bank branches). For these providers, this route to market is far more cost-effective than, for example, direct mailing to prospective customers. In addition, store cards provided opportunities for cross-selling other financial products to well-targeted segments of the population, taking advantage of the ready-made database of consumers. SBCCs may provide a similar route to market and, hence, an SBCC may be a close substitute to a store card from a credit provider's point of view; almost all of them told us that they thought they were.
- 6.45 Considering retailers and providers together, therefore, from the supply side there would appear to be significant differences between the characteristics of store cards and of credit cards, including SBCCs.

Store card characteristics: summary

- 6.46 We noted that many of the characteristics of store cards are also exhibited by other cards—notably loyalty cards and credit cards. On the demand side, survey evidence appeared to suggest that cardholders regarded store cards as being different from credit cards. On the supply side, it seems clear that retailers regard store cards, credit cards and loyalty cards as being distinct products with somewhat different characteristics. For providers, store cards and loyalty cards differ, largely because one is a payment mechanism that offers credit and the other is not.
- 6.47 Store cards therefore appear to have different characteristics from products with which they might potentially compete, both from the demand and the supply side. In our Emerging Thinking document, we stated that store cards form a distinct and

identifiable segment of any wider market including other payment and credit cards. The question for market definition was whether this 'wider market' of similar products acts as an economic market, in the sense that substitution between consumer credit through store cards and credit cards could provide a competitive constraint on store card pricing. We therefore now turn to economic market definition.

Economic market definition

6.48 In order to define relevant markets using the concepts and tools of economic market definition, we need to determine:

- (a) the appropriate services for which to define markets (credit, or other services as well);
- (b) the appropriate prices to use in defining markets (interest, or other prices as well); and
- (c) the alternative possible substitutes for a given store card (credit cards and other credit instruments, as opposed to other store cards).

We set out our thinking on these matters below. We deal with (a) in paragraphs 6.49 to 6.57; (b) in paragraphs 6.58 to 6.91; and (c) in paragraphs 6.92 to 6.170.

Determining the services for which to define markets

6.49 There are a number of different stages at which customers of a particular retailer make decisions in respect of store cards (by definition, a customer must first decide to shop at a store offering a store card before any of these becomes relevant):

- (a) take-up and first use—the decision to take up the offer of a store card and use it on the first occasion to pay for goods or services may be based partly or wholly on the discount or other benefits offered; as a consequence, many customers may be unaware of, or uninterested in, the APR on the store card at this stage;
- (b) subsequent use as a means of payment—on subsequent occasions when goods or services are being purchased from the same retailer, customers can choose whether or not to use the store card as the means of payment; this choice is also influenced by the offer of any discounts or benefits for paying with a store card; and
- (c) taking credit or not—when customers receive the store card statement for the first time, and on each subsequent occasion when they have used it to pay for goods or services, store cardholders can choose whether to take credit and pay interest or pay off the outstanding balance.⁷¹

6.50 Store card providers and retailers have different conceptions of the market. Providers will naturally focus on the provision of credit (and insurance) as their revenue from the store card programme largely derives from these products. In contrast, we recognize that retailers' interests in this industry are principally in the store card as a mechanism to compete in the wider retailer market. By building relationships with customers, and possibly also encouraging additional spending, a store card

⁷¹As should be clear from this statement, throughout this section we use 'credit' to mean interest-bearing (or revolving) credit, to distinguish this decision from the automatic take-up of non-interest-bearing credit whenever a store card is used to purchase goods.

programme is one of several possible competitive tools available to a retailer. Although retailers appear increasingly to benefit financially from customer payments for credit and insurance (see Appendix 7.9), we accept that they do not regard this as the principal driver of their decisions to run or promote store card programmes.

- 6.51 The different stages of customers' decisions represent very different activities. It could be argued that different 'services' are provided at each of these stages, at different prices, with different potential substitutes and, therefore, that they define different markets. In principle, markets could be defined separately for the take-up and use of store cards, as well as for credit, by considering whether substitution possibilities outside any proposed market definition could prevent prices profitably rising within that market definition (the hypothetical monopolist, or SSNIP test). We rejected this approach for reasons set out later but, for completeness, we set out the likely market definitions that would have resulted from it below.
- 6.52 Beginning with a SSNIP test for market definition at the take-up stage, it seemed clear that the key 'price' for this decision is often a discount provided on the initial purchase, and not—for example—the APR.⁷² Had we defined a market for taking up cards, an application of the SSNIP test would involve a reduction in the initial discount (because it could be viewed as a subsidy—a negative price) from, say, 10 to 9.5 per cent. We would then ask whether this would be unprofitable because of substitution to competing products.
- 6.53 We did not examine this question in detail but initial consideration suggested that there are few, if any, constraints arising from direct substitution by customers at this initial decision stage. Since the principal alternative to taking a card is simply not taking the card⁷³ (and there is no fixed budget for how many cards can be held, and cards can always be cut up), the justification for any given level of discount is more likely to be the need to overcome apathy than direct competition from alternative cards (or any alternative tools for building a customer relationship). Such apathy might create a constraint, but it would not be a competitive constraint that would define a market wider than the programme itself.
- 6.54 However, we also noted that there was substantial common use of discounts of 10 per cent across different store card programmes (although not all programmes had discounts and some had discounts at a different level). It seemed plausible that retailers' concerns not to appear to be poor value compared to their competitors might lead to a reluctance unilaterally to reduce discounts below 10 per cent. Similarly, none seemed to see an advantage in increasing discounts above 10 per cent, at least on a regular basis. The comparison between retailers could in principle act to create a degree of price constraint across different card programmes in a manner that could be regarded as giving rise to a 'market for taking store cards' across retailers, although the longer-term concerns of retailers for their brands do not necessarily act in quite the same way as direct price competition for the customer's business.
- 6.55 Similarly, were we to define a market for the second stage—use of the card—we would probably consider the appropriate 'price' to be the cost of using the card. Since there are no charges for using cards as payment, this price is at most zero and in

⁷²As the qualitative market research conducted by ORC for the CC reported, 'During the actual process of taking out storecard accounts no respondent from any category felt that they were at all influenced by the interest rates. None of them considered this to be important at the time. For light and heavy revolvers, the idea of owning a store card, of having credit and obtaining a 10 per cent discount was the over-riding factor that outweighed anything else.'

⁷³As [redacted] response to our Emerging Thinking document put it, 'It is not clear that consumers are choosing between a store card and another product at all, let alone in response to relevant prices; customers can take all products and then choose which to use.'

fact, again, any benefits of use (such as ‘points’ providing discounts—typically 1 per cent) make the ‘price’ negative (ie a subsidy). Here, the principal alternative to using the card is using alternative payment mechanisms. We have encountered no evidence to suggest that, were the subsidy to be reduced by 5 per cent, people holding a particular store card would substitute away. Again, it seemed appropriate to consider whether the use of one card was part of a wider market for ‘using store cards’ (albeit one defined more by long-term brand image considerations than by direct substitution by customers) as benefit programmes often show similarity across different store cards.

6.56 However, we did not seek to resolve questions of market definition for these two stages because we did not see a need to examine the separate ‘products’ on offer in these stages. Our terms of reference refer to consumer credit through store cards and to insurance and our inquiry therefore focused on these products. They are in any case the only products for which customers directly pay. Defining markets separately at the take-up and use stages would not, in our judgement, help us understand the markets for consumer credit through store cards or for insurance.

6.57 Even so, we recognized that demand for credit was not solely driven by the third decision stage—the decision to take credit on an existing balance. The total demand for consumer credit through store cards is the product of decisions taken in each of the three stages. That is, the demand for consumer credit through store cards could be expected to increase if there were an increase in any of:

(a) the take-up of cards;

(b) customers choosing to use the store card as a means of payment; or

(c) customers choosing to revolve credit on that store card.

Determining the prices or other competitive responses to use for market definition

6.58 This raised the question of which prices, or other competitive responses, to use when assessing whether consumer credit through store cards is supplied within the same market as credit cards. A number of parties put it to us that several different prices must be considered, and that non-price responses also indicate competition between the two card types. The context for many of these statements was the observation that store card APRs often did not appear to have responded to falling credit card APRs. It was put to us that other prices had responded, or that alternative competitive responses had occurred (and therefore that these divergent price series did not indicate separate markets).

6.59 We therefore considered competitive variables other than the APR. We first considered the use of customer benefits, such as discounts (paragraphs 6.60 to 6.82). We then assessed the use of late payment fees (paragraphs 6.83 and 6.84). Finally, we considered the use of other competitive responses, such as increased acceptance rates (paragraphs 6.85 to 6.88).

(a) Prices and competitive responses: customer benefits

- 6.60 It was put to us by several parties to the inquiry that we must analyse the effects of benefits⁷⁴ when considering market definition for consumer credit.
- 6.61 The OFT report identified this issue as potentially being important for market definition. The OFT set out two scenarios. In the first scenario, consumers would take credit only if the price, net of benefits, was lower than that on alternative instruments available to them (such as credit cards), and would switch to such alternatives if the store card APR increased. It concluded: 'If a large enough number of consumers behave in this way it will not be profitable for a store card provider to raise its APR, and thereby the actual net price, above the competitive level, implying that store card credit is not in a separate market'.⁷⁵
- 6.62 The OFT continued:
- A second scenario, however, is that it may be that not all non-captive consumers are aware of how interest rates operate, especially if this is not transparent. Alternatively, they may not bother to compare or may overestimate the value of the store card benefits. ... If a large enough number of consumers behave in this way it could be that store card providers can raise the APR (and thereby the actual net price) on their store cards above the competitive level. If so, store card credit will be in a separate market.
- 6.63 The OFT also noted that APR movements alone should provide clear evidence relating to market definition, in the absence of any countervailing changes in benefits.
- 6.64 However, a number of parties put it to us that the financial value of benefits must be assessed when considering market definition and that it was inappropriate to consider market definition for consumer credit through store cards principally by reference to APRs (or other charges for credit). Parties argued that net benefits represent a more effective way to respond to reduced APRs on credit cards than reducing store card APRs. Thus, one retailer, Bhs, put it to us that the more likely reason for the failure of most store cards to reduce their APRs was that they had chosen to compete in a different way—that is, not just on APRs. For example, this retailer said, store card providers had sought to improve the various discounts and other loyalty benefits available and provided greater leniency on late payment charges. Some stated that the costs of providing credit through store cards limited the scope for APR reductions, others noted that card take-up, in particular, responds more to changes in benefits than changes in APR. Several also claimed that this has been the response to decreased APRs on credit cards, suggesting that the two card types might be in the same market despite recent divergent APR trends.
- 6.65 We considered it important to draw a distinction between an assessment of market definition and an assessment of the fairness, or value for money provided by store cards. We accept that, where benefits are substantially greater than those available on credit cards, they could well make store cards better value for money on average relative to credit cards than would appear to be the case from a simple comparison of higher APRs on store cards with lower APRs on credit cards. Various parties put calculations to us to illustrate this point.

⁷⁴Throughout the following discussion, the term 'benefits' is used to mean discounts or other cash or non-cash benefits provided to all store cardholders or users, regardless of whether they revolve credit on the card.

⁷⁵Office of Fair Trading: *Store Cards—Report of the OFT's inquiry*, March 2004 (OFT 706), paragraph 4.64.

6.66 GECF provided examples such as the following in their initial submission:⁷⁶

To give a more concrete example, a customer wishing to make a purchase worth £100 would, if they use their store card for credit on a day when they receive a 10 per cent discount, pay back a total of £96.66 over six months. If they had chosen to use a credit card at the point of purchase and paid off the £100 balance over six months they would have paid a total of £104.13. The store card option would thus save the consumer £7.47.⁷⁷

6.67 Like several such illustrations submitted to us, this shows customers paying negative prices, overall, for using their store card. This feature of the example depends critically on the assumption that it is a first-time user receiving a 10 per cent initial discount off the goods purchased. To achieve a similarly negative price, an example using an initial discount of just 5 per cent would need an APR as low as 7 per cent (and an example with no initial discount would need a negative APR). On average, customers pay for store cards, rather than being paid to use them, so such examples may not be representative. They also lead to unrealistic outcomes—in the example above, customers would only choose a credit card in preference to the store card if the APR on the store card were 69 per cent or more. The business model would not be sustainable were this the whole picture. Nonetheless, the point may be valid in principle, even if such examples over-state its importance.

6.68 We accept that this effect would invalidate any assertion that the higher average APRs on store cards compared with credit cards necessarily indicates that the two types of card are in separate markets. Indeed, as several parties argued, this assertion would be faulty on other grounds as it will often be the case that two products in the same market have very different prices. Some credit cards even have higher APRs than store cards, although those credit cards tend to offer specialized risk-based products.

6.69 However, having carefully considered the points put to us, we do not accept the argument that, when assessing market definition, benefits needed to be included, to create a 'net price' for a store card. There are five reasons why we took this view; these are set out in paragraphs 6.70 to 6.81.

6.70 Firstly, when assessing the impact of changes in APRs, when benefits do not change at the same time in the opposite direction, we would still expect to see significant substitution were store cards and credit cards in the same market. If one component of a multipart price changes, switching would still be expected, as the OFT report noted. Thus, the exclusion of a constant level of customer benefits from analysis of sensitivity to APRs would not invalidate that analysis. We report such analysis later in this section.

6.71 Secondly, a SSNIP test applied to such a 'net' price can result in market definitions that are highly dependent on the assumptions made. For example, applying a 5 per cent increase just to the APR (from 30 to 31.5 per cent) would increase the price net of benefits by more than 5 per cent (if the value of benefits were half the cost of credit, for example, the net price would increase by 10 per cent) and therefore any measured elasticity would be an over-estimate. Equivalently, the appropriate SSNIP would be a smaller increase than 1.5 percentage points.

⁷⁶On the CC's website.

⁷⁷CC note: GECF assumes APRs of 28 per cent on store card borrowing and 15 per cent on credit card borrowing in this example, and no benefits from the use of the credit card.

- 6.72 In contrast, one provider [X] argued that the SSNIP requires the APR to increase by enough to be equivalent to a worsening of both benefits and APR, providing an example⁷⁸ in which the relevant SSNIP test required an increase in APR from 30 per cent to between 34.2 and 38.4 per cent.
- 6.73 We do not accept that this is necessarily the appropriate way to impose a SSNIP, any more than we would require the SSNIP test as applied to a vertically-differentiated product to compensate for a 5 per cent worsening of quality as well as a 5 per cent increase in price. However, even if the approach were correct in principle, applying the SSNIP test would then depend critically upon the assumed size of the cardholder's purchase and the timing (whether the first or a subsequent purchase, for example).
- 6.74 Thirdly, there was no clear rationale for the argument that it is easier to increase benefits on store cards than to decrease APRs, as a competitive response to reduced APRs on credit cards. Only revolvers provide the revenue that makes a store card programme viable. To provide all customers with additional benefits—while it might lead to increased demand through increased take-up and use—would be an odd and cost-ineffective response to lower APRs on credit cards, compared to the obvious response of providing revolvers with lower interest costs. This would be true even if all customers were equally likely to be attracted away by lower APRs on credit cards. However, it seemed more likely that any APR reduction on credit cards would see a disproportionate loss of revolvers. So a policy of increasing benefits for all users seemed a particularly inefficient response compared to simply matching the credit card APR reductions. We are not aware of any store card programme in which customer benefits are tied to taking interest-bearing credit.
- 6.75 One provider [X] argued that to increase revenues generated from credit, customers must be induced to spend more in store and that the relevant basis is the overall price of the good (including benefits and credit). Small changes in APR have a tiny impact on the overall price of the good. For the example provided in footnote 15, above, a 25 percentage point change in APR (for example, from 30 to 22.5 per cent) would be needed to change the total cost to the consumer of the goods and credit combined. However, it was not clear to us that providing an equivalent discount of the goods would be any cheaper. Furthermore, it is not the case that this is the only way to increase revenues generated by credit—the decision to revolve could be targeted instead, through a reduced APR.
- 6.76 Several parties suggested that there was less 'scope' or 'flexibility' to reduce APRs on a store card than on a credit card (and therefore we should consider benefits increases as the likely competitive response instead). It was not clear to us why benefits were more 'flexible' if an increase in benefits is simply to be treated as a reduction in net price, as was suggested by those parties arguing for inclusion of benefits in the price to be subjected to the SSNIP test.
- 6.77 We noted in this context that many of the calculations of benefits were for very short-term users of the store card. Revolvers (taken as a whole) have average balances of around £300 (and the heavier revolvers have average balances of around £800). To compensate these store card users for a 10 percentage point difference in APRs (APR at 29.9 per cent, rather than at 19.9 per cent, for example), the benefits accruing to them would have to increase by around £30 a year. Even if the customer base were static, this would imply additional expenditure of £30 for all customers—equivalent to 20 per cent of average balances if revolvers are only half of the total

⁷⁸ An initial purchase of £300 of goods, paid off over six months, with a 10 per cent initial discount and an APR of 30 per cent.

base. However, the customer base is not static but there is considerable ‘churn’ or ‘attrition’. Increasing benefits is therefore an even more costly way of maintaining the attractiveness of the store card for revolvers. If consumers of credit through store cards were sensitive to APR differentials against credit cards—as all the parties making these points to us argued they were—then the obvious response would be to match the APR reduction.

- 6.78 Such a policy would not be perverse, of course, if revolvers could be induced to maintain balances with a benefit increase that is smaller than the additional interest savings they could achieve by using a credit card instead.⁷⁹ However, this would only occur if, as the OFT put it, revolvers ‘overestimate’ the value of benefits: attracted by lower prices, they end up paying more. If revolvers overestimate the value of benefits, then store cards and credit cards should be considered to be in separate markets.⁸⁰
- 6.79 Fourthly, although it was claimed that longer-term trends of falling credit card APRs have induced store card providers to respond by increasing benefits, we have not seen evidence that this has indeed occurred on a scale that corresponds to the reduction in credit card APRs. Given average balances across all store cardholders of around £150, the improvement in benefits would have to be worth about £15 annually to compensate, on total expenditure of £220: equivalent to a fall of 7 per cent in the price of goods.
- 6.80 Finally, we decided that even if benefits had significantly increased in response to falling credit card APRs, this would not necessarily impose any competitive constraint on consumer credit through store cards. APRs represent payment for credit, benefits could be regarded as a net price for taking or using the card. If, as was claimed, benefits had increased as a reaction to credit card APR reductions (while store card APRs remained constant), then this simply reflected a reallocation of revenues raised from the sale of consumer credit to holders and users of store cards. If all holders and users of store cards also took credit to a similar degree, this might be equivalent to a reduction in the price of credit. However, given the patterns of revolving set out in Section 3, this is clearly not the case.
- 6.81 The argument that benefits had increased did not appear to us to protect consumers of credit through store cards (ie revolvers, mainly) from market power, and consequently did not seem to support the proposition that we should take a ‘net price’ including benefits as the starting point for the SSNIP test.
- 6.82 For the reasons above, therefore, we are not persuaded by the considerable volume of argument we have received on the need to include an assessment of customer benefits in the analysis of market definition for consumer credit through store cards or for insurance.

(b) Prices and competitive response: late payment fees

- 6.83 Parties have also suggested that store card providers’ greater leniency in applying late payment charges should also be considered when defining the market. One party [X] has claimed that:

⁷⁹It was interesting in this context to note GECF’s report in its initial submission (on the CC website) that a one-off event day with extra benefits did not increase balances. ‘However, rather than take on additional interest payments, revolvers took advantage of the special discount opportunity and paid off the extra spend immediately so that their balances did not increase compared to the control group.’ This suggested to us that benefits were unlikely to act as a competitive instrument in the market for consumer credit through store cards.

⁸⁰See statements by the OFT in paragraphs 6.62 and 6.63.

- (a) historically, it has not applied late payment charges in all of the cases in which it could do so;
- (b) credit card providers have increased their revenue from such charges in recent years; and
- (c) the cost of credit on the two card types is therefore comparable and the relative movements in APRs in recent years therefore overstate the degree to which store cards have become relatively more expensive.

6.84 We have considered this argument thoroughly in working papers and hearings. We believe that it is not relevant, principally because we have not seen any evidence that customers' decisions to incur interest-bearing balances is affected by such a policy. We do not accept as likely—and the survey evidence supports this view—that consumers will consider late payment charges at all, let alone the likely severity with which the provider will seek to apply them, when taking out or using the card. Indeed, we do not believe that consumers are likely to be aware of the incidence of late payment charges at these stages. It is more plausible that they may do so when considering paying off the balance, because it is at this stage that late payment charges become relevant, but the only customers whose behaviour would be affected are those with sufficient funds to make at least a minimum payment on the store card or on the credit card, but not on both. Even in the event that customers have sufficient information to make a rational decision in these circumstances, we do not believe that a sufficient proportion of customers is in this position to act as the overall constraint on the pricing of store card credit.

(c) Prices and competitive responses: other competitive responses

6.85 Some providers argued that other charges and benefits—such as interest-free periods—should be taken into account. However, we were presented with no analysis of how such benefits should be taken into account in market definition, nor any illustrative calculations demonstrating that changes in these prices resulted in substitution to or from credit cards. Again, there is an important distinction to be made between whether store cards might be considered a 'good deal', and what competitive constraints act to define the market.

6.86 A number of parties put it to us that there was less 'scope' or 'flexibility' for store card APRs to fall than for credit cards, thereby explaining why providers and retailers did not match reductions in credit card APRs (but, rather, took other actions). These arguments seemed to be based on store card costs. However, if consumer credit through store cards were in the same market as credit cards, it is not clear how cost differentials would allow that price differential to be maintained.

6.87 One provider [redacted] argued that it increased acceptance rates in response to reductions in funding costs arising from the fall in base rate, as a result of competitive pressures from credit cards. It provided evidence that acceptance rates had increased in some programmes. Another provider [redacted] told us that 'whenever the opportunity arises, [redacted] will tend to increase the acceptance rates on a store card programme rather than reduce the APR'. However, we did not find this helpful for market definition. It was not clear how a change in the use of credit scores could be seen as a competitive response to a price reduction by a competitor. In any case, increasing acceptance rates would be a profit-maximizing response to reduced costs of providing credit (lower funding costs) regardless of competitive conditions. Finally, the evidence in support of this argument did not convince us and there was little clear relationship between the timing of changes in acceptance rate and changes in base rate.

6.88 Several parties argued that store card providers, with retailers, have innovated in response to the reduction in APRs on credit cards, notably by introducing SBCCs.⁸¹ We accepted that the store card market has been in relative decline, at least compared to credit cards, and that increased availability and better terms on credit cards could be part of the cause of this decline. Furthermore, we accepted that any such innovation might in part be in response to any such decline. However, products can be substitutes, at least to some degree, without being in the same market. As we discussed when considering ‘upstream’ market definition (paragraphs 6.4 to 6.27), the introduction of an SBCC, requiring as it does considerable investment on the part of a provider solely of store cards, seemed to us more akin to entry into a new market than a competitive response within a market. In any event, any such long-term response through innovation would not invalidate an analysis of market definition using sensitivity to price changes to conduct a SSNIP test.

Determining the alternative possible substitutes

6.89 Having:

(a) considered whether to define markets for services other than ‘consumer credit’ (paragraphs 6.49 to 6.57); and

(b) considered whether to use prices other than APR, or to consider other competitive responses in assessing the relevant market (paragraphs 6.58 to 6.82);

we were satisfied that it was appropriate to examine market definition for consumer credit through store cards principally by considering changes in APR.

6.90 We did so in two stages:

(a) first, by considering the evidence on whether direct substitution by customers resulted in consumer credit through store cards being part of a wider market including credit cards; and

(b) secondly, by considering whether retailers’ concerns about the level of APR on their store card programmes created a sufficient constraint on APRs as to result in a market for ‘consumer credit through store cards’.

6.91 We now set out our analysis of these two questions in detail.

Assessment: whether each store card programme supplies consumer credit within a wider market, including credit cards

6.92 We considered whether consumer credit through store cards could in principle be part of a wider market that included many forms of plastic card that can be used for payment or credit. The parties typically took the view that it could, many claiming that store cards and credit cards were in the same market. Not all store cardholders have credit cards. However, the majority do, and we see no reason to doubt that sufficient store cardholders (and sufficient revolvers, where relevant) could switch to credit card borrowing to create the potential for a competitive constraint. The question is therefore whether this potential is realized, under current market conditions. In our

⁸¹This is not the same point as the question of whether SBCCs themselves change the appropriate market definition for store cards (see paragraph 6.178). Instead, the argument here is that this innovation was evidence of a competitive response, required because store cards were in the same market as credit cards.

Emerging Thinking document, we took the provisional view that, because of their different characteristics, store cards formed a distinct and identifiable segment of any such market.

- 6.93 We tested the proposition that consumer credit through store cards was supplied in the same market as credit cards principally by considering evidence on direct substitution—at the level of an individual customer—between consumer credit through store cards and credit cards, particularly in response to APR movements. Our Guidelines state that we should consider a 5 per cent price increase (for a store card with a 30 per cent APR, this would be an increase to 31.5 per cent).
- 6.94 Because, for an individual consumer, one store card is not a good substitute for another (a Debenhams card cannot be used in JLP, for example), the appropriate alternative market definition at this stage was the individual store card programme.
- 6.95 One party [X] argued that the relevant benchmark was total customer expenditure and that it would be surprising if a SSNIP test applied as above resulted in significant substitution. It noted, for example, that a reduction in APR from 29 per cent to 18.9 per cent would reduce total expenditure, for a purchase costing £300 paid over six months, by just 2.5 per cent. If we accepted this approach, we should only consider substitution possibilities in response to a 5 per cent increase in total expenditure—which in this example would require an increase in APR from 30 per cent to over 50 per cent. We did not accept that a competitive constraint that acted only to restrict APR to 50 per cent or below would be an appropriate benchmark to define the market.
- 6.96 In the face of a SSNIP on consumer credit through store cards through an increase in the APR, cardholders could substitute away through several channels. These channels essentially correspond to the three decision stages set out earlier (paragraphs 6.49 to 6.57): take-up of the card, use of the card and taking interest-bearing credit on the card ('revolving'). In principle, others could be added: the initial decision to shop at that retail chain, for example, or the decision not to transfer the balance to a credit card.
- 6.97 Each of these channels could matter for market definition, and the total substitution effect in response to an increase in APR will be the cumulative effect of each of these channels. For example, in response to a SSNIP through a store card APR rise, fewer people might take the card; of these, a lower proportion than previously might use the card frequently to buy goods and, of those, a lower proportion than previously might retain an interest-bearing balance. If the sum total of these effects was to render that SSNIP unprofitable, then the market would be wider than credit through that store card. It is not always necessary to distinguish the effect through each of these channels, but it is important as far as is feasible to measure the total effect with precision. Most evidence relates to the cumulative effect of all three decisions.
- 6.98 Several parties have argued that the evidence on this total substitution effect in response to APR changes shows that store cards and credit cards are in the same market. In particular, they cited:
- (a) survey evidence on customers' stated willingness to substitute, at various stages in the decision-making process. In both NOP's study for the OFT and McCallum Layton's study for GECF,⁸² significant numbers of customers stated that they would use store cards less than previously in response to a small but significant

⁸²See summaries on the CC website.

increase in APR; also revolvers were more price sensitive than non-revolvers. The answers to other questions from the GECF survey also implied that customers substitute between the cards in response to relative price changes (for example, that revolvers pay off store card balances first and that significant proportions of customers were willing to transfer balances or had done so);

- (b) the decrease in the share of total borrowing held on store cards compared to that on store cards and credit cards combined, over a period when credit card APRs have fallen and most store card APRs have not; along with other indicators of a relative decline of the store card model, presumably as a result of competition from credit cards; and
- (c) internal documentation indicating that providers themselves regarded credit cards as providing the principal competitive constraint on store card APRs.

6.99 We now set out and discuss the evidence—including those three categories cited above—on customer sensitivity to APR, and the consequent likely degree of any substitution from taking credit on store cards to taking credit on credit cards, in response to a SSNIP on store card APRs. We discuss, in turn:

- (a) experimental and historical evidence (paragraphs 6.100 to 6.125);
- (b) survey evidence (paragraphs 6.126 to 6.142);
- (c) evidence from balance transfer activity (paragraphs 6.143 to 6.146);
- (d) providers' internal documentation (paragraphs 6.147 to 6.150); and
- (e) aggregate data on APRs and demand for credit through store cards and credit cards (see paragraphs 6.151 to 6.164).

Experimental and historical evidence on sensitivity to APR decreases

6.100 Substitution by customers in response to real changes in price could be considered to represent the most direct evidence on the SSNIP test for market definition. We have seen no evidence relating to increases in store card APRs, presumably because there have been almost no examples of such increases in recent years.⁸³ We did receive several sets of data relating to decreases in store card APRs. Some of this evidence relates to deliberate experiments with temporary reductions in APR, the rest to 'natural experiments' following APR reductions in the normal course of business.

6.101 It was put to us that this evidence on sensitivity to APR decreases was not useful and should be disregarded. In support of this position, different parties stated that this analysis was:

- (a) incorrect in principle, because evidence on the effect of decreases in store card APRs could not answer the question of whether credit card APRs constrained store card APRs from increasing; and
- (b) irrelevant in practice, because survey and other evidence indicated that customers' sensitivity to APR increases would be much larger than to APR decreases.

⁸³JLP increased the APR on its store card from 14 per cent to 15.5 per cent as from February 2006.

- 6.102 The objection in principle was that the hypothetical monopolist test for market definition considers whether a price rise would induce substitution outside the proposed market. A price decrease, it was argued, did not feature in this test. Examining the effects of a decrease in price on substitution would only be useful for assessing whether store cards provided a constraint on the credit card market. Given the relative scales of the two proposed markets, it was unlikely that such a constraint would arise.
- 6.103 We did not accept this argument because we were not, in the main, seeking to apply the findings from a decrease in APR to the hypothetical monopolist test, but rather to use those findings to shed light upon the likely response to an increase in APR. If credit through store cards and credit cards were in the same market, different customers would have different preferences between these products. We would therefore expect to see demand for credit continuously increasing as store card APRs fall and decreasing as they rise. Furthermore, in a market inquiry, our concern is with existing market power which would be manifested in existing prices being above the notional competitive level. While our initial analysis did not assume existing prices were above the competitive level, our subsequent analysis (set out in our provisional findings) found evidence indicative of a lack of competitive pressure on APRs, late payment fees and insurance charges in the store card sector. To that extent, decreases in store card prices from existing levels towards more competitive levels are more relevant to market definition in this inquiry than further increases.
- 6.104 It is possible in principle that no store cardholder would want to borrow more even in the face of an APR reduction. This would arise if all of those store cardholders who possess a credit card already use the store card in preference whenever possible (similar to a capacity constraint). However, a comparison of the overall size of the store card and credit card markets, and consideration of penetration rates, seem to make it clear that this capacity constraint does not apply. Furthermore, most store cardholders do not regularly revolve, suggesting that there is ample scope for further borrowing on store cards, were customers to choose to do so. Finally, even for revolvers, the period over which they pay credit back is flexible. They could demand more credit through taking longer to repay, were credit terms improved. We would therefore expect to see an increase in demand (higher balances) in response to a reduction in store card APRs if store cards and credit cards were in the same market. If there is no increase in demand, that is evidence that they are not in the same market.⁸⁴
- 6.105 We turn now to the practical argument that customer responses to APR increases and decreases are likely to be asymmetric. We accept that survey evidence (from the OFT and GECF surveys, see discussion from paragraph 6.127 below) suggests that customers are more likely to respond to an increase than to a decrease (and even if we had doubts about the scale of the stated sensitivity, that would not invalidate this difference). We do not accept that APR increases are more relevant than decreases. Indeed, to the extent that existing store card prices are above competitive levels (see paragraph 6.103), reductions from those levels are more relevant to market definition in this inquiry than increases which take prices further above competitive levels.

⁸⁴Suppose we were examining whether cars produced in Luxembourg are part of a wider geographic market, for example including Germany. It is quite correct to state that the real question is whether a price increase for cars from Luxembourg would result in significant substitution to German cars. It might also be true to state that Luxembourg is too small to constrain the German market. However, we would still expect to see an increase in demand for Luxembourgish cars in response to a price decrease unless either (a) there is no scope for increased consumption of cars from Luxembourg (capacity limits) or (b) Germany and Luxembourg are not in the same market.

6.106 We therefore concluded that evidence on the effect of APR reductions on customer behaviour was relevant to assessing whether store cards and credit cards were in the same market, although as with other evidence it must be interpreted carefully.

6.107 We received three categories of evidence on responses to changes in store card APRs:

(a) three experiments, in which APRs were temporarily reduced for existing customers;

(b) examples of permanent APR reductions; and

(c) tender documentation setting out forecast profitability at different APRs.

(a) *Experimental evidence*

6.108 In the [redacted] experiment over 12 months to November 2000,⁸⁵ APRs for groups of test customers in [redacted] card programme were reduced from 29.9 per cent to either 23.9 per cent or 18.9 per cent. The purpose of the experiments was to test whether lowering the APRs (without any increase in utility) would drive further spend, such that the increased balances would be sufficient to offset the APR reduction. Separate groups were constructed of customers with different spending patterns, including customers identified as revolvers. In principle, substitution could have arisen either through greater expenditure using the card or increased propensity to revolve. However, the other important opportunity for substitution—card take-up rates—was not tested, because the experiment applied only to existing customers. To act as an increase in demand for consumer credit through store cards, the combined effects of both decisions would have to have led to higher balances for those customers in the groups facing lower APRs, compared to control groups remaining on 29.9 per cent. This controlled experiment therefore provided direct evidence on whether customers' decisions to use the card or revolve were sensitive to reductions in APR, but not whether the decision to take the card was sensitive to APR.⁸⁶

6.109 In the event, balances of both test groups were lower than that of the control group who remained on an APR of 29.9 per cent, and thus there was a substantial loss of interest income to the card provider. Although revolvers facing a lower APR showed higher expenditure (of on average [redacted] per account, or 6.5 per cent, over the 12 months), this difference does not appear to have been statistically significant⁸⁷ and in any case, unless higher expenditure acts to increase balances it does not constitute an increase in demand for interest-bearing credit that would provide providers with increased revenue. Groups not identified as revolvers showed essentially no change in expenditure.

6.110 A further experiment was undertaken [redacted] in which the APR to transactors was further reduced to 9.9 per cent in June 2002. Again, this does not seem to have led to increased sales or balances. As the provider [redacted] put it, this data indicates 'that substantially lower APRs (9.9 per cent) do not bring new revolvers into the market (ie non-revolvers in the store card programme are not induced to become revolvers)'.⁸⁷

6.111 It was put to us [redacted] that it is unsurprising that expenditure by revolvers did not increase, as these cardholders have already taken the decision not to use a credit

⁸⁵Described in more detail in Appendix 6.1.

⁸⁶However, many parties separately put it to us that APR was not the main influence on the card take-up decision.

⁸⁷That is, the increase was not statistically significant from zero. [redacted]

card and expenditure itself is unlikely to respond to APR. We accepted the latter point but we did not necessarily accept that all revolvers had no opportunities to increase their demand for credit in response to a reduction in APR. They could have used the card instead of another payment mechanism more often, decided to 'revolve' credit more frequently or take longer to pay credit off. Each of these decisions—and the sum of them—would result in greater consumption of store card credit by revolvers.

- 6.112 As noted earlier, these experiments did not provide any scope for increased take-up of cards in response to lower APRs. To the extent that lower APRs drive card take-up, the results of these experiments therefore understated the overall sensitivity of demand to APR. However, many providers and retailers put it to us that card take-up would not strongly be driven by decreases in APR, rather that benefits were the critical factor at this stage. It therefore seemed unlikely that the potential demand response not picked up by the experiments was very large.
- 6.113 The results of these experiments therefore seemed to us to be highly significant for market definition. If consumer credit through store cards were in the same market as credit cards, we would have expected revolvers (through the mechanisms discussed above) to borrow more as APRs fell by 10 percentage points (a 33 per cent reduction) and for transactors to begin to borrow in response to APRs below those on most credit cards.
- 6.114 Had the experiments shown even some small degree of substitution in response to these APR reductions, it might have been reasonable to presume that the sensitivity to any APR rises might be rather larger—and therefore that the response to a 5 per cent (1.5 percentage point) rise in APR would be sufficient to render that APR increase unprofitable. However, the fact that there was no response at all (in terms of higher balances, and therefore increased demand for interest-bearing credit) to price reductions of 20 per cent, 37 per cent or 70 per cent (the latter only for transactors) strongly suggested to us that store cardholders in aggregate are insensitive to APR.
- 6.115 Another experiment, carried out by a different card provider, had a very similar result. [X] told us that in 2001 it reduced the APR to about 3,000 high spenders and 'VIPs' on the [X] card base. [X] said 'there was no significant impact on sales, either positive or negative. In terms of interest payers, there was no increase in the number of cardholders paying interest, so the result was a loss of interest income.'

(b) Historical evidence

- 6.116 There are also examples of reductions in APR applied to all cardholders of a store card programme.
- 6.117 [X]. This was a fairly small reduction in APR and there appears to have been no effect on balances. It would therefore appear that the only effect was a reduction in interest income, with no offsetting substitution from credit cards or other potential competitors to offset this loss.
- 6.118 [X]. We have seen no evidence of any increase (or break in a decreasing trend) either in card take-up, use or borrowing.
- 6.119 A provider [X] reduced the APR on a retailer's [X] store card from 36 to 29 per cent for some customers in August 2001. Again, there appears to have been no significant effect on balances.

- 6.120 JLP reduced its APR from 16 to 13 per cent in October 2000. [REDACTED]. It is interesting to note that, of all of the experimental and historical APR changes we were presented with, this change from the lowest APR starting point seems to have had the largest effect. This would be consistent with a view that there are alternative ways of operating a store card—one at a high APR with a relatively small, self-selected customer base that is insensitive to APR changes and one at APR levels closer to those often available on credit cards, with a larger and more APR-sensitive customer base.
- 6.121 [REDACTED]. However, the provider told us that they also expected a significant increase in the economics of the store card business: increased demand, through greater take-up and use of the card. The APR reduction was accompanied by a significant sales ‘push’ to increase demand. [REDACTED], the total loan book had increased by [REDACTED]. The price elasticity of demand for store card *credit* was therefore low, at -0.5 , measured [REDACTED] after the price reduction (although the loan book might continue to build, leading to a higher elasticity in the longer run).
- 6.122 In each case, the lower APR did not result in a countervailing increase in demand and so direct profitability of the store card operation will have fallen. In other words, store card profitability was higher when the APR levels were higher than those prevailing today.

(c) Forecasts in tender documentation

- 6.123 Finally, tender documentation that we have seen implies that when retailers choose between different APR levels on a new or re-tendered store card, the projected profits to be shared will be higher at higher APRs. A few providers seemed sufficiently confident of this to offer differently-structured deals at different APRs. However, it should be noted that retailers have chosen the highest APR levels in those examples that we have seen, so there is no evidence on what the highest achievable APR level is. Thus, this evidence is similar to the evidence set out above: it supports the conclusion that APR reductions compared to prevailing levels would reduce profits but does not conclusively demonstrate that increases are unconstrained by competition from credit cards.

(d) Conclusion on experimental and historical evidence

- 6.124 We recognized certain drawbacks in using experimental and historical evidence for market definition. In the [REDACTED] experiment, only existing store cardholders were included in the experiment. However, we have no reason to believe that card take-up is sensitive to APR—discounts are the key to this decision. Consequently, the fact that [REDACTED] did not include the effects of this first customer decision (of the three we defined), does not seem likely to render it invalid as a pointer to low customer sensitivity. In [REDACTED] only transactors were offered 70 per cent reductions (21 percentage points from an APR of 29.9 per cent) in the price paid. Consequently, when interpreting the results of this second experiment the only conclusion to be drawn is that this very large price reduction did not induce transactors to become revolvers. The historical data was not sufficiently detailed to allow statistical analysis to be carried out. Finally, all of this evidence relates to APR reductions from existing levels, not to APR increases upon those levels, an issue we discussed above.
- 6.125 These drawbacks would have given us greater cause for concern about interpreting these results as evidence in defining the relevant market, had the results from the analysis of these various pieces of evidence been unclear or inconsistent. However, we found it highly significant that in almost every case there was no increase in

borrowing by customers whatsoever, even in response to very large APR reductions; the exceptions were JLP and Ikano. This to us constituted powerful evidence that consumer credit through store cards is not supplied as part of a much larger market including credit cards. If that wider market definition were correct, then an improvement in the credit terms for one very small part of it—a store card programme—should attract at least some substitution from the much larger sums being borrowed on other cards.

Survey evidence on substitution

6.126 We took three quantitative surveys into account in this inquiry:⁸⁸

- (a) NOP's survey for the OFT ('the OFT survey');
- (b) ORC International's (ORC's) survey for the CC ('the CC survey'); and
- (c) a survey conducted by McCallum Layton for GECF, and submitted by GECF to the inquiry ('the GECF survey').

Summaries of all three surveys are available on our website.

(a) Summary of survey evidence on substitution

6.127 The OFT and GECF surveys asked questions to assess customers' stated sensitivity to APR increases (the CC survey did not). In several cases, answers clearly indicated that customers considered themselves sensitive to APR changes and this was especially true for revolvers (who are more exposed to APR changes than those who rarely pay interest).

6.128 The OFT survey found that:

- (a) 42 per cent of revolvers would use their card less and a further 34 per cent not at all in response to a 5 per cent rise in the store card APR (we note that it does not appear to have been clear whether respondents understood this to mean, for example for a 30 per cent APR, a 5 per cent increase to 31.5 per cent⁸⁹ or a 5 percentage point increase to 35 per cent).
- (b) 38 per cent of all revolvers said that they would pay off the amount owing more quickly if the interest rate went up.

6.129 In the GECF survey:

- (a) 30 per cent of store card revolvers with credit cards (and 46 per cent of those with high balances) said that they would use their credit card more were the store card APR to rise by 3 percentage points (ie around 10 per cent of a 30 per cent store card APR).
- (b) 15 per cent of revolvers with credit cards stated that they would use their store card less were the credit card APR to fall by 2 percentage points (ie around 10 per cent of a 20 per cent credit card APR, or a little more for lower-APR cards).

⁸⁸As noted earlier, we also found the results of our qualitative survey helpful but we do not draw upon those results in this section.

⁸⁹As it should be, for the normal use of 5 per cent in a SSNIP test.

- (c) 53 per cent of revolvers disagreed with the statement that they ‘do not pay much attention to the relative costs of the two cards (store card and credit card) while only 33 per cent agreed. 44 per cent of those with above-average balances strongly disagreed.
- (d) 31 per cent of those who had been approached to transfer balances had done so and 33 per cent of revolvers said they would do so if offered. Again, the proportion was higher for those with higher balances.
- (e) Almost half the people who revolve on both credit and store cards prefer to pay off their store card balance first (with 86 per cent of those saying this was due to the APR differential).

6.130 In addition to these responses to questions directly concerned with the changes to APRs, other questions in all three surveys indirectly supported the conclusion that customers do believe that they are sensitive to changes in APR. For example, in the CC survey, the APR was cited as an important factor when taking out the card by 19 per cent of all respondents and 56 per cent of revolvers.

6.131 We noted that significant proportions of respondents declared little or no sensitivity to APRs. For example, in the GECF survey 74 per cent of intentional revolvers said that a 3 percentage point fall in their credit card APR would make no difference to their behaviour, and 66 per cent said that a 3 percentage point rise in their store card APR would make no difference to their behaviour.

6.132 However, not all customers need to be responsive to price to render a SSNIP unprofitable. If (for illustration) the variable costs of store card provision accounted for about half the total cost, then the critical loss for a 5 per cent SSNIP (1.5 percentage points on a 29.9 per cent APR) is about twice this price increase (ie a 10 per cent fall in demand). The critical loss for the 3 percentage point increase tested in the GECF survey would be about a 20 per cent fall in demand. Although the survey results above do not quantify the reduction in use (except for those declaring they would not use the card at all), the percentages declaring a willingness to switch seemed high enough to make it likely that a SSNIP would be unprofitable.

(b) The CC’s reservations about survey evidence on substitution

6.133 These surveys clearly showed significant proportions of customers—especially revolvers—stating that they would respond to higher APRs on store cards. This is evidence in support of the proposition that consumer credit through store cards is supplied within the same market as credit cards.

6.134 We had some reservations about accepting this survey evidence. The surveys showed a high level of customer ignorance of APR levels. For example, in the GECF survey, 45 per cent of revolvers did not know the APR on their store card at all (compared to 26 per cent on their credit card) and only 11 per cent claimed to know it exactly. In the CC survey, 55 per cent of revolvers did not even claim to know the APR on their store card. We note that even these figures only show the revolvers who claimed to know. They could be wrong: the CC survey showed that many revolvers must be significantly wrong in their belief about the current APR level (the distribution of APR levels in customer responses is very different from that in the store card population and, in an extreme example, 11 per cent of those revolvers claiming to know the APR believed it to be below 10 per cent, which is not true of any store card). Such ignorance of APR levels at the time a survey is conducted does not make it impossible that customers will take well-informed decisions in reality—but in our view it makes it less likely.

- 6.135 The surveys also appeared to show confused and inconsistent responses in places. For example, in the OFT survey 8 per cent of respondents and 9 per cent of revolvers said that they would use the card less or not at all if the APR fell by 5 per cent. Responses on revolving behaviour in both the OFT and the GECF surveys appear to indicate that some respondents did not correctly report their repayment behaviour (those customers identified as unintentional revolvers believed they always or almost always paid in full, for example). Also, in the GECF survey [§] borrowers said they would use their store card more if the APR on their credit card rose by 2 per cent but [§] borrowers said they ever used their credit card instead of their store card in the relevant store.
- 6.136 We also note that 63 per cent of revolvers in the CC survey declared that they were not prepared to pay £1 in annual fees for their store card—implying an implausibly high price-elasticity if customers intending to revolve weigh up all of the financial costs of holding and using a store card. Although this attitude might be perfectly reasonable, it does suggest that customers do not carefully weigh up overall prices, but rather react badly to particular ways of payment or thresholds.

(c) Survey evidence on sensitivity to APRs: conclusion

- 6.137 Overall, however, we did not regard these problems with the survey evidence as necessarily invalidating its conclusions. We were therefore left with an apparent contradiction between the evidence of customers' willingness to respond to APR changes as expressed in response to survey questions on hypothetical changes in APR and the evidence of there having been essentially no such substitution response to any actual changes in store card APRs.
- 6.138 Several parties submitted that there was no contradiction and that we should accept the results of the OFT and GECF surveys in this respect. In particular, as previously noted, it was put to us that information on responses to APR *reductions* was not as relevant as survey responses relating to hypothetical APR *increases*.
- 6.139 We have noted above (see paragraph 6.103) that, where—as is generally the case in the store card sector—prices are above the competitive level, price reductions towards the competitive level are likely to be more relevant than price increases. Moreover, even if we were more concerned with price increases, we would expect substitution in response to a reduction to be an imperfect guide to the likely effects of an increase but we would expect nonetheless to see some relationship between the responses to a reduction and an increase. Had the experimental and historical evidence suggested some significant sensitivity of the demand for credit to reductions in APR, it might reasonably be posited that the sensitivity to increases would be higher and therefore that this evidence could be considered consistent with the survey evidence. We were, however, particularly influenced by the fact that most of this evidence showed no sensitivity whatsoever, even in the face of relatively large APR reductions. This led us strongly to doubt that the survey evidence of significant stated willingness to respond to APR increases would be borne out in practice.
- 6.140 Some parties also suggested that the apparent contradiction between the evidence on responses to actual changes in APR and to survey questions might arise from the timing of the two sources of evidence. If customer attitudes are changing, then the historical evidence might not be as relevant as a more recent survey. However, no supporting evidence was put forward to justify this suggestion that customer sensitivity to APRs might be increasing. Furthermore, although the most comprehensive experimental evidence of insensitivity [§] dated from 2000, so did one example of higher sensitivity to changing APRs (JLP); while the remaining historical and experimental evidence was all consistent in showing no significant

sensitivity from 2001 to 2003—the latter being the year the OFT survey was conducted. The most recent evidence (from [X]) showed somewhat greater sensitivity, but only in response to a [X] APR reduction, accompanied by a sales ‘push’. Even in this case, overall the demand for credit was inelastic compared to the figures derived from hypothetical survey questions. We therefore did not believe that the historical and survey evidence were consistent with one another, the different results simply representing customer behaviour changing over time.

- 6.141 We therefore concluded that the evidence from surveys submitted to us on responses to hypothetical APR changes on the one hand and the evidence on responses to actual recent APR changes on the other, were in conflict. Both were taken into account when forming our view of the relevant market but a direct conflict of this sort requires us implicitly or explicitly to choose one form of evidence over another. It seemed clear that evidence on actual behaviour should be considered more reliable than evidence relating to declared intentions, particularly when considering financial questions, for the reasons we set out as our reservations relating to this survey evidence above.
- 6.142 We therefore did not consider that the evidence from the OFT and GECF surveys (or any evidence from the CC’s own survey) should cause us to set aside evidence that the measured demand for consumer credit through store cards appears to be insensitive to changes in store card APRs, and therefore that store cards should be regarded as being in a separate market from credit cards.

Balance transfers

- 6.143 Balance transfers represent the most direct and obvious way of substituting credit through credit cards for credit through store cards. Store card customers holding credit cards can take the store card, use it, obtain benefit and still avoid paying the store card APR through balance transfer to a credit card. If credit through store cards is supplied in the same market as credit cards, it might therefore be expected that there would be significant balance transfer activity and that this activity would show a clear relationship to relative APR levels.
- 6.144 Some parties put it to us that such activity is substantial. The two main pieces of evidence cited were that credit card companies (and others) actively target store cardholders and that some survey questions showed large balance transfer activity. On the latter:
- (a) In the CC survey, 38 per cent of revolvers stated that they had considered transferring their store card balance to another credit instrument; of these, 41 per cent had not done so (implying that 59 per cent had done so, ie 22 per cent of all revolvers).
 - (b) The OFT survey indicated that 21 per cent of revolvers who had a credit card had transferred their balance to a credit card; of these, 31 per cent had done it more than once. 9 per cent of all revolvers had transferred their balance to a personal loan.
 - (c) The GECF survey only asked about credit cards (and might therefore have understated balance transfer activity). It found that 44 per cent of respondents had been approached to transfer the balance and that 31 per cent of those had taken up the offer. It also found that 33 per cent of store card revolvers who also had credit cards would be likely or very likely to switch if contacted with an offer to transfer their store card balance to a credit card.

- 6.145 However, given that any benefits—financial or those arising from affinity—of using the store card have either already been received at the point at which balance transfers are considered or can continue to be enjoyed even if the balance is transferred, these figures did not appear to us to be high. The majority of respondents to the GECF survey had not been approached to transfer their balance; the majority of respondents to the CC survey had never considered transferring the balance. Overall, the surveys appeared to suggest that only about 20 per cent of revolvers and a rather lower proportion of all respondents have ever undertaken a balance transfer. Many credit cards offer special introductory offers for balance transfers. It is therefore quite possible that the respondents to the GECF and CC surveys who had transferred balances had done so only once, in response to an introductory offer. The OFT survey provides support for this—only 31 per cent of those revolvers who had transferred balances had done so more than once.
- 6.146 The survey evidence implied that few revolvers (fewer than 10 per cent) had transferred balances more than once. The evidence was consistent with balance transfers from store cards to credit cards being driven by specific events, such as a low or zero-rate balance transfer offer on a new credit card or by the customer's existing credit card provider. Consequently, it seemed to us unlikely that the level of balance transfers was sensitive to the store card APR—the level of balance transfers from a store card would be similar at an APR of 25 per cent to that at an APR of 29.9 per cent. Hence balance transfers are unlikely to constrain the level of store card APR. We accepted, however, that balance transfers are a factor in the economics of store cards (in this they are similar to non-revolving behaviour) and that balances and profits are lower than they would be in the absence of balance transfers.

Internal documentation

- 6.147 Firms' own statements about which products constrain their pricing can provide important clues to market definition. If a product is in the same market as another group of products, we might expect assessments of the prices (and any expected movements in the prices) of those competing products to feature heavily in internal documentation.
- 6.148 One party [X] has supplied us with internal documents that it argued showed that credit cards, and APRs on credit cards, were identified as a competitive threat. However, several of these related to SBCC programmes and therefore did not directly provide evidence relating to store cards. Those strategy documents relating to store cards clearly referred to the long-term decline in the store cards business that [X] several parties have identified as arising from the competitive threat created by credit cards. In places, these documents also specifically referred to credit cards, and to credit card pricing, but (in our opinion) in slightly oblique terms. As we discuss below, competitive pressures from credit cards could be responsible for a long-term decline in the store card model without implying the tight and continuous price constraint that arises when products are in the same market.
- 6.149 If store cards merely constituted a few percentage points of a large credit market, the providers of store cards could be expected to be price-takers within that market. It might be expected that store card providers would be very interested in pricing trends, and the details of movements in pricing trends, within that market, since competition would presumably imply that the prices of their own products would overwhelmingly be determined by such pricing trends. The documents drawn to our attention in this context did not do so. Nor did internal assessments of specific programmes mention credit cards, and it was particularly notable that none explicitly assessed the risks of credit card APRs falling further, despite sensitivities for events

specific to store cards being considered. This suggested to us that although credit cards might provide an important element of the environment within which store cards operate, providers do not regard store card credit merely as one, very small, part of a single, wider market for credit.

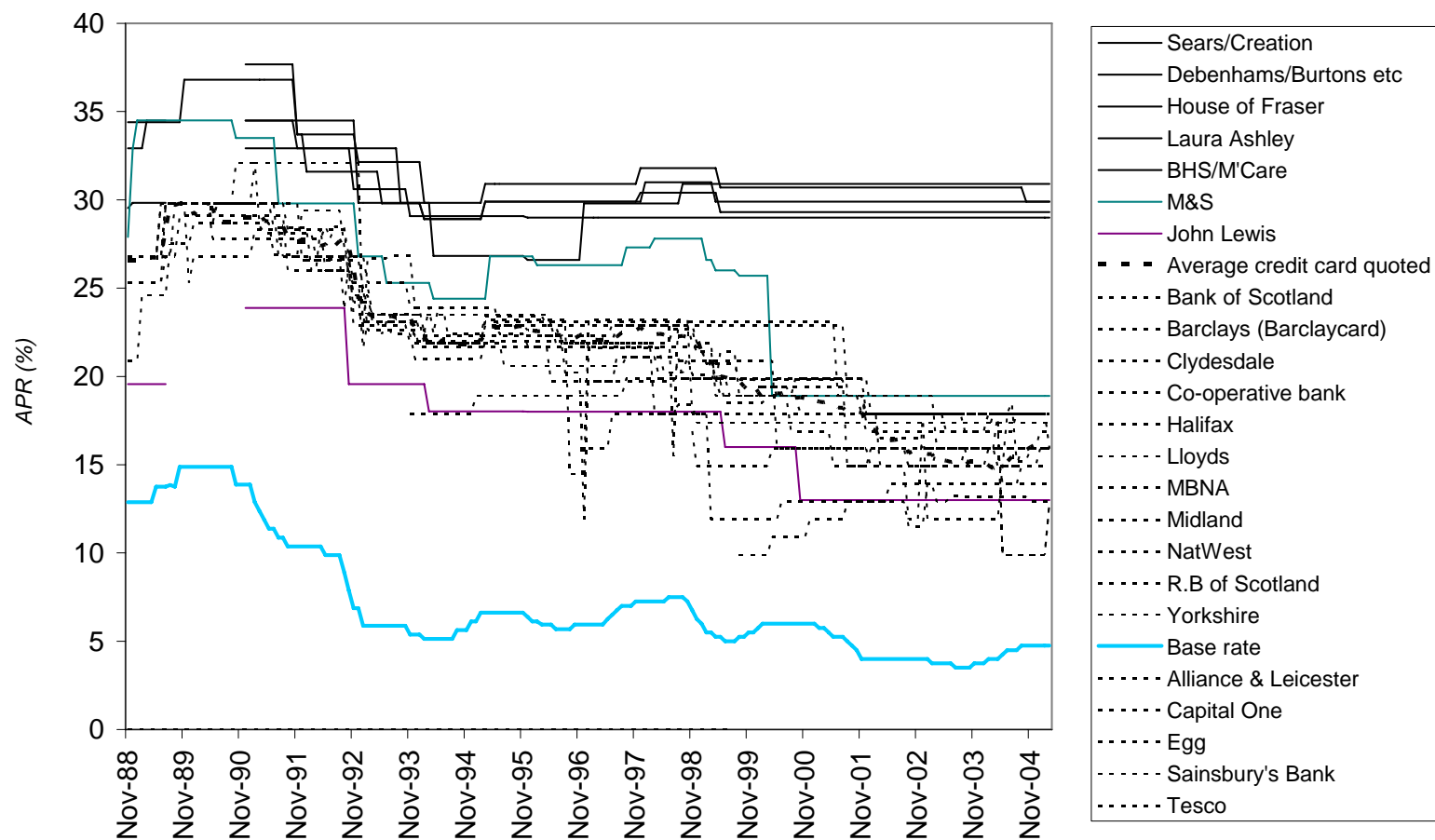
- 6.150 On balance, therefore, we judged the internal documents we saw on this issue as providing evidence against, rather than for, the proposition that consumer credit through store cards was supplied as part of the same market as credit cards.

Aggregate data on APRs and demand for credit through store cards and credit cards

- 6.151 Finally, in this section, we consider price trends for store cards and credit cards over the medium term and the implications for market definition. In Figure 6.1 we present trends in quoted APRs for store cards and credit cards since 1988. Solid lines show store card APRs, dashed lines show credit card APRs and the base rate is shown as a solid light blue line.

FIGURE 6.1

Trends in quoted APRs since 1988*



*Quoted store card APRs are those applicable to customers not paying by direct debit. Quoted credit card APRs are not necessarily paid by all credit card borrowers, but Bank of England data suggest that trends in the weighted average effective APR (computed from actual interest payable and interest bearing balances) are similar to trends for the weighted average of quoted APRs.

Source: CC calculations

- 6.152 Our interpretation of this price history is that:
- (a) credit card APRs seem to show clear common price movements;
 - (b) store card APRs—with the possible exception of those on the JLP and Marks & Spencer store cards—also show clear common price movements; but
 - (c) the two groups of cards show different price movements, at least since about 1994.
- 6.153 If two groups of products show much stronger common trends in pricing within groups than they show between groups, a natural conclusion to draw is that the two groups of products are in separate markets.⁹⁰
- 6.154 Several parties challenged our interpretation of the divergent APR series', commenting that:
- (a) The apparent divergence over-states the true divergence in the cost of credit on the two card types, particularly because credit card providers have been increasing the revenue they obtain from late payment and other default fees, while store card providers typically have not.
 - (b) Store card providers have responded to the competitive threat from lower credit card APRs, but that it has been more effective to do so by increasing customer benefits on the card, or responding in other ways,⁹¹ than by reducing store card APRs.
 - (c) Store card providers have responded to this competitive threat in other ways, by innovating (and particularly by introducing SBCCs, at lower APRs).
- 6.155 We considered carefully the argument that other 'prices' such as late payment fees and customer benefits should be included in the price comparison. We set out our reasons for rejecting these approaches in paragraphs 6.58 to 6.88. We do not repeat this assessment here, but note that we concluded that it would be reasonable to expect to see reduced APRs in response to falling credit card APRs, whatever was happening to other prices, were consumer credit through store cards supplied within the same market as credit cards.
- 6.156 The point about innovation is important. It is clear that new approaches and products have been introduced. Some parties, although not all, told us that the traditional store card model was in long-term decline. It is possible that this decline is a result of increased competition from credit cards. However, the question for market definition is whether consumer credit through credit cards and store cards are sufficiently close substitutes to prevent the relative price of credit through store cards increasing by 5 per cent. Products can be substitutes and competitors to some degree, without being such close substitutes and competitors as to be considered to be in the same market. This seems particularly relevant in this case, since the decision to introduce an SBCC is a significant strategic decision. We further note that most traditional store card programmes have not introduced SBCCs.

⁹⁰We note that this conclusion from an assessment of the movements in prices does not depend on the absolute levels of those prices. If the two card types were in the same market, then a credit card APR of around 20 per cent apparently constrained many store card APRs to 29.9 per cent in 1996 but in 2003, a credit card APR of around 15 per cent also constrained most of those same store card APRs to 29.9 per cent. This seemed implausible.

⁹¹See paragraph 6.87.

- 6.157 More generally, several parties put it to us that the relative decline in store card borrowing vis-à-vis credit cards represents a response to the relative reduction in credit card APRs as compared to store card APRs. Overall, recent movements in prices and relative demand could be interpreted as providing straightforward evidence of a significant cross-elasticity of demand between store cards and credit cards. In recent years, demand for credit through store cards appears to have been stable, while demand for other forms of consumer credit (notably through credit cards) has been increasing rapidly. These trends were illustrated in Figure 3.1 in Section 3.
- 6.158 The proportion of the total transactions on store cards and credit cards accounted for by store cards fell by approximately 40 per cent (from 6.4 to 3.7 per cent) from 1996 to 2002, reflecting flat sales as credit card transactions doubled. Over the same period the average APR on credit cards fell by 36 per cent (from 18.8 to 13.8 per cent), while the average APR on store cards excluding JLP and Marks & Spencer was essentially unchanged. Thus, the measured 'elasticity' was greater than -1 .⁹²
- 6.159 It was put to us that this decline in relative demand for credit through store cards indicates substitution, in response to this increasing APR differential, from store cards to credit cards—and therefore provides evidence that the two card types are in the same market. More generally, some parties argued that other key drivers of store card profitability were in decline because of competition from lower-APR credit cards.
- 6.160 We noted that this elasticity cannot be interpreted as a simple transfer of demand for borrowing on store cards to credit cards, because the increase in credit card borrowing so significantly exceeds the total size of the store card market (see Figure 3.1 in Section 3). We therefore put it to the parties that the increase in credit card borrowing and stable store card borrowing simply represented trend movements unrelated to recent movements in relative APRs. [X] responded that the hypothesis was not that store card demand transferred to credit cards, but rather that store card borrowing would have shown a similar trend to credit card borrowing, absent the APR differential. It was natural to hypothesize that store cards and credit cards were in the same market, and therefore that measures of elasticity should be taken at face value in the absence of specific evidence to the contrary.
- 6.161 However, we rejected this interpretation of recent trends in APRs and borrowing because:
- (a) We were not presented with any analysis showing a close link between movements in relative APRs between store cards and credit cards, and the trend towards greater relative use of credit cards. Within the period for which we had data on APRs and borrowing, for example, the proportion of borrowing accounted for by store cards was falling well before the APR differential increased.
 - (b) In any case, Figure 3.1 in Section 3 suggests, any examination of the relationship between shorter-term movements in the relative use of store cards and the APR differential would entirely be driven by changes in credit card use that are presumably unrelated to store cards. In effect, there is one observation over the period as a whole and it is capable of two interpretations: either that an increased price differential resulted in essentially flat store card borrowing (implying a low elasticity) or that the price differential resulted in falling relative use of store cards (implying a high price elasticity).

⁹²Inclusion of JLP and Marks & Spencer price reductions would increase it still further.

(c) The calculated high elasticity would imply that store card providers and retailers were irrational, in that a reduction in APRs would have been profit-enhancing through increased borrowing.

(d) High price-elasticity is inconsistent with the results of the experimental evidence discussed above⁹³ which showed that store card borrowing was not sensitive to reductions in the store card APR.

6.162 The same provider [X] noted that credit card use could have increased at the expense of store cards, as well as there being a new demand, which has not been tapped previously. We accept this, but since the 'new demand' must substantially exceed any substitution from store cards, the point seems merely to demonstrate that the trends in credit card and store card use do not necessarily imply substitution.

6.163 More generally, much of the evidence we received on this topic suggested that the store card market is in long term decline and that credit cards are the principal reason for this.⁹⁴ It is worth noting again that market definition is concerned with relatively rapid substitution in direct response to price changes. Again, therefore, without necessarily rejecting the proposition that credit cards might have been partly responsible for any long-term decline in the store card business, we did not accept that the flat demand for borrowing on store cards in recent years constitutes evidence that such borrowing was part of a wider market including credit cards.

6.164 We noted in paragraph 6.152 that the JLP and Marks & Spencer store cards were possible exceptions to the pattern of common price movements among store cards. HSBC, which now provides both of these store cards, argued that they competed with credit cards and should be considered to be in the same economic market as credit cards. We considered this argument but we concluded on balance that the JLP and Marks & Spencer store cards, like other store cards, were in a separate economic market from credit cards. The historical evidence (see paragraph 6.120) suggested that APR reductions were not profitable even on store cards, such as JLP, with APRs similar to those on credit cards, albeit borrowing on low APR cards was more responsive to APR changes than borrowing on store cards with higher APRs. This suggests that increases in JLP's store card APR would have been profitable, albeit JLP decided not to make such an increase and kept its APR at a lower level than other store cards. Thus, although the level of APR on the JLP store card, and perhaps the Marks & Spencer store card, has tended to follow that of credit card APRs (see Figure 6.1) this reflects decisions of the retailers concerned rather than direct competition from the credit card market. While these retailers may have been concerned to some extent with the overall perception of their brand, this does not imply that credit cards are close enough substitutes for their store cards to be in the same economic market as credit cards. HSBC also pointed out that when JLP and Marks & Spencer began accepting credit cards in their stores, they experienced a decline in store card usage as a means of payment. In our view this supports the proposition that credit cards are the closest alternative means of payment to store cards, but it does not in itself imply that credit cards are sufficiently close a substitute to be in the same economic market as store cards (ie that substitution of credit on credit cards for credit on store cards would make unprofitable store card prices that were 5 per cent above the competitive level).

⁹³And statements by several parties have noted that existing customers are not sensitive to APR and that new customers are principally driven by initial discounts.

⁹⁴We show figures on trends in the store card market in Section 3, especially paragraphs 3.14 to 3.21 and Table 3.1.

Conclusion on whether each store card programme supplies consumer credit within a wider market, including credit cards

- 6.165 Overall, the evidence was mixed on whether consumer credit through store cards is provided in a wider market, including credit cards. We summarize the main points below, although it should be recognized that the summary does not represent all our views or those of the parties, which have been discussed in detail above, and to which reference should be made.
- 6.166 The key question is whether the price of credit through store cards is constrained by the threat of substitution to credit cards (these being the closest *direct* substitutes for credit on any given store card).
- 6.167 Providers and retailers argued that it is so constrained, citing in particular a declining or stagnant store card industry and the results of questions to store cardholders in surveys for the OFT and GECF. As to the point about the store card industry being stagnant or in decline, we did not regard any long term decline as necessarily being relevant to market definition, which relates to more immediate price constraints. As to the survey evidence, despite having some concerns about this, we accepted that the responses to questions on hypothetical APR increases were consistent with a single market including credit cards.
- 6.168 However, all of the evidence we received on actual responses to APR changes seemed directly to contradict these survey findings. Almost every actual change in store card APR that we observed produced no substitution whatsoever. We did not accept that there was no scope to do so, as both revolvers and transactors have scope to increase their demand for credit and could therefore be expected to do so were they sensitive to changes in APR. Faced with this contradiction, we chose to regard evidence on actual cardholder behaviour as more significant for market definition than responses to hypothetical questions. The evidence clearly showed low—or zero—propensity to substitute between store cards and credit cards in response to changes in the APR differential, implying that credit card APRs are unlikely to provide a competitive constraint on store card APRs. Internal documentation and evidence on balance transfers, as well as APR trends, seemed to support this finding, although they did not play a large part in our decision.
- 6.169 It has been put to us that such insensitivity is only to be expected, since customers will focus on the total cost of the purchase, any discounts and credit—a package within which credit is a small element. Furthermore, in many cases the sums involved are fairly small, again helping to explain why there is little substitution to cheaper products. Both explanations seem plausible to us, but the fact that this behaviour has a rational explanation does not diminish the importance of this insensitivity to our inquiry—either to the topic of market definition or more generally to the question of whether it creates the potential for a distortion of competition.
- 6.170 We therefore concluded that credit cards did not provide competitive constraints on store card APRs sufficient for us to consider them to be in the same market.

Assessment: whether each store card programme supplies consumer credit within a wider market, including other store cards

- 6.171 Having determined that customers for consumer credit through store cards would not switch to alternative credit instruments in sufficient numbers to render a SSNIP unprofitable, we could therefore have concluded that consumer credit through each separate store card programme was in a separate market. This view received no

support from the parties to this inquiry, although it was consistent with the scenarios presented by the OFT. It also seems to follow from our assessment that consumer credit through store cards is not supplied in the same market as credit cards, if the SSNIP test is applied taking account only of direct substitution by cardholders (because store cards do not compete directly with store cards).

- 6.172 However, we saw a considerable body of evidence to the effect that there is an alternative source of competitive constraint on store card APRs: some retailers are concerned with the relative level of their APR, compared to APRs charged on the store card programmes of rival retailers. In some cases, retailers appeared actively to prefer lower APRs to their rivals, although in most cases the concern was more with the negative effects of unusually high APRs (several retailers noted that they did not want to be seen as being 'out of line' with their competitors). We discuss this further in Section 8.
- 6.173 The implications for market definition of this concern by retailers did not appear straightforward. One interpretation would be that a SSNIP would be unprofitable. If a single store card's APR were to rise by 5 per cent (1.5 percentage points on an APR of 30 per cent), the retailer's brand image would suffer, with adverse consequences for the retailer's profitability. Expressed in these terms, this constraint upon APRs acts as any other competitive constraint. The appropriate market definition would be the store card programmes of the group of retailers concerned with such comparisons—effectively the entire existing range of store card programmes on offer.
- 6.174 On the other hand, this pricing constraint arising from retailers' concern with their brand seemed to us unlikely to act as quickly or effectively as a 'normal' competitive constraint. We considered that any reduction in profitability resulting from a decline in brand perception would occur more slowly than would be required for a strict application of our market definition, even if in the longer run any such damage were significant. Moreover, although retailers might suffer when APRs rose, we thought it unlikely that one retailer would benefit sufficiently rapidly as a result of increased demand from undercutting the market average in the way that they might when engaged in normal price competition (and we received no evidence to suggest that this would occur). Retailers' concerns regarding the relative APRs on their store card programme, in short, did not seem as direct or as important as their concerns regarding the relative prices of their final goods.
- 6.175 We therefore did not regard this inter-comparison between retailers as being fully equivalent to competition within a market. A formal application of the tools of market definition would not, in our view, result in a market wider than an individual store card programme even taking account of this behaviour by retailers. In particular, we did not see any reason to doubt our finding that customers for consumer credit through store cards do not show any significant sensitivity to changes in APR.
- 6.176 Since, however:
- (a) we regarded this inter-comparison between retailers as being the most significant factor constraining APRs in this industry from rising;
 - (b) various parties put it to us that we should regard such a constraint as being important for market definition; and
 - (c) a narrow market, limited to each store card programme did not, in our view, best meet the purpose of market definition as set out in our Guidelines,

we concluded that all ‘consumer credit through store cards’, could best be regarded as a single product market.

6.177 We were therefore satisfied that the relevant ‘downstream’ market for consumer credit could be defined in this way.

SBCCs

6.178 Among credit cards, an SBCC may be the closest substitute for those store cards operating in parallel with SBCCs. In principle, such a card might link the market for credit through store cards to a wider credit card market through a chain of substitution. Other credit cards might be effective substitutes for SBCCs, which themselves might be effective substitutes for store cards. It has also been put to us that an SBCC provides a ‘reference point’ for APRs, potentially making store cardholders more aware of, and sensitive to, APRs. Both mechanisms seem plausible in principle, but we have no evidence that either was operating to constrain store card APRs during the period of our inquiry⁹⁵. Since SBCCs are typically currently provided by the same provider as the relevant store card, and choice between the two cards is influenced or constrained by the provider and retailer, we might in any case be cautious about interpreting any shifts in demand as representing demand-side substitution, let alone a competitive mechanism. We note, in addition, that the number of SBCCs relative to the number of store cards is still small. However, at this stage our conclusion is simply that during the period of our inquiry SBCCs did not have sufficient effect to cause us to revise the market definition set out above. We consider recent market developments further in Section 8.

Downstream geographic market

6.179 Geographic market definition at this downstream level appeared to be straightforward. Customers do not consider substituting to store cards supplied outside the UK in response to price changes, nor do retailers appear to consider the APR on their store card programmes in comparison to those available outside the UK. Thus, neither of the substitution mechanisms assessed above results in a geographic market wider than the UK (and nor did we receive any representations that the geographic market was wider). However, most store cards are available to customers throughout the UK, so no obvious regional issues emerge. Consequently, we regard the relevant geographic market as the UK.

Downstream insurance market

6.180 Insurance is an optional product purchased only alongside, or after, a decision to take out a store card. In principle, it is possible for insurance to be either in a wider market or in a narrower market than is consumer credit through store cards. If, for example, customers were likely to consider the possibility of substitution to similar insurance products supplied from outside the store card market when making their decision as to whether to sign up for insurance, the market could be wider.

6.181 One provider, GECF, put it to us that insurance on store cards forms part of a wider insurance market for consumers. In support of this proposition, it cited:

⁹⁵Indeed, as we note in Section 8, GECF’s recently introduced or modified ‘DualCard’ programmes (which we refer to as ‘combined programmes’), some of which have multi-tier APRs for store cards and SBCCs, often do not make these ranges known to cardholders, who are simply offered a card at an APR that reflects their credit rating.

- (a) the optional nature of insurance, both at the initial take-up stage and through the possibility of subsequent cancellation;
- (b) the availability of demand-side alternatives: ‘... consumers have many alternatives as to the type of cover that they take, both through competing cards and other, non-card-based platforms’;⁹⁶ and
- (c) ‘From a supply substitutability viewpoint, to the extent that insurers may not currently be offering comparable stand-alone insurance products, there are no barriers to one or more of them providing such products’.
- 6.182 It is clear that insurance is a secondary and optional product, although some components of the insurance offer are typically bundled together and there may be concerns relating to the information customers possess when offered insurance with a store card. These matters are discussed in Section 8.
- 6.183 So far as market definition is concerned, the evidence cited for demand-side and supply-side substitution related to possibilities, rather than historical, experimental or survey evidence of substitution—particularly in response to price changes. We received no evidence that substitute products provide a pricing constraint on store card insurance.
- 6.184 Responses to the CC and OFT surveys show little evidence of careful decision-making when customers sign up for insurance (we discuss this evidence further in Section 8). One provider [X] presented results of a survey of its insurance customers, showing high levels of satisfaction with the account-opening process and high declared understanding of the features and benefits of the cover at the time of purchase. Some 78 per cent of respondents agreed that they had a good understanding of the features and benefits of cover at the time they decided to purchase insurance. However, this declared level of understanding was not fully reflected by other sections of the survey as only 32 per cent of the customers were aware of roughly what percentage of their balance would be paid each month if they lost their income.
- 6.185 Overall, in the absence of any evidence of a pricing constraint arising from competition, we rejected the suggestion that insurance is offered as part of a wider market. A strict application of the tools of market definition would therefore have implied that insurance within each store card programme was supplied within a separate market.
- 6.186 However, as with consumer credit, there was evidence that retailers were concerned with the relative level of charges for insurance on their store cards. Again, this concern seemed to us unlikely to act as effectively to constrain pricing as would normal competition in a market. Nonetheless, because this concern seemed to us best to explain why charges for insurance were at the level they were, and to provide a framework within which to analyse the effects of market features, we chose to regard the relevant market as being ‘insurance purchased in association with the provision and use of store cards’.

⁹⁶In particular, [X], cited stand-alone provision of price protection by [X] and possibly others; availability of purchase protection through credit cards or home contents insurance; and payment protection cover on credit cards or through stand-alone insurance.

Conclusion on market definition

- 6.187 We therefore conclude that the economic markets for our inquiry are the supply of:
- (a) store card credit services to retailers and services, including insurance services, related thereto (store card credit services) in the UK (the ‘upstream market’); and
 - (b) consumer credit through store cards and insurance purchased in association with the provision and use of those store cards in the UK (the ‘downstream market’).
- 6.188 We applied the SSNIP test, as set out in our Guidelines, both to define the upstream market and to consider carefully, and reject, arguments that the downstream market was wide enough to include credit cards.
- 6.189 However, we did not directly apply the SSNIP test to identify the downstream market because different store cards do not compete directly with one another. The process of comparison between retailers’ programmes through which we define the downstream market, either for credit or insurance, does not appear to us likely to act in quite the same manner as competition within a market. It would be possible for a provider with a relatively small market share to possess market power, for example, because direct customer sensitivity to changes in APR or insurance charges appear to be low. We therefore regard the downstream market as being wider than each store card programme individually and we consider this to be the right framework within which to analyse the effects of market features.

Summary of findings and conclusions on market definition

- 6.190 We re-state below our findings on each of the matters discussed in this section. We considered them to be of particular significance in arriving at our understanding and definition of the relevant markets and, a later stage in the inquiry, in helping us to identify any relevant features of those markets, as we are required to do (see Section 5). However, these findings should not be read in isolation: they emerged from, and cannot properly be interpreted except in the context of, the totality of the evidence in this section and in the other relevant sections of the report.
- (a) Store cards are designed to enable retailers to communicate with and reward their customers, and hence generate loyalty and repeat purchases (Section 3, in particular paragraphs 3.2 to 3.4 and paragraphs 6.11 and 6.32).
 - (b) There is an upstream market for the supply of store card credit services to retailers and services, including insurance services, related thereto (store card credit services) in the UK (paragraphs 6.4 to 6.26 and in particular, paragraph 6.27); and a downstream market, involving the supply of consumer credit through store cards and insurance purchased in association with the provision and use of those store cards in the UK (paragraphs 6.28 to 6.186 and in particular 6.187).
 - (c) The most important factor in a cardholder’s decision to take out a store card is the discount available on the day. Most customers, when considering taking out a store card, do not view it primarily as a source of credit. It follows from this that the APR is unlikely to have much effect on the take-up of cards, although we recognize that potential revolvers are likely to be more sensitive than the average cardholder APR at this stage (paragraphs 6.29 to 6.39).

- (d) On the demand side, most customers view store cards as having characteristics that differentiate them from any other card that would be likely to offer competition to them (paragraphs 6.34 to 6.40). On the supply side, and considering retailers and suppliers together, there would appear to be significant differences between the characteristics of store cards and of credit cards, including SBCCs (paragraphs 6.41 to 6.45). Store cards therefore appear to have different characteristics from products with which they might potentially compete, both from the demand and the supply side (paragraphs 6.34 to 6.46 and in particular, paragraphs 6.46 and 6.47).
- (e) It is appropriate to examine market definition for consumer credit through store cards principally by considering changes in APR (paragraphs 6.49 to 6.88 and in particular paragraph 6.89).
- (f) Taking into account all the evidence on whether consumer credit through store cards is provided in a wider market, including credit cards (see paragraphs 6.100 to 6.169), we concluded that credit cards did not provide competitive constraints on store card APRs sufficient for us to consider them to be in the same market (paragraphs 6.165 to 6.169 and in particular 6.170).
- (g) Some retailers are concerned with the relative level of their APR, compared to APRs charged on the store card programmes of rival retailers (paragraph 6.172). On the other hand, this pricing constraint arising from retailers' concern with their brand seemed to us unlikely to act as quickly or effectively as a 'normal' competitive constraint (paragraph 6.174). We therefore did not regard this inter-comparison between retailers as being fully equivalent to competition within a market (paragraphs 6.171 to 6.175 and in particular 6.176).
- (h) Since, however (in relation to (g) above):
 - (i) we regarded this inter-comparison between retailers as being the most significant factor constraining APRs in this industry from rising;
 - (ii) various parties put it to us that we should regard such a constraint as being important for market definition; and
 - (iii) a narrow market, limited to each store card programme did not, in our view, best meet the purpose of market definition as set out in our Guidelines;

we concluded that all 'consumer credit through store cards' could best be regarded as a single product market (paragraphs 6.171 to 177 and in particular paragraph 6.176).

- (i) We regard the relevant geographical market as the UK (paragraph 6.179).
- (j) There was some evidence that retailers were concerned with the relative level of charges for insurance on their store cards. Again, this concern seemed to us unlikely to act as effectively to constrain pricing as would normal competition in a market. Nonetheless, because this concern seemed to us best to explain why charges for insurance were at the level they were, and to provide a framework within which to analyse the effects of market features, we chose to regard the relevant market as being 'insurance purchased in association with the provision and use of store cards' (paragraphs 6.180 to 6.185 and in particular paragraph 6.186).

6.191 We therefore conclude (paragraph 6.187) that the economic markets for our inquiry are the supply of:

- (a) store card credit services to retailers and services, including insurance services, related thereto (store card credit services) in the UK (the 'upstream market'); and
- (b) consumer credit through store cards and insurance purchased in association with the provision and use of those store cards in the UK (the 'downstream market').

6.192 We now turn to our analysis of these markets.

7. Competition for store card credit services to retailers

Introduction

- 7.1 We now turn to address the central question in our terms of reference, namely whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. We have found that the economic market at the upstream level that we need to consider for the purpose of identifying features of the relevant market are store card credit services to retailers and services, including insurance services, related thereto (see paragraphs 6.4 to 6.27).
- 7.2 In our Emerging Thinking document, we identified five matters that we said might amount to ‘features’ of the ‘upstream’ markets.⁹⁷ These were: (1) Market structure; (2) Barriers to entry; (3) Switching costs; (4) Price matching; (5) Insurance services provided by store card credit providers to retailers.
- 7.3 As we noted in that document, price matching and insurance issues are equally matters of concern at the downstream level (that is, the market for consumer credit through store cards and insurance purchased in association with the provision and use of those store cards). We have therefore taken the view that these issues are best addressed in the context of the downstream market in Section 8. In the remainder of Section 7, we examine competition to provide store card services to retailers at the upstream level, including the other matters raised in paragraph 7.2.

General views of the parties

- 7.4 There was broad consensus among the parties the CC consulted that the ‘upstream market’ was competitive. Style, for example, in responding to the Emerging Thinking document, told us that in its view all the evidence pointed to a highly competitive market, in which GECF was losing substantial market share, store card contracts were being competed for—including those not involving SBCCs—switching was common and new store card programmes were likely over the next few years. Barclaycard⁹⁸ wrote that ‘to the extent that in the past there may have been some constraints on entry and growth, these are not characteristic of the store card sector today, and the upstream market identified by the CC is highly competitive’, as evidenced by new entry and better terms for retailers. Among retailers, too, there was little dissent from the view that the upstream market had become more contestable. In Arcadia’s view, ‘there are a number of credible suppliers and alternative products available in the market, providing effective competition ... switching will occur despite the costs involved’ if the financial terms and quality of service a provider offered were favourable. Selfridges believed that ‘competition for the provision of store card services is strong’. Another retailer [X] told us there were now a significant number of large players in the market and that it anticipated that a greater number of credit providers may now be able to offer the full range marketing, support and other services than when it last tendered its store card. Two retailers [X] commented that the original store card market had changed dramatically over the years, strengthening the negotiating position of retailers.
- 7.5 However, some credit providers and retailers expressed certain anxieties over the issue of the transfer of data from an incumbent provider to a prospective successor,

⁹⁷CC store cards web page: Emerging Thinking, paragraphs 5(a) to 5(e).

⁹⁸Throughout this report, references to Barclaycard are deemed to include Clydesdale Financial Services (CFS). However, when the text concerns CFS specifically, the term ‘Barclaycard (CFS)’ is employed.

among them [REDACTED]. We discuss these concerns in the context of ease of switching of store card contracts, in paragraphs 7.39 to 7.53.

- 7.6 We now consider in more detail the nature and extent of competition at the upstream level, drawing further on evidence received from the parties. We discuss in turn barriers to, and the costs of, entry; the ease and costs of switching (by retailers from one provider to another); and the balance of power as between store card credit providers and retailers. We first summarize the broad picture on entry.

Entry

- 7.7 Appendix 7.1 provides a brief history of market entry by store card credit providers. Although, as we have noted in Section 3, the sector is undergoing change, and some large portfolios changed hands in 2003 and 2004, the provision of store card credit services to retailers is still highly concentrated, with the four largest providers accounting for more than 90 per cent of the sector and the largest market share [REDACTED] being still significantly greater (on any measure) than any of the others (see Table 3.3 following paragraph 3.37 in Section 3). (Indeed, the transfer to HSBC of JLP's and Marks & Spencer's portfolios has increased concentration since 2003.) And although contracts are mostly won following a tendering process, they typically last between five and ten years, and this has made market shares relatively static over time.
- 7.8 However, contracts for store card services are now increasingly put out to tender. Through the tendering process, incumbent credit providers can lose (and in some cases have lost) sizeable store card contracts to competitors, and this may indicate that market share does not necessarily reflect the ability to exercise market power. Retailers can choose whom they invite to bid for a contract, and we were told that the largest incumbent store card credit provider [REDACTED] was not invited to tender for two large recent contracts, [REDACTED]. The pattern of largely stable market shares over time may not, therefore, necessarily hold true in the future.
- 7.9 Since contracts are now usually awarded through a bidding process, we consider as 'entrants' not only those suppliers who have successfully entered the market and supplied store card services, but also those who participated in a tender and were unsuccessful. In this context, following the move by some large retailers to issue (or consider issuing) SBCCs, specialist credit card companies and banks have begun to compete for store card businesses for the first time. Barclaycard recently won the contract for providing store card services for House of Fraser from 2007; this agreement would also allow the introduction of an SBCC. MBNA, for example, told us that it had participated in some tenders for store card business, although it currently operated only as a pure credit cards issuer. Citi Cards told us that it was continuously evaluating the store card sector and would move from the credit card business into other possible markets and products as opportunities arose. Citi Cards said that it would be interested in bidding for a self-standing store card programme, provided it was of sufficient scale (which it said was probably in the potential order of 100,000 accounts, if that was part of a broader portfolio programme and depending upon expected account activity). Capital One told us that it was not really interested in the store card on its own but only in conjunction with an SBCC. However, it said that it had the capacity to develop a store card business, as it was already running a cashback rewards programme. Between them, these companies tendered for six substantial contracts over the period since 1999 [REDACTED]. None of the 'monoline' credit card companies has yet won a store card contract. Nevertheless, their declared intention to participate in tenders for contracts that could include a store card element shows that the threat of successful entry by new providers is always present and thereby increases the competitive pressure on the existing store card providers.

7.10 In the Emerging Thinking document we expressed some concern that:

The preference of some potential entrants to tender only for contracts that offer them the opportunity to provide both store cards and SBCCs (as opposed to store cards alone) may reduce competition with respect to tenders which concern store cards alone, and reinforce ... incumbency advantages.⁹⁹

We have noted above (see paragraphs 6.20 and 6.21) that some retailers think that a bidder gains some advantage from having a track record in store cards. However, as also noted (see paragraphs 6.22 and 7.9), this does not imply an entry barrier, and in practice, companies without direct experience of providing store cards are proving to be highly credible potential entrants to the market.

7.11 As already noted (see Section 3), the store card sector is mature and most major retailers already have store cards. We note in this context HSBC's comment that it had been looking for a route to enter the sector in a major way for a long time (it has run a small store card operation for Harvey Nichols for many years) and the opportunity to do so arose with JLP's decision to contract out its store card programme in 2003. HSBC told us that, in its view, although economies of scale are achieved by a bigger portfolio, it was not necessary to supply a number of major retailers with large customer bases in order to become a credible player in the store card sector. With only a handful of in-store programmes now remaining (and only one such store card portfolio, that of Argos, being of any size) and the probability that any new retailer starting a store card programme will be small, it seems likely that new entrants must from now on rely predominantly on retailers switching to other credit providers, if they are to gain a foothold and then increase their market share.

7.12 Nevertheless, new programmes are still being created. According to the evidence submitted to us, 23 new store card and budget card programmes have been launched in the five years from 1999 to 2004. Of these, four are run by GEFCF, ten are managed by Style, four by Creation, two by Lloyds TSB, two by Barclaycard (CFS)¹⁰⁰ and one by Argos. Another provider [redacted] commented that it had identified further potential store card opportunities, which cumulatively could represent a substantial sales turnover. Barclaycard believed the scope for new entry and expansion will continue to exist and that new opportunities for store card business will arise. The company observed that some retailers seemed to have realized that they could leverage the value of their retail brand also to market financial services generally; it was in discussion with more than a dozen retailers about providing a range of consumer lending propositions (see Appendix 7.2).

7.13 We now turn from a general survey of the situation with regard to market entry to consider whether or not certain factors could operate as barriers to entry, specifically: regulatory requirements; the issue of sunk costs and scale economies; contract lengths and other contract features; and the level of competition for contracts with smaller retailers.

Regulatory requirements for setting up as a store card credit provider

7.14 No party maintained that the regulatory requirements were unduly onerous or constituted a barrier to entry. 'Licensing' (to manage a consumer credit business), Style told us, 'is not a significant regulatory barrier'. As explained in paragraphs 4.1 to

⁹⁹CC store cards web page: Emerging Thinking, paragraph 5(b)

¹⁰⁰See Footnote 98 in this section.

4.4, store cards are regulated as consumer credit products. Part III of the CCA requires most businesses that offer goods or services on credit, or lend money, to be licensed by the OFT. Of 16,418 consumer credit licence applications received by the OFT in 2004, only 35 were refused, and the total number of licences at present is around 157,800. (It is not at present possible to break these overall figures down into different business categories.) Retailers offering store cards or credit cards to consumers, as well as the lending institutions providing them, need to be licensed (although this is not the case for retailers which merely accept credit cards as payment for goods and services).

- 7.15 In practice, it is likely to be necessary for a store card provider to apply for a deposit-taking licence from the FSA if it wishes to introduce SBCCs. The FSA told us that credit card lenders do not strictly need to do so (see paragraph 4.4). But a provider told us that at least one of the international payments networks stipulates that participating financial institutions must be under regulation, ie authorized by the FSA and complying with the FSA's rules applying to deposit takers. One factor may be that if credit cardholders were to overpay, the lending institutions may be considered to be taking deposits.

Sunk costs

- 7.16 We considered whether a new entrant needed to incur significant, irrecoverable, set-up costs. We considered operational and infrastructure costs (which are only incurred if and when a tender is won), tendering costs (which are only irrecoverable if a tender is lost) and the need for a provider to demonstrate a strong reputation.
- 7.17 Credit card providers seeking to enter the market will already have much of the necessary infrastructure (such as IT and call centres) and expertise (particularly risk management) already in place, although we understood that some investment would be required to connect to retailers' point of sale equipment and develop the necessary capabilities in relation to the loyalty aspects of store card programmes (one provider also suggested it would be necessary to develop field sales and credit-scoring capabilities). MBNA told us that the operation of a store card programme would require additional investment. Although it had a credit card platform, it was not currently involved in merchant acceptance and therefore had no connectivity to the retail point of sale equipment and would need to develop this. Capital One said that, so as to provide SBCCs, it would have to develop improved capabilities to handle the loyalty elements of these programmes; it could either upgrade its own systems or outsource to one of the networks such as Mastercard.
- 7.18 Store card credit providers told us that new entrants would be able to outsource most of the functions needed to run a store card programme and that there were a number of companies from which to choose for particular services. Activities capable of being outsourced appear to fall into four main areas: analytic services (for credit and fraud risk); customer information (the maintenance, provision and analysis of databases and the provision of CRM and data management software); customer contact (including call centres and statements); and plastic card production. Experian, the largest provider of information and customer relationship management, confirmed it could provide about 50 per cent of the functions of a store card provider. These activities—along with more generic activities which can also be outsourced, such as IT or legal services—encompass most of the core functions of a store card provider (see Appendix 7.3).
- 7.19 As discussed in paragraphs 6.19 to 6.21, providers looking to offer store card credit services to retailers also need to satisfy these retailers that they have the appropriate skills and reputation. While not necessarily acting as a barrier to entry, lack of

reputation will inevitably place a first-time bidder for a store card contract at an initial disadvantage. However, as noted in paragraphs 6.22 and 7.09, new entrants can, and have, overcome this barrier either by acquiring an existing provider or offering particularly attractive terms to a retailer. Moreover, some credit providers [redacted] commented that retailers were increasingly inviting them to propose a range of credit service options, rather than specifying that they were interested in the provision of store card credit services only.

- 7.20 We also considered the costs that prospective store card providers might incur in the tendering process itself. These costs include legal fees, management time in preparing tender documents and subsequent negotiations (including demonstrating to retailers their credibility as a provider). One provider [redacted], for example, suggested that typical providers' tendering costs could total some £20,000. These costs are, of course, irrecoverable if the provider does not win the contract, but we do not consider them to be significant.
- 7.21 We did not consider that any of the above costs would generally constitute irrecoverable sunk costs. To the extent that a provider has invested in the market, some at least of its costs may be recoverable should a provider choose to withdraw (except in exceptional circumstances, such as the failure of a retailer, for example, Alders), since portfolios of existing card programmes have tended to attract a premium when transferred to another provider. This is evidenced by an active market in recent years for store card programmes and in particular the transfer of the JLP and Marks & Spencer portfolios to HSBC.
- 7.22 In summary, we consider that there are no substantial sunk costs constituting a barrier to entry in the market for provision of store card credit services.

Economies of scale

- 7.23 We considered whether there were any fixed costs in this industry that might result in lower costs for larger providers. Most providers suggested that there were some fixed costs (at least in the short to medium term) in relation to infrastructure (IT, buildings) and personnel (call centre staff etc). One in-house provider [redacted] said that call handling costs fell with volume. Providers generally felt that there were economies of scale in the industry in that IT platforms and other infrastructure could be shared over several retailer programmes. In addition we thought it likely that variable costs such as those related to credit checks would be likely to fall as volume increased (as Ikano confirmed, see paragraph 7.25 below).
- 7.24 We examined each provider's operating costs in comparison to its average number of active accounts over a five-year period. Providers with less than 500,000 active accounts appeared to have significantly higher costs per active account than those with more active accounts. There was evidence that where providers had lost contracts, operating costs did not reduce in proportion to revenues, at least in the short term (one year).
- 7.25 GECF, with significantly more than 500,000 accounts, agreed that possible reasons for its apparent cost advantage would include scope economies such as the ability to share its UK platform over several programmes. It recognized that it was able to obtain key elements of its infrastructure at advantageous rates; [redacted].¹⁰¹ Argos

¹⁰¹GECF emphasized scope economies as possibly helping to explain the company's apparent cost advantage in its Response to the Emerging Thinking (see: CC store cards web page/Evidence/Responses to Emerging Thinking/GECF). Other efficiency reasons cited by GECF were its outsourcing to centres of excellence and 'learning by doing' through the constant revision of its processes on the basis of lessons drawn from its world-wide operations.

considered that there were economies of scale in the store cards business because there were fixed costs that any provider would have to incur irrespective of the number of accounts it had. This was likely to mean that a larger provider would have lower operating costs, in particular in relation to handling incoming and outgoing calls. We heard a similar view from another provider [X]: once a provider had a platform, it would want to add further programmes, which would enable the fixed costs to be spread across more cards. It said that the ability to transfer the [X] store card programme on to the platform used by [X] (and perhaps [X]) would change the cost dynamics. The provider [X] told us that, under these circumstances, it would consider small programmes with the potential to generate as few as 5,000 active accounts over time. Creation said it would not be surprised to learn that volume implied fixed costs that could be spread and therefore lower operating costs per account. Ikano said that its bottom line would be expected to improve as each new portfolio was added because the fixed infrastructure costs would be supported by a wider base. The addition of new portfolios could be managed with limited increases in fixed costs. Ikano also noted that some variable costs such as credit vetting were priced according to volume.

- 7.26 Our general conclusion is that, once a provider has established a store card platform, including an IT system and an associated call centre, and has developed a credit and risk management capability, it is relatively easy to expand this for use in further contracts. However, it would not be worth installing such systems without an expectation of winning a contract (or a sufficient number of small contracts) large enough to justify an in-house platform. This suggests that new entrants might find it costly to enter on a small scale and then seek to expand.

Contract length and other features of contracts

- 7.27 As there are now relatively few retailers launching new store card programmes, or outsourcing in-house ones, entrants must rely mainly upon winning contracts from retailers with existing programmes. Contract length can vary from three to ten years and some key contracts have recently been renegotiated or renewed; a potential new entrant could in principle find this a barrier to building quickly a significant client base. Moreover, exclusivity clauses in many contracts with providers preclude a retailer from signing a contract with another provider to provide store card services, and sometimes related services, alongside the existing contract provider (see Appendix 7.4).
- 7.28 We considered whether contract length and other features of store card contracts might act to some extent as barriers to entry. At the outset of our inquiry, HSBC told us that many contracts between GECF and its retailers appeared to be for an initial ten-year term, or in one case 15 years, which seemed unjustifiably long, even given the need to recover their initial investment. Long contracts meant, HSBC said, that fewer opportunities would arise in any given period for other finance providers to establish a significant presence, and therefore obtain the credibility to be a realistic alternative to GECF; and the greater would be the reluctance of retailers to switch, once inertia had set in. HSBC subsequently noted, however, that the situation relating to formerly immutable long-term contracts had started to change (for example, with Alders and House of Fraser switching providers). HSBC thought that five to seven years was a sufficient period in which store card credit providers should be able to generate an economic return. During the period of the Inquiry, the provider entered into seven- and ten-year contracts, with two of the largest store card programmes.
- 7.29 Providers told us that a new programme would need to be running for some years before it reached an annual break-even point. One provider, for example,

suggested that three years was typical for its programmes, while evidence from others suggested that different programmes broke even at different stages after start-up. In any event, a new programme would be likely to be loss-making in its initial years, because:

- (a) account opening costs (for example, promotional costs, credit vetting procedures, welcome pack and plastic card production) are higher, as new accounts make up a substantial proportion of the portfolio;
- (b) a new programme generates lower interest and insurance income, as average balances are below the level of a mature portfolio;
- (c) the high initial incidence of 'hit and run' customers contributes to a relatively low proportion of active accounts;
- (d) there are diseconomies of scale, as any fixed costs of the programme are shared over fewer accounts;
- (e) bad debt costs are initially likely to be high, as credit-scoring procedures will not have been fully tailored to the customer base; and
- (f) there may be amortization of up-front premium costs.

7.30 Cumulative accounting profitability may not be achieved for a given programme for five or more years, and a provider might sustain economic losses on a programme for even longer (Appendix 8.9 provides a further discussion of life cycle profitability). Against this background, contracts of five years or more might be justified by the need to recover initial costs before generating a return (a contract would also need to be longer if the initial provider is unable, at the end of the contract, to recover its investment by obtaining a premium on the book value of the accounts). The offer of longer-term contracts may even encourage new entry by providing a greater incentive to new entrants than would be the case if the contract was only for one or two years.¹⁰²

7.31 The move to more flexible contract arrangements noted by HSBC (see paragraph 7.28) is borne out by the CC's analysis (see Appendix 7.5). While we estimate that around 30 contracts are due to reach their termination date by 2010 (with the length of the notice period to be given varying between six months and two years) one retailer [X] has been able to negotiate a switch in provider in advance of the notice period, with no change to termination date, and three others [X] have renegotiated the terms of existing contracts—developments which attest to the increased strength retailers are able to wield in negotiations with store card providers. We received no evidence that providers are able to force long-term contracts on retailers. Nor did the evidence persuade us that major providers had acted pre-emptively to take major retailers out of the market through agreeing long-term contracts with them.

7.32 In many cases, it is the retailer who specifies the contract length—and some major retailers have specified as long as seven years. Apart from the provider's and retailer's mutual interest, either directly or indirectly, in profits, retailers have pointed to a number of advantages in longer contracts, including the avoidance of the disruption and risks associated with switching contracts too often, and the value of long-term certainty or assurance of supply.

¹⁰²[X]. This suggests a start-up cost of around £25 per account. A credit card company [X] said that it would be unlikely to be able to justify the up-front investment on a store-branded credit card if it would generate fewer than 50,000 to 100,000 accounts per year. A store card provider told us that set-up and conversion costs for a provider could be about £4 million.

- 7.33 The difficulties a potential entrant might encounter in securing information about a potential contract from an incumbent provider are dealt with below, as a factor in the switching of providers—paragraphs 7.39 to 7.47. As one provider [redacted] noted, these barriers to switching do not constitute barriers to entry because they do not apply to all retailer contracts—for example, in relation to the outsourcing of in-house contracts—and the barriers apply as much to providers who already have retailer contracts as to those who do not.

Smaller retailers

- 7.34 In our Emerging Thinking document, we expressed concern that there may be less choice of store card credit provider for smaller retailers. In general the evidence we received did not bear this out. The providers told us that store card contracts with ‘small’ retailers were strongly contested whenever tenders were issued. Many of the smaller retailers, with annual sales of some £100 million or less, benefit from participation in one of the network schemes: Duet, issued by Creation Financial Services; Style issued by Style Financial Services; and, prospectively, the new Edge card issued by GECF. This potentially gave participating retailers some access to all the consumers in the network (for example, for retailers in the Duet network, through the Duet magazine). One provider [redacted] said that there were unlikely to be occasions when it would refuse to bid for a tender; the minimum size of economic business for its operations was extremely low—of the order of £750,000 to £1 million of sales a year.
- 7.35 Some small retailers may not seem attractive partners for store card providers because customers have only limited disposable income and average transaction value is low. However, there are store card providers catering for such retailers. [redacted]
- 7.36 There are inevitably extra direct costs in running programmes for a large number of smaller retailers. One provider [redacted], for example, had to execute some 70 to 80 different marketing campaigns each month for its different retail clients and products. On the other hand, each client retailer makes some general reduction in the provider’s overheads (see paragraph 7.23). We have already noted the views of [redacted] that it would consider smaller accounts as making a valuable marginal contribution to its store card business.
- 7.37 In the providers’ view, the ability of smaller retailers to secure favourable terms in store card contracts reflected a dramatic improvement over the past few years in retailer negotiating power. They were helped in this by having access to the professional advice that has become increasingly available to retailers in this segment of credit provision. (We discuss the generally improved terms secured by retailers over recent years in paragraphs 7.54 to 7.63.)

Market entry: conclusion

- 7.38 We have found that the various possible barriers to entry into the store card market discussed above do not in practice stand in the way of financial institutions with a credible reputation. Licensing is not a significant regulatory barrier. Most potential entrants would possess the necessary technological and infrastructural capacity. Moreover, many functions can be outsourced. Tendering costs are relatively modest. Once a provider has established a store card platform, it is relatively easy to expand this for use in further contracts and to achieve economies of scale. We do not think that contract length operates as a barrier to entry to this market. Contracts for both large and small store card contracts are strongly contested. We have therefore concluded that market entry is not a cause of concern.

Switching and switching costs

Ease of switching

- 7.39 Appendix 7.6 (data on switching) sets out evidence suggesting that there is a significant amount of switching in the market for store card credit provision. Switching has occurred through retailers seeking a better deal from a new provider. This suggests that switching costs are not a significant barrier to entry.
- 7.40 We were also told, however, that limitations placed by credit providers on the information made available to retailers at the tender stage could make switching more difficult because it meant that potential competitors were at a disadvantage relative to the incumbent provider. In particular, a lack of data, to which the retailer concerned would not have access, on such areas as the current loan book value (or information from which this could be derived), the number of active accounts, the average size of outstanding balances, average transaction value, average spend per account, total number of accounts, the revolve rate, default rates, bad debt rate and other such variables were said to make it difficult for bidders accurately to price the tender and hence offer the most effective competition to the incumbent provider. One provider [redacted] maintained that a bidding provider's lack of access to such valuable information sometimes made it difficult to compete for an existing contract without incurring significant financial risk. It said that it had identified eight such key information categories and in each of five recent tenders had not received data on between three and five categories. HSBC believed that such information asymmetries may prevail in competition for existing contracts nearing the end of their initial term. (HSBC noted that its contracts with JLP and Marks & Spencer included clauses to ensure such barriers would not arise.) Another provider [redacted] argued that there were inconsistencies in how much information was disclosed when tendering against an incumbent provider; it would welcome a 'level playing field'.
- 7.41 So far as retailers were concerned, we heard concern expressed that barriers to switching persisted in relation to data transfer. Arcadia, for example, in its response to our Emerging Thinking document, suggested that any remedies in this case should be directed to improving transparency, and improving the ability of retailers to carry out tenders in the future and therefore switch between providers. Another retailer [redacted] told us that there was currently a disincentive for providers to co-operate on switching, given that they could otherwise rely on informational asymmetries to tie in the retailer to contracting with that provider; moreover, the inability of the retailer to provide a proposed provider with relevant information regarding its current store card services left the retailer in a poor negotiating position with other providers. Other retailers were uncertain about the amount of data their provider would be ready to share with them. One [redacted] said that retailers contracting with a new credit provider and without the resources to obtain specialist support, might find switching difficult. Its current provider [redacted] was not contractually bound to transfer the credit facilities or to hand over data concerning, for example, purchase patterns, cardholder preferences or other customer spend data over the past decade. This uncertainty was an inhibition on switching and would add time and costs not quantifiable in advance; it might also allow the incumbent to charge a high premium on the value of the data to be transferred.
- 7.42 GECF did not consider that there was a problem here. It maintained that there would always be ample information available at the time of the bidding process for a credible player to make a credible bid. Such providers would not be disadvantaged if they did not know the specific variables listed above, such as revolve rates, average balances and receivables. They would be able to assess what was achievable with the programme, on the basis of raw material such as the demographics of customers

using the stores, the number of stores, anticipated footfall, the sort of credit products the customers would typically take, the associated risk profile, and so forth. These assumptions would be fed into the models that each provider employed for its operations. GECF said that providers would be able to put a response to tender based on their assumptions and modelling techniques. If the provider was concerned about a particular assumption, the bid would be explicitly conditional on that assumption; if it subsequently needed modification, the structure of the offer would be amended accordingly.

- 7.43 We accept that incumbents may be in a stronger position as regards data about, and experience of, a contested store card programme than those tendering to win it from the incumbent. However, we do not think that this informational imbalance represents a significant barrier to the potential new entrant. Much relevant data, on which to base a reasonably appropriate bid, can be gleaned from the retailer's knowledge about the demographics, shopping habits and other characteristics of its customer base. Any bidding provider is likely to have to put forward a business case that is to a greater or lesser extent conditional on a variety of matters, including the retailer's own requirements. The bidder has the option to make a provisional bid or to take the financial risk inherent in a firm offer. Many broad assumptions, for example on general economic developments, have to be made in bidding for a long-term contract, and even perfect current information will not ensure that a negotiated contract will remain favourable in the future; conversely a contract which is not initially favourable to the provider can become so over time. In view of all the factors involved in bidding for a contract, we are therefore satisfied that imperfect data does not constitute a serious barrier to switching.
- 7.44 A related issue is the possible disruption to customer services if the incumbent is not ready to cooperate with a new provider. One provider [redacted] discovered that this could be a prevailing barrier in the case of existing contracts nearing the end of their initial terms. Some retailers agreed [redacted]. One of these retailers [redacted] said that there was the risk of serious disruption to its customer relations if information was not properly exchanged between providers. All these retailers argued that the transfer of receivables from an incumbent provider to a new provider could be problematic because it meant that the retailer was operating two store card businesses, in effect, until it managed successfully to convert all store cardholders to the new provider. This was usually due to the inability of the incumbent provider and new provider to reach agreement over the terms of the transfer when these terms were not covered in the exiting provider's contract. This process can be protracted—we were told of cases which took up to two years to finalize. Lack of cooperation between providers could lead to customers having to re-apply for their cards, and this could be damaging to the retailer's brand image. It could, however, be argued, as one company maintained [redacted], that providers terminating their services would see it as in their interests to work with their successor, as they would hope to be reappointed at a later date.
- 7.45 Retailers have now begun to include in their contracts with credit providers provisions covering the transfer of portfolios and ownership of and access to accounts data, in order to make switching easier in future tenders. It seems likely that such terms will go some way to overcoming the sorts of problems experienced in this area in the past. Moreover, as we discuss below (see paragraphs 7.54 to 7.63), retailers have now begun to acquire more buyer power in relation to their credit provider, assisted in some cases by external advice from retail consultants, and we are satisfied that this will lead to more satisfactory arrangements in respect of such matters as the transfer of portfolios in future.

- 7.46 The incompatibility of IT systems may have acted as a barrier to switching in the past, but is no longer a serious obstacle. As Creation stated in its initial submission: 'IT systems are more compatible with one another than was previously the case, which makes data transfer and systems set-up less difficult than it used to be'. However, at least one retailer [redacted] had ruled out one prospective provider on the grounds of the IT system it operated.
- 7.47 Upfront payments are increasingly being paid, under contractual arrangements, by providers to retailers, as PricewaterhouseCoopers (PwC), among others, told us. Two providers [redacted] argued that this practice presented a significant barrier to switching—in one case because of the limited financial resources of the company, in the second because it would unacceptably depress commercial returns. We recognize that upfront payments introduce a new element of risk for a provider. But in our view, their increasing incidence reflects the increase in competition in the upstream market and, in particular, the enhanced negotiating strength of retailers. Upfront payments constitute just one of a number of elements featuring in negotiations between providers and retailers and both sides will be seeking to strike a balance of advantages taking all the elements into account. One retailer, for example, negotiated a substantial up-front payment but this represented purely an advance payment of commission charges due otherwise for settlement during the course of the contract (see Appendix 7.7).

Costs of switching

- 7.48 In general, switching costs may be divided into two categories: first, there are costs associated just with carrying out a tender: most contracts can be rolled over after their initial term and hence tendering costs may be avoided if the retailer and its existing provider continue the existing contract; second, there are costs associated with actually switching provider. We consider each of these in turn.

Carrying out a tender

- 7.49 Retailers' costs at the tendering stage are mainly accounted for by management time, legal fees and the cost of any external advisers. Although most retailers were unable accurately to estimate their costs of switching, a number did provide estimates. These estimates varied from £5,000 for a small informal tender to around £550,000 for a large formal tender (typical tendering costs for a provider, in contrast, have been said to be around £20,000; see paragraph 7.20). In general the cost of tendering seems to be loosely related to the size of the retailer, with larger retailers investing more in the tender. Nearly all retailers from whom we obtained information had carried out a formal or informal tender of some kind (see Appendix 7.8). The evidence we received indicated that tendering costs did not represent a significant deterrent to switching provider.

Switching provider

- 7.50 Most of the specific costs of switching provider are related to negotiating the deal and transferring the accounts. The direct costs of the transfer of the store card business from one provider to another are mainly to do with updating IT software, data transfer and reissuing of cards, and contacting account holders, and are usually borne by the provider.
- 7.51 For retailers, there are two other considerations that may be more powerful inhibitors to switching than the upfront monetary costs involved. These are the risk of losing customers in the course of switching, and the risk of damage to their reputation if the

move to a new provider is not carried through smoothly. Moving store cardholders to another provider, particularly in circumstances where a new card is issued or where cardholders are invited to sign up to the new card, may risk loss of customers. So far as risk to the brand is concerned, retailers might be deterred from attempting any move to a new provider because of potential damage to their reputation should the transfer not run smoothly (see also paragraph 7.44).

- 7.52 Some parties initially drew our attention to the legal requirements relating to the variation of regulated credit agreements, as well as to data protection as factors to be considered in switching store card providers. We looked into this (see Appendix 7.9). Questions we considered included whether or not each customer is required to sign a new credit agreement with a new provider, whether or not customers need to be notified of the transfer of their contract to a third party, and whether or not there are any constraints imposed by the Data Protection Act or the CCA. Overall, although practices differ in some respects between providers, the legal requirements imposed do not appear in practice to inhibit switching.

Switching: conclusion

- 7.53 Our Emerging Thinking document had suggested that information asymmetries and uncertainties associated with the transfer of the portfolio of receivable from one card supplier to another might deter some retailers from switching between credit providers when their contracts come to an end. Some providers and retailers assert this remains the case. We accept that some incumbents may be in a stronger position as regards data about, and experience of, a contested store card programme than those tendering to win it from the incumbent. But we consider that the retailer should be able to provide a good deal of relevant information, and there are so many factors and assumptions involved in bidding for a contract that we are satisfied that imperfect data does not constitute a serious barrier to switching. And the high incidence of switching suggests that this barrier is not insurmountable.¹⁰³ The problem is, in any event, a diminishing one as it becomes the norm to include clauses in contracts dealing with the ownership and transfer of data and providing for the smooth transfer of portfolios at the termination of the agreement (see paragraph 7.45). Tendering costs do not constitute a significant deterrent to switching provider, and there are no serious legal or technical barriers. There remains some question about the degree of cooperation an incoming provider can expect from its predecessor, with consequent concerns about the continued smooth operation of the programme and possible effect on the retailer's brand image, but we received no conclusive evidence that this was a problem in practice. The growing incidence of up-front payments by providers to retailers introduces a new element of risk for the former but is, in our view, an indicator of the increased competition in the upstream market. Overall, we do not believe that the costs and risks identified represent significant deterrents to switching provider.

Benefits to retailers

- 7.54 In their evidence, the store card providers emphasized that the negotiating position of retailers had strengthened markedly over the past five years or so. 'Retailers, aware of the competitiveness of the market and well advised professionally, are exploiting this to their benefit' (GECF). 'Both large and small retailers have been able to secure increasingly favourable terms from store card credit providers' (Barclaycard). 'Retailers, as sophisticated and savvy purchasers of services, have exerted buyer

¹⁰³See Section 3. [↩]

power' (Creation). And, as mentioned above (see paragraph 7.4) some retailers have acknowledged this shift in the balance of negotiating power.

- 7.55 The final area that we therefore consider, as providing evidence on the competitiveness of the provision of store card credit services to retailers, concerns the shares of the profits that retailers have been able to secure from the contract between themselves and store card credit providers.

Retailers' store card profitability

- 7.56 Retailers do not regard their store card operations as a separate profit centre, but as part of their marketing programme. In their evidence to the CC, retailers generally said they were more interested in improving brand loyalty and building customer relationships through the possession and use of the store card than in generating income from the card. At least two retailers [redacted] nonetheless acknowledged that sales made on store cards accounted for a significant proportion of total sales and in some cases that the average store card transaction value was relatively high, and some [redacted] thought that the direct impact on sales of a store card programme was likely to be positive. However, almost all said they would be unable to estimate the profitability of their store card operations because, while the costs of discounts, loyalty benefits and other expenditure could be measured, there was no established methodology by which to calculate any offsetting incremental sales generated as a result of a store card programme.¹⁰⁴
- 7.57 Only one retailer [redacted] attempted to estimate the level of incremental sales as part of an assessment of the profitability of its store card. It calculated that, over a three-year period from 2001/02 to 2003/04, and taking into account the costs of loyalty benefits and estimated incremental sales, it had made a substantial loss in the first year and low profits in the following two years. The retailer maintained that traders spending relatively more on discounts, events, loyalty privileges, communications and other benefits would have higher costs and so be less profitable than those with lower levels of such expenditure. We did not accept that this would necessarily be the case. Since the evidence from almost all the retailers indicated that extra sales flowed from a store card programme and suggested that the net impact on sales income was at worst marginal, we believe that retailers spending relatively more on the loyalty features of a programme could be expected to generate additional sales so as to cover or exceed the costs of the loyalty elements.
- 7.58 In any event, the main issue in the financial relationship between retailers and store card providers relates to the direct payments passing between them. In this area, it is clear there has been a distinct shift in the balance of payments from providers to retailers, a matter to which we now turn.

Direct payments

- 7.59 The payments to retailers take the following forms:
- (a) *Profit share*: This is calculated in accordance with specified provisions in each contract, often after allowing the provider a minimum return on equity, and might be paid in advance or in arrears depending on the contractual arrangement with the retailer. Advance profit share payments are normally recouped over the life of the agreement.

¹⁰⁴[redacted]

- (b) *Commission*: This is calculated as a percentage of total card sales, or as a flat fee per new account opened, or both.
- (c) *Marketing support payments*: Typically the provider and retailer agree to spend a certain percentage of card sales on marketing of the store card programme. Where these expenses are borne by the retailer, they may be reimbursed by the provider, under the terms of the contract between them. These expenses may include staff incentives for opening accounts, staff training, customer mailings and point of sale promotional material. They do not include the costs of retail discounts or loyalty points, which are borne by the retailer.
- (d) *Non-reimbursable 'access' or 'conversion' payments*: These are made at the start of a new or renewed contract. These payments were not widespread. Unlike advance profit share payments, which might be repayable under certain circumstances, these payments are not reimbursable.
- (e) *Other payments*. These include reimbursements for retailers' costs incurred in the provision of specific in-store cardholder facilities, for example account opening bureaus.

7.60 Payments to retailers increased between 1999 and 2004 for the four main providers for which such payments were relevant. This is illustrated in Appendix 7.10. The level of payments to retailers reached a peak in 2003, and reduced somewhat in 2004. We noted that the payments in any particular year could be distorted by one-off contractual arrangements.

7.61 We considered a number of recent store card tenders (see Appendix 7.7) to identify those areas in which the retailer had sought improvements, and to establish how and whether those improvements were realized in the new contract. In the cases we examined, the retailers' primary objective appears to have been to reinvigorate the store card programme as a marketing tool and increase its potential to drive customer loyalty and brand awareness. Retailers perceive new contracts as having addressed this issue by aligning their interests with those of credit providers more closely. Profit-sharing arrangements are one result of this trend; as are more collaborative management or corporate structures akin to contractual joint ventures in some cases. We also noted increased marketing support payments made by providers to retailers in some recent contracts; payments of this nature might be expected to jointly benefit the provider and retailer, as the marketing expenditure increased both card sales and interest-bearing receivables. Retailers with established portfolios are aware that these portfolios are valuable, and in some cases they are assisted by consultants in quantifying this value. As noted above, up-front or advance payments are often sought. It has also been observed that retailers recognize that a reasonable minimum length of contract would prevent the disruption of their main business brought about by frequent retendering and would allow the provider sufficient time to cover its start-up costs and earn a reasonable return. In several cases, new contracts are somewhat shorter than previously, although some retailers sought (and obtained) contract lengths in excess of five years.

7.62 We found that it was common in larger, recently tendered contracts for the store card receivables to be transferred and held in a separate legal entity, in order to facilitate transfer of the portfolio should the retailer wish to switch provider at the end of the contract (see paragraph 7.53). One provider [redacted] commented that this trend demonstrated the retailers' enhanced power to dictate the form of the relationship. The company suggested that, while increasing numbers of retailers were demanding and securing profit-sharing arrangements in their store card contracts, some of the

recent structures created were not 'joint ventures' in the sense of also being equitable risk-sharing arrangements.

Benefits to retailers: conclusion

- 7.63 The matters set out in paragraphs 7.54 to 7.62 suggest a shift in the balance of negotiating power between retailers and providers which has led to an increase in retailers' share of the total returns generated by store cards. This shift has been manifest too in the considerably improved non-price terms retailers have been able to negotiate when contracts have come up for renewal, in particular the inclusion of arrangements to ensure the smooth transfer of portfolios at the end of their contract term.

Findings

- 7.64 We have found that there are no discernible barriers to entry into the market by financial institutions with an established reputation and the requisite in-house or outsourced commercial capacity. Some remaining hurdles for providers aiming to tender for an existing contract on its expiry, relating to informational asymmetries and the hand-over of portfolios, can be surmounted and have been successfully cleared in many cases. A shift in the balance of negotiating power in favour of the retailers has enhanced competition and has resulted in an increase in their share of the total returns generated by store cards. This does not necessarily imply, however, that the additional benefits gained by retailers are being passed on to consumers, for example in the shape of lower prices or more innovation. In the next section we consider these and other questions pertinent to the extent of competition for consumer credit through store cards in the downstream market. We therefore find that the upstream market for the supply of store card credit services to retailers displays no feature which prevents, restricts or distorts competition and we have concluded that that market is competitive.

8. Competition for consumer credit through store cards—the downstream market

Introduction

- 8.1 In Section 7, we concluded that the supply of store card credit services to retailers and services, including insurance services related thereto, was competitive. We now turn to competition in the downstream market. Again, we are required to consider whether any feature, or combination of features, of the relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. In this case, the relevant market is the market for the provision of consumer credit through store cards and insurance purchased in association with the provision and use of those store cards.
- 8.2 As we noted in paragraph 5.1, a ‘feature’ is defined by the Act as the structure of the relevant market or any aspect of that structure, any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned, or any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.
- 8.3 We have found that the economic markets at the downstream level that we need to consider for the purpose of identifying features of the relevant market are: consumer credit through store cards, and insurance purchased in association with the provision and use of those store cards in the UK (see paragraph 6.187). Our analysis is accordingly conducted on that basis.
- 8.4 We have taken into account all the evidence submitted to us during the course of our inquiry and up to very shortly before the publication of our report. So far as accounting and other types of quantitative data are concerned, in the early stages of our investigation we considered data for the period 1999 to 2003. As the inquiry progressed we added relevant data for 2004. Subsequently, we sought from the relevant parties in the inquiry projections for 2005 and 2006. Naturally, from the beginning, we recognized that, given the expected length of the inquiry, there would be changes and developments in the store card market. We have taken these into account in our analysis and interpretation of the data we have received.
- 8.5 The structure of Section 8 is as follows. We begin by considering the three most important revenue streams for store card providers, namely interest income, late payment fees and store card-related insurance, for which there is a (largely) common cost base (paragraphs 8.6 to 8.10). We then examine these income streams in turn, beginning with interest income (paragraphs 8.11 to 8.105), continuing with late payment fees (paragraphs 8.106 to 8.126), and ending with insurance (paragraphs 8.127 to 8.159). In each case, we ask whether prices are subject to competitive pressures and if so, of what kind; and second, whether the outcomes in the market are competitive. We then consider to what extent, if any, the types and amount of information available to cardholders on their monthly statements might be relevant to the competitiveness of the downstream market (paragraphs 8.160 to 8.165). Finally, we consider how cost-reflective APRs might look across store card programmes (paragraphs 8.166 to 8.172). We set out our conclusions on the matters discussed in this section in paragraph 8.173.

The provision of store card services

- 8.6 In Section 3, we described the nature of the transactions between store card credit providers, retailers and store cardholders (see in particular paragraph 3.41) and

compared the respective revenue models for store cards and general credit cards (paragraphs 3.55 to 3.59). Apart from the structural difference between store cards and general credit cards (the three-party—credit provider, retailer, retailer’s customer—structure in the case of store cards and the link with an international payment network in the case of credit cards), and the more limited utility of store cards (use limited to a single retailer or retailer network), other important respects in which store card and credit card programmes differ include the generally higher acceptance rates and significantly lower average account balances for store cards than for general credit cards and SBCCs.

- 8.7 Fundamental to the store card business are three main revenue streams, namely interest income, late payment fees, and card-related insurance income. For some card programmes, there is also other income, including merchant fees from retailers. We also saw in paragraph 3.43 that the store card business has a common cost base supporting these sources of revenue; costs may broadly be grouped into funding and bad debt costs, payments to retailers and operating costs. Figure 3.3 illustrates the main revenue sources and cost elements that contribute to a store card credit provider’s profit. It can be seen that, in addition to the various costs associated with funding the balances, there are various payments made to retailers. These take two main forms: all payments made to reimburse retailers for certain costs specifically associated with the store card programme, including marketing costs; and payments made to retailers by way of profit share.
- 8.8 Our store card and credit card income analysis (see paragraphs 3.55 to 3.59) showed that credit cards are used more widely than store cards and have more spent on them—average balances and average annual purchases per active account are about ten times greater on credit cards than on store cards (see Table 3.4). Store card providers derive a greater proportion of their income from store card-related insurance than credit card providers. On the other hand, credit card providers derive a significant proportion of their total income from interchange fees, a source of income not available to store card providers (see paragraph 3.59 and Table 3.5). It will also be seen from Table 3.5 that the proportion of income derived from late payment fees is similar for both types of card, although credit card providers secure more income than store card providers from fees incurred by cardholders for spending over their credit limit.
- 8.9 Store card credit providers may seek to re-balance the different revenue elements so that revenues are derived to a greater or lesser extent from each of these other revenue streams. The loss of interest income brought about by, for example, a lowered APR, might be offset by one or more of the following: lower acceptance rates (which act to reduce providers’ costs), a more rigorous approach to fees and charges (for example, not waiving late payment fees), reduced retailer commission or other payments to retailers, or a greater emphasis on the cross-selling of other financial products.
- 8.10 Further details of the revenue and costs of store card providers are set out in Appendix 8.1.

APRs

- 8.11 In this first part of Section 8, we consider the following issues:
- (a) **How APRs are set and what competitive constraints operate on the setting of APRs.** In this connection, we discuss:

- (i) the contractual provisions governing the setting of APRs (paragraphs 8.13 to 8.19);
- (ii) inter-retailer APR comparisons (paragraphs 8.20 to 8.24);
- (iii) why most APRs have been clustered around 30 per cent (paragraphs 8.25 to 8.36);
- (iv) recently introduced lower-APR programmes and the ‘tipping point’ (paragraphs 8.37 to 8.45); and
- (v) the lack of pressure on APRs from the upstream market (8.46 and 8.47).

We summarize our findings on the setting of APRs in paragraphs 8.48 to 8.50; and:

(b) Whether store card APRs are above competitive levels. In this connection, after an introductory section (paragraphs 8.51 to 8.55), we discuss:

- (i) credit card APRs compared to store card APRs (paragraphs 8.56 to 8.58);
- (ii) the relationship between APRs and costs (paragraphs 8.59 to 8.65);
- (iii) the profitability of store card credit providers (paragraphs 8.66 to 8.83);
- (iv) the relationship between acceptance rates and APRs (paragraphs 8.84 to 8.90); and
- (v) existing and prospective store card programmes with lower APRs (paragraphs 8.91 to 8.101).

We summarize our findings on whether store card APRs are above competitive levels in paragraph 8.102. Our overall findings on APRs are set out in paragraphs 8.103 and 8.104.

How APRs are set

8.12 Throughout the discussion that follows, we refer to the extent of consumer sensitivity to store card APRs and other charges. We discussed the evidence relating to consumer sensitivity and attitudes in Section 6 (particularly paragraphs 6.93 to 6.152), in connection with our discussion of market definition. That evidence underlies our discussion in this section.

The contractual provisions governing the setting of APRs

8.13 We begin by considering how store card APRs are set and why most have been clustered around the 30 per cent level. It is important to distinguish between the options available to credit providers and retailers under existing contracts and those available to them when negotiating a new contract. We note, in particular, that under existing contracts, for the most part APRs have not changed at all, from month to month or indeed from year to year (see Figure 6.1—Trends in quoted APRs from November 1988 to November 2004)¹⁰⁵. Figure 6.1 shows that credit card APRs have

¹⁰⁵However, see paragraphs 3.62 to 3.69, which describe some very recent changes to APRs, and our discussion of these changes in paragraphs 8.37 to 8.45.

steadily fallen since about 1994, while store card APRs have, until very recently, remained largely unchanged. Changes in APRs, when they occur, seem to take place mainly when contracts are renegotiated (see paragraph 8.16).

- 8.14 As regards existing contracts, at present the most common arrangement is for the provider to have discretion to change the APR, in some cases after consulting the retailer. Thus, most of [X] contracts give the provider 'sole discretion' to set the APR, while most of [X] give it 'absolute discretion' to do so. Most of [X] contracts require the provider to consult with the retailer but some stipulate that the provider should agree the APR with the retailer. Under the two large HSBC contracts (JLP and Marks & Spencer), APRs are set jointly through the Executive Committees which in each case comprise representatives from these retailers. In the case of [X], most contracts state that the provider must consult with the retailer before varying the APR; however, in some cases, [X] has the sole discretion to set the APR. There are very few store card programmes in which the retailer contractually has the unilateral right to determine the APR.
- 8.15 Even under existing contracts in which the provider has the absolute right to set the APR, in reality there is likely to be a negotiation between the parties if the retailer wishes the APR to be reduced. In these circumstances, the provider may wish to try to accommodate a strongly expressed view by a retailer, since the success of the programme and the likelihood of winning a renewal of the programme depend upon a good relationship between them.¹⁰⁶ But the ability of retailers to influence the APR during the term of existing contracts may in practice be limited; and retailers seeking lower APRs would have to be prepared to accept some off-setting reductions in provider support. We were told by one retailer [X] that its bargaining position so far as the APR was concerned was limited and that, although it would have liked to obtain a lower APR for its store card, it had been unable to achieve this under its current contract. Other retailers, [X] and [X], made much the same point to us. [X] told us that it was consulted about the APR on its store card, but thought that, as the provider was the party lending the money to consumers and bearing the cost of bad debt, its provider [X] was best placed to evaluate the price to be charged to cardholders. Long contracts previously entered into by providers and retailers may also have weakened retailers' negotiating position in this respect.
- 8.16 We considered whether retailers would be in a stronger position to influence the APR when re-tendering or re-negotiating a contract, contracting out an in-house programme or establishing an entirely new store card programme.¹⁰⁷ Thus, retailers may specify an APR when tendering, or negotiate over the APR (or the right to set it) in bilateral negotiations. For example, a retailer [X] told us that when re-tendering its existing contract, it had expressly requested in the tender documentation that bidders offer APRs which were lower than currently applied in its existing agreement with [X]. The evidence suggests that while providers have been reluctant in the past to re-negotiate APRs with their retailer customers,¹⁰⁸ the position may be changing as the result of increased competition upstream and greater consciousness by retailers of the image given of their business by APR levels. We note that [X] offered a 'menu' of different APRs and other contract terms to prospective retailers. [X] pointed to demands from retailers including [X] for programmes that provided lower APR alternatives to their customers. [X]. Although both retailers ultimately remained

¹⁰⁶This is, of course, not the only factor—retailers and their staff will need actively to promote the store card if the programme is to succeed.

¹⁰⁷The information retailers possess about providers' ability to run a programme successfully with a given APR is likely to be lower for the last of these, of course.

¹⁰⁸For example, one retailer [X], which has recently agreed a significantly lower store card APR with its provider [X], told us that the high levels of APR to date had been largely the result of its inability to negotiate anything lower in the market place.

with GECCF, each secured lower APRs as a result of exploiting their opportunity to switch to another provider or to enter into a new contract. The evidence therefore suggests that some retailers have been able to re-negotiate the level of their store card APR at the time of re-tendering or renewing their contract. A separate question is whether retailers see it as in their interests to bring about lower store card APRs.

- 8.17 Negotiated changes in the APR would be unlikely to leave other sources of revenue and other contract terms unchanged, as providers will seek to off-set lower income from interest with changes to other aspects of the agreement. Some retailers have told us, for example, that they would not want the APR reduced because, if it were, providers would insist that acceptance rates would have to fall, payments to the retailer would be reduced or other aspects of the contract would have to change—or any combination of these—in ways that were unfavourable to them. Thus, although retailers may propose lower APRs, the provider can respond in a manner that both reduces its own costs and directly reduces card take-up. Similarly, retailers could choose a lower APR and accept corresponding changes in other aspects of the programme: for example, where they pay merchant fees, these could be raised; or they could receive lower up-front payments, allow more cross-selling of insurance and other products to their customers, or tolerate higher and more rigorously applied late payment fees. Or they could take a reduced share of profits. These variations also illustrate the inter-dependent nature of several features of the contracts—the setting of APRs, the acceptance rate, insurance premiums, late payment fees, cross-selling rights and payments to and from retailers.
- 8.18 It is clear that store card providers have a direct interest in APRs being set as high as possible. Indeed, there is evidence to suggest that an increase in many store cards' APRs might be profitable for the store card provider because—as we have shown in Section 6—customer sensitivity to APRs is low. Such sensitivity as there is appears to be higher for increases than for decreases in APRs, and may be higher still if APRs rise above certain thresholds (notably 30 per cent) to which customers have become accustomed (we discuss such thresholds later, in paragraphs 8.31 to 8.36). The expectation that cardholders would continue to take credit on their store card rather than switch away if APRs were increased is supported by evidence from store card contract terms, which often imply that the direct effect of an increase in APRs would most likely be an increase in provider profitability.¹⁰⁹ So far as decreasing, rather than increasing, store card APRs is concerned, at the very least, it seems clear that a decrease in APRs would in most cases reduce provider profitability (in the absence of any compensating changes in other revenue streams),¹¹⁰ giving providers a clear incentive to oppose reductions.
- 8.19 Retailers' objectives in relation to the level of store card APRs are more complex. On the one hand, they benefit from increased direct profitability of the store card programme. This is because, in some cases, contracts explicitly assign a profit share to the retailer. Such contracts provide retailers with a direct interest in higher APRs. In other cases, even retailers without such profit-sharing arrangements may expect to benefit in the longer term from higher store card profitability, as they can capture such profitability in subsequent contract (re)negotiations; so these retailers, too, have an interest in higher APRs. (We note, from the examples of tender documentation that we have seen in connection with a new or re-tendered store card, that when presented by providers with differently structured deals at different APRs, retailers have always chosen the highest APR.) On the other hand, retailers may be

¹⁰⁹We have seen a number of tender documents in which different APR options are presented to a retailer, with lower payments to the retailer at lower APR levels. Thus, an increase in APRs within this range—holding other contract terms such as retailer payments constant—would be expected to increase provider profit.

¹¹⁰From experiments with lower APRs and other event studies (see Section 6).

concerned—some increasingly so in view of adverse publicity about levels of store card APRs shortly before, and during, our investigation—about the adverse effects on their ‘brand’ of their store card being associated with high APRs, and the consequential effects on card take-up and sales. We discuss the nature of this concern in the following paragraphs.

Inter-retailer APR comparisons

- 8.20 Although, as we have just seen, retailers share with store card credit providers a direct interest in keeping APRs high, they are also concerned about the level of their own store card APR compared to that of their competitors’ store cards. Thus, retailers’ concern about their APR appears to relate as much to its level relative to other store cards as to its absolute level. We have already said (paragraphs 6.172 to 6.175) that we do not regard this concern as amounting to competition within a market, because it provides no continuous downward pressure on APRs, but we do consider it to be one of the most significant factors in the setting of APRs, for the reasons set out below; and it was a key consideration in our finding that there is a single product market for the provision of consumer credit through store cards (see paragraph 6.176). We note that no retailer except JLP¹¹¹ told us that it compared its store card APR to credit card APRs.
- 8.21 This concern by retailers about the relative level of their store card APR is made explicit in some contracts, which tie the APR to the APRs on other retailers’ store cards—for example, [redacted] contract with [redacted] makes it a condition that its APR does not exceed that of named competitors. [redacted] contract with [redacted] makes the APR subject to agreement by both parties, based on a ‘basket of store cards’. [redacted] contract with [redacted] provided that this retailer [redacted] might terminate the contract if its APR exceeded that of ‘comparators’ by more than one percentage point.¹¹² Even where it is not explicit in the contract, retailers have told us that they are concerned not to be out of line with their retailer competitors (for example, [redacted] and [redacted]) and so the APR relative to other store cards would presumably feature in discussions between retailers and providers. This gives the retailer a motive to resist increases in the APR when it is already near the level charged by the cards of competing retailers. As already noted (see paragraph 3.62), there is evidence that a few retailers have become more sensitive to adverse press comment concerning the APRs on store cards generally and, presumably considering that their brand could be damaged and sales threatened, have sought to negotiate reductions.
- 8.22 We considered why this concern by retailers about their relative APR levels arises. In principle, it could arise from the benefits flowing from the increased take-up of store cards—in terms of greater spend in their stores—where APRs were somewhat lower (and certainly no higher) than those offered by rival retailers. However, it seemed to be common ground among both providers and retailers that the take-up of store cards is not affected significantly by APRs, but rather by discounts and other benefits. Survey evidence confirms this view (see paragraphs 6.35 to 6.39). Consequently, we think it unlikely that the level of the APR has a significant effect at this take-up stage, and believe that retailers have only weak incentives, if any, to reduce APRs on the grounds that take-up was too low. No retailer told us that it thought its sales would increase if its store card APR were to fall.

¹¹¹JLP told us that it had introduced its store card in the 1960s, in order to provide easily accessible credit to its customers; and that in 1985, it had introduced a more flexible account with a comparatively low rate of interest to compete against credit cards (see JLP evidence on the CC website).

¹¹²[redacted]

8.23 It seems to us that, in general, retailers' motivations in relation to APRs have reflected not so much immediate financial considerations arising out of concern about the take-up, penetration and use of their cards to obtain credit; but, rather, broader and longer-term customer relationship and brand considerations. Thus, one retailer, Arcadia, told us that it could not allow itself to have the highest APR on the high street. ASDA wishes its APR to reflect its general value proposition. We note that there are more recent examples of retailers who have sought a much lower APR than those of their competitors. Thus, New Look told us that, in terms of brand image, it considered that to be able to advertise a store card with an APR that was substantially lower than that of its key competitors would be a selling point, and reflect the value of the brand. Another, [§<], has lowered its APR because of the 'bad press' it was receiving and also because it sought a better deal for its customers. However, in general retailers seem to be content with APRs broadly in line with those of their competitors. Even these examples of retailers seeking substantially lower APRs do not seem fully analogous with price competition, in which one firm can gain greatly from undercutting rivals even by only a small amount. It seems clear that concerns with relative APRs do not act symmetrically, as would normally be expected of price competition in a market. That is, retailers are concerned about increases in their relative APR but do not seem to expect additional sales as a result of reducing their APR. This suggests that the inter-relationship between retailers' store card APRs is not equivalent to normal price competition where there is an incentive to under-cut rivals in order to take business from them.

8.24 We therefore conclude that the only constraint on APRs is provided by retailers' concern not to have what is regarded as an excessive APR, relative to other store cards¹¹³. However, this same concern does not provide pressure to reduce APRs, for the following reasons:

- (a) to the extent that higher APRs drive direct store card profitability, retailers benefit from high APRs, at least in the long term; and provided the levels of APR do not put retailers out of line with competitors, they do not, in general, seek to have them reduced;
- (b) overall, retailers are likely to have a mutual interest with the provider in higher APRs; and although there are incentives for each retailer to have an APR that is no higher than that of other retailers (because of concerns about damage to its brand), there is little or no incentive for most retailers¹¹⁴ to undercut other retailers (because in most cases the brand is not significantly enhanced by a low APR and is almost certainly unaffected by a marginal reduction); and
- (c) providers' incentives are unambiguously for higher APRs and they have a significant degree of control over this element of the service offering.

Why most APRs have been clustered around 30 per cent

8.25 In Figures 8.1 and 8.2, we illustrate the distribution of basic APRs¹¹⁵ across store card programmes, and store card accounts, by provider as at the end of 2003. It is clear that most store card APRs have been tightly clustered around 30 per cent, and

¹¹³In this context, we are referring to constraints provided by the market. We discuss later (paragraphs 8.37 to 8.45) the pressures to offer lower APRs that adverse publicity caused by the TSC and our own investigations into store cards might have brought to bear on retailers.

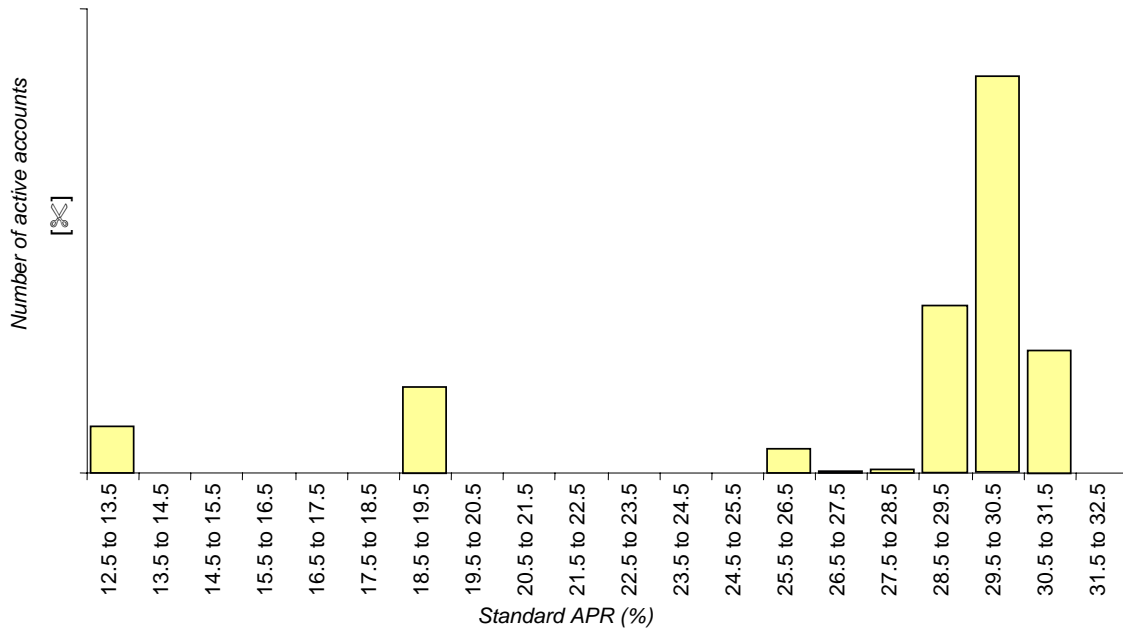
¹¹⁴There are significant exceptions, such as JLP and Marks & Spencer and, more recently, Ikea, Monsoon and River Island. Low APRs are also part of ASDA's 'value proposition'. We discuss these counter-examples later (paragraphs 8.91 to 8.101).

¹¹⁵That is, APRs that do not include discounts for paying by direct debit and so on. Data relates to APRs at the end of 2003. Some have since fallen.

that this is particularly true for those provided by three store card providers, GECF, Style and Creation, each of which has a large number of programmes with retailers of widely different types and sizes. The information supplied to us by these three providers showed that until the end of 2003 they ran programmes with widely differing revolve rates, bad debt rates and average balances, yet all had APRs in the range 29 to 31 per cent. We refer to the distribution illustrated in Figures 8.1 and 8.2 in the discussion that follows.

FIGURE 8.1

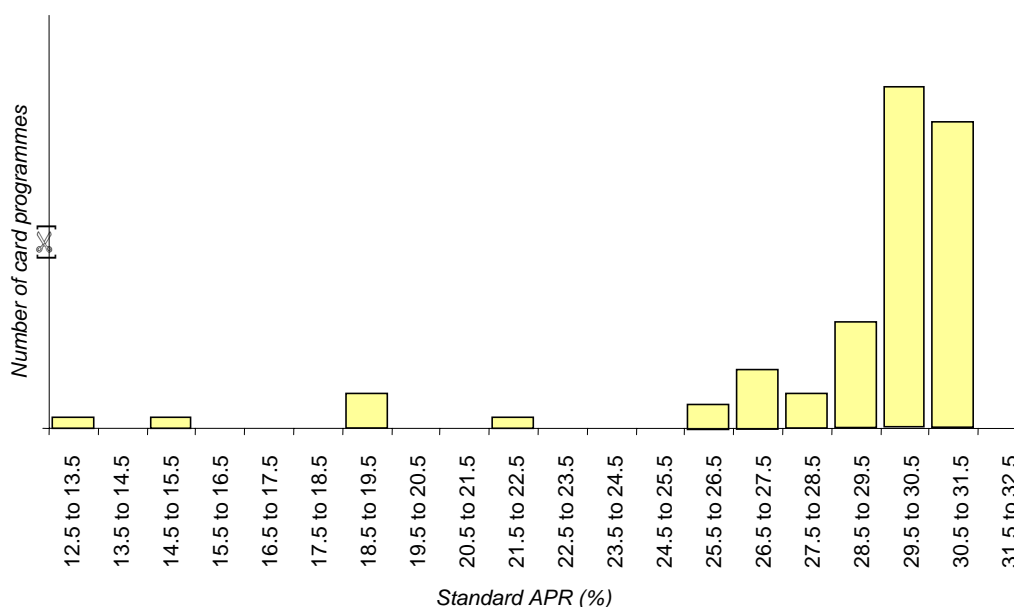
Distribution of standard APRs by provider (active store card accounts 2003)



Source: CC analysis of provider data.

FIGURE 8.2

Distribution of standard APRs by provider (store card programmes, 2003)



Source: CC analysis of provider data.

8.26 There were few store card programmes with APRs below 20 per cent. As shown in Figure 8.2, JLP (with an APR of 13 per cent in 2003—although since increased, first to 14 per cent and then, in February 2006, to 15.5 per cent) and Marks & Spencer (APR, 18.9 per cent) had store card programmes with APRs substantially lower than the average in 2003 (and comparable with those of general credit cards¹¹⁶). JLP and Marks & Spencer were among the largest store card programme providers, with [X] active accounts between them in 2003. As we noted in paragraph 3.16, the number of active store card accounts of these retailers reduced significantly following the transfer of large numbers of those accounts to SBCC accounts and this is a continuing process. Nevertheless, Marks & Spencer had around [X] active store card accounts in 2004, and JLP had [X] in that year. Much smaller store card programmes with APRs below 20 per cent include Liberty and Fortnum & Mason (the latter run in-house). We note that none of the store card programmes with APRs below 20 per cent included in Figure 8.2 was provided by GECF or Style, and only one very small programme was provided by Creation (Nevada Bob's).

8.27 During our inquiry, GECF re-negotiated lower store card APRs with some of its retailers. In a few cases, a single lower APR was agreed; thus Monsoon's store card APR is now 18.9 per cent and River Island's 17.9 per cent, both reduced from 29.9 per cent. In other cases, for example, Debenhams and Mothercare, the new arrangements involve combined store card and SBCC programmes¹¹⁷ (see paragraphs 3.12 and 3.63 to 3.69); here, customers are offered either a store card or an SBCC, and a corresponding APR that depends on their particular risk profile. As a result, a proportion of these retailers' cardholders have APRs under 25 per cent. We discuss these programmes in more detail in paragraphs 8.37 to 8.45.

¹¹⁶We found that most credit cards quoted APRs of between 10 and 20 per cent—see paragraph 8.56.

¹¹⁷In describing its combined programmes to us, GECF has used the term 'DualCard' to denote the dual nature of the offer. However, this term is not used in GECF's marketing material.

8.28 Notwithstanding the lower APRs of the retailers referred to in paragraph 8.26, and the most recent developments mentioned in the previous paragraph, most retailers retain store card APRs significantly above those of JLP or Marks & Spencer. We consider that this may be attributable to one or more of the following factors:

- (a) When a sufficient number of retailers have store card APRs that are low enough to ‘embarrass’ the remainder, then a ‘tipping point’ may be reached and higher APRs may no longer be sustainable. That point has not yet been reached, partly because there are, as we have seen, still only a limited number of retailers with low APRs and, importantly, because JLP and Marks & Spencer are different from other retailers: in the past, they were different because they did not accept credit cards; now they are different because they mainly promote their SBCC, not their store card, and many of their cardholders have SBCCs. Moreover, as noted in the previous paragraph, several combined programmes have recently been introduced with risk-based pricing, involving a number of APR tiers some of which are lower than APRs previously available. However, the existence of multi-tiered APRs, particularly where both a store card and an SBCC are on offer, may obscure customer and retailer perceptions of applicable store card APRs and limit the pressure that these programmes might otherwise bring to bear on a potential tipping point.
- (b) There are fewer benefits for cardholders from the low-APR store cards: for example, [X] has abandoned its loyalty programme; [X] offers customers limited retail benefits on its store card; JLP’s store card customers do not benefit from points giving vouchers to be spent in store, whereas SBCC-holders get points equivalent to 1 per cent off for purchases at the store; and Marks & Spencer gives points worth 1 per cent on its store card but does not offer 10 per cent-off promotions to those cardholders as it does to its SBCC-holders.
- (c) JLP and Marks & Spencer may be viewed by the preponderance of retailers offering store cards with APRs at around 29 per cent as sufficiently distinct (at least partly because of their previous refusal to accept credit cards) as not to invite unfavourable comparison with their own higher store card rates. So long as the bulk of these retailers maintains similar APRs, and perhaps (as in the case of Debenhams now and House of Fraser in future) offer an SBCC (at a lower APR) as well, there is less pressure on them to bring store card APRs down, other (perhaps) than the pressure of adverse publicity.

8.29 For providers such as GECF, Style and Creation, who have multiple store card programmes, there is an additional disincentive to lower the APR on any particular programme. If the APR on one of their store card programmes were reduced, and other retailers in that same provider’s portfolio of store card programmes sought to match this reduced APR because of concerns about relativities,¹¹⁸ that provider could suffer losses on each of the programmes affected by the APR cuts unless it was able to make corresponding changes to other aspects of those programmes. This is because a provider which cuts the APR on one of its programmes risks pressure being exerted by other retailers in its portfolio for a cut in their programmes as well—a domino effect. As one provider [X] put it to us: ‘Reflecting competition in the environment, [X] has lowered APRs on two accounts. The change should not be underestimated. The inevitable consequence is that other retailers will require lower APRs on their accounts’. Consequently, a provider with a large number of programmes in its portfolio would have a greater incentive to resist a reduction in APR on any store card as its total reduction in revenue would in all likelihood be

¹¹⁸Possibly even embodied in contractual terms to match the APR on comparator store cards.

much greater than the economics of that card considered alone would suggest. [§]. The outcome, therefore, is that the levels of store card APRs that have characterized the greater part of the market result from retailers tending to discourage rises in APRs (and in some cases unsuccessfully pressing for reductions), and providers (in particular those with multiple programmes) tending to block reductions in APRs, on their store cards.

8.30 Thus, we see low APRs when retailers (such as JLP, Marks & Spencer, Monsoon, Ikea) are able to insist on such APRs, and can accept the consequences of that approach. Otherwise—and more generally—retailers seek to limit the setting of high APRs by providers only to the extent of ensuring that their own APRs are not out of line with the generality of store card APRs. This, in turn, helps to explain why, in general,¹¹⁹ providers do not try to win new contracts by offering to run store card programmes with lower APRs. This is because: firstly, lower APRs lower their profits, and potentially by a significant amount if they are providers with many store card programmes, as such providers risk the ‘domino effect’; secondly, low APRs are not an important part of the value offer of most retailers—retailers see themselves as disadvantaged when their APRs are high relative to those of competitors, but their image or brand reputation is otherwise not much affected by the APRs on their store cards, if at all. Moreover, as we discuss later (see paragraphs 8.84 to 8.90), lower APRs do not increase card acceptance rates (which retailers care about) and may lower them, and hence they have no incentive to seek a change in the APR, the effect of which will only be to lower their profits.

8.31 The above considerations may explain why the majority of store card APRs are not at the levels of those of JLP, Marks & Spencer and a few smaller retailers. They do not, however, completely explain why the majority of APRs are precisely where they are—that is, around 30 per cent and not, say, around 25 per cent or even, say, 35 per cent. Possibly, there is no satisfactory explanation as to why 30 per cent (or thereabouts) is the prevailing level. If providers (and to a lesser extent retailers) have a direct financial interest in higher APRs and retailers care only about relative levels, we might expect APRs to rise for all store cards. Part of the explanation for high APRs charged on some cards may lie in the high costs of these programmes (for example, because of higher bad debts). We discuss this possibility later.

8.32 However, we note the following evidence:

- (a) absolute APR levels may start to become important at or around a particular level (for example, at thresholds such as 30 per cent, although we note that a few store card APRs are higher than 30 per cent by 1 or 2 percentage points);
- (b) survey and experimental¹²⁰ evidence suggests that customers’ reactions are not symmetric—that they are more likely to spend less, or to say that they are more likely to spend less, if APRs rise than to spend more if they fall;
- (c) increases in the APR of an existing store card programme may in themselves be damaging to a brand. When renegotiating or tendering, it appears that retailers often explicitly or implicitly require there to be no increase in the APR but do not insist on a reduction;¹²¹ and

¹¹⁹[§] is an exception.

¹²⁰See Section 6.

¹²¹This was explicitly the case for [§] and implicitly the case for [§]. JLP’s recent increase in its APR supports the view that JLP and Marks & Spencer are different from other retailers (see paragraph 8.28).

(d) given that contracts for the provision of store card services to retailers mature and come up for renewal across the sector at different times, it may be hard for providers to bring about increases in the APR simultaneously; those moving first would necessarily be out of line with their peers which, as we have seen, is precisely what retailers are most concerned to avoid.

8.33 Thus, if we ask why most APRs have clustered at 30 per cent rather than some other number such as 25 or 35 per cent, the answer may simply be that this is the rate at which APRs settled. In the 1980s, APRs were above 30 per cent. At this time APRs were being reduced and it appears to be in the early 1990s that APRs stopped reducing, even though other interest rates continued to fall (see Figure 6.1 and Appendix 8.3). This may be because, by this time, the more interest-sensitive customers had stopped borrowing on store cards (by that time having obtained credit cards with significantly lower APRs); another possibility is that the contracting out of store card portfolios to specialist providers such as GECF led to a more commercial approach and to a realization that the take-up and level of store card borrowing was fairly insensitive to the precise APR.

8.34 Economists use the term ‘focal point’ to mean a value that becomes established and stable, even if it has no economic justification. It may well be that 30 per cent has been a focal point for most store card APRs.¹²² As long as retailers are concerned only to avoid having an APR that is significantly higher than that of their competitors (and are not interested in undercutting those competitors), and as long as providers’ financial objectives are met or exceeded, it is likely that almost any APR level that is settled upon by the majority of the industry will remain stable. If this perspective is correct, there is no particular answer to the question of why APRs cluster around 30 per cent—had history been different, they might perhaps have clustered around 25 or 35 per cent instead.

8.35 However, it is fairly clear from Figure 8.2 (paragraph 8.25) that three providers—Creation, GECF and Style—have tended to have APRs at the high end of the range.¹²³ These parties’ market shares and their role as providers of multiple store card programmes have influenced the prevailing levels of APR across the sector, because they have had a disproportionate influence on the focal point at which APRs have settled, and help to explain why store card APRs neither fell nor rose. Because of GECF’s much larger market share, this may be true to a lesser extent for Creation and Style than for GECF. But, even so, there is no evidence that GECF is a price leader in the standard economic sense.¹²⁴

8.36 Overall, Creation, GECF and Style charged APRs that, at least until the end of 2003, were higher and within a narrower band of APRs¹²⁵ than the rest of the store card sector.¹²⁶ Each of the three had an average APR, across its portfolio, of between 29 and 30 per cent. Despite the fact that their costs varied, the great majority of the store cards supplied by GECF and these two other providers had APRs between 29 and 31 per cent. As Figure 8.2 illustrates, in 2003 GECF had few card programmes with APRs outside this range. In that year, with one small exception, none of the store cards with APRs below 20 per cent was provided by these three firms, but the 43 store cards with the highest APRs of the 90 store cards programmes we are

¹²²During 2004, GECF and Style reduced APRs on all their continuing store cards that were above 30 per cent to just below 30 per cent.

¹²³We note that HSBC, with large store card programmes, does not have high APRs, for reasons already given (see paragraph 8.28).

¹²⁴See for example the discussion of ‘price leadership’ in Appendix 7.9 to the CC’s 2000 report on supermarkets: http://www.competition-commission.org.uk.rep_pub/reports/2000/fulltext/446a7.9.pdf.

¹²⁵All quoted APRs relate to standard terms (without discounts for direct debit, for example).

¹²⁶As noted in paragraph 8.26, Creation has one very small programme with an APR under 20 per cent.

considering were provided by them. Collectively, these three providers had 74 store card programmes and the APR was below 27 per cent on only five of them. Together, these five programmes comprised 300,000 active accounts out of a total of some 15.5 million active accounts at the end of 2003 (see Table 3.1).

Recently introduced lower-APR programmes and the 'tipping point'

- 8.37 The market has not remained static during the course of our inquiry. There have been some potentially significant developments and we now assess whether these have led to a change in market conditions. Thus, during our inquiry, a number of retailers renegotiated their contracts to provide for significant reductions in APRs. In mid-2004 Ikano reduced the APR on the Ikea store card to 12.9 per cent. [redacted]. As we have already noted (paragraph 8.27), another provider, GECF, has reduced the APR on store cards for Monsoon and River Island. Monsoon brought its APR down from 29.9 to 18.9 per cent from July 2005. River Island's store card APR was reduced from 29.9 to 17.9 per cent from August 2005, [redacted]. We also note that New Look has agreed a lower rate of 25.9 per cent with its new supplier, Ikano; the APR was previously 29.9 per cent. The APR on HSBC's card for Harvey Nichols also fell from 28.5 per cent to 21.9 per cent in June 2005. In all these cases, the store card was reduced from one single rate to another single (lower) rate.
- 8.38 GECF has adopted different strategies for other retailers, involving combined programmes encompassing both store cards and SBCCs, and/or programmes with multi-tier APRs and risk-based pricing. Thus, shortly before our provisional findings were published in September 2005, GECF provided us with details of the launch of new lower-APR combined programmes for Debenhams and Mothercare and of its plans to reduce the APRs on its ASDA combined programme which had been launched in September 2004. All these initiatives are described in more detail in paragraphs 3.63 to 3.69. It was also, it said, conducting trials for lower APRs with other retailers. GECF said that these initiatives were part of its ongoing product innovation and constituted a material market development in the evolution of lower APRs. It said that, in essence, store card APRs had been higher than those for credit cards, reflecting the differing business model. Competition, including powerful new entrants, had led to steadily increasing pressures to change the store card model, this provider added, a process that had, it said, no doubt been enhanced by the CC's investigation. It anticipated that, on current plans, seven of its major retailers [redacted], accounting for about 76 per cent of its gross receivables as at June 2005, would each have either launched, or would be conducting trials of, a new lower APR product by the end of 2005.
- 8.39 Until October 2005, ASDA's store cards had been available at APRs of 28.8 per cent and 24.8 per cent, the lower of the two rates being available to more creditworthy customers; around [redacted] of ASDA's store cardholders were on the higher of these rates. GECF told us that, as from October 2005, a new lower store card APR of 19.7 per cent was introduced, in addition to the existing 24.8 per cent and 28.8 per cent. GECF has estimated that the proportion of store cardholders paying the highest (28.8 per cent) APR will have fallen to [redacted] per cent by the end of 2005 and to around [redacted] per cent by the end of 2006.
- 8.40 In July 2005, GECF launched a new lower APR combined programme for Mothercare, replacing the store card with its single APR of 29 per cent. APRs on the new store card are 19.9 and 24.9 per cent, and there will be four SBCC APRs offered to new cardholders ranging from 14.9 per cent to 22.9 per cent. These rates will be offered to all new Mothercare customers and to existing store cardholders on new purchases. GECF's projections are that by the end of 2005, some [redacted] per cent of all store cardholders would still be on an APR of 29 per cent, this percentage reducing

to [redacted] per cent of all store cardholders by the end of 2006. The actual APRs received by new cardholders will not be known until there is some historical data. However, the majority of new store cardholders are expected to receive the typical APR of 19.9 per cent and most existing store cardholders will benefit from an APR reduction.

8.41 At the end of September 2005 and following a lengthy trial, GECF launched a new Debenhams combined programme in place of the previous programme with its single store card APR rate of 29.9 per cent. Customers apply at point of sale for a Debenhams card and are allocated either a store card or an SBCC, depending on their particular risk profile. The store card APR would, we were told, range from 18.9 to 29.9 per cent, while the SBCC APR would range from 13.9 to 22.9 per cent. GECF calculated that by the end of 2005, most (that is, some [redacted] per cent of) active store cardholders would still be on an APR of 29.9 per cent; this high percentage would fall only modestly (to [redacted] per cent) by the end of 2006. Moreover, it appears that existing store cardholders who decline the offer of an SBCC will stay on the 29.9 per cent APR rate. GECF told us that at the present time, it did not believe that offering a lower rate to these customers without any changes to the product structure would generate the higher balances necessary to sustain lower APRs for these accounts. However, it said that it would continue to evaluate alternative options for these customers. More generally, GECF said it needed to be emphasized that the proportions of customers moving to lower rates should be considered in the context of the overall changes to these retailers' combined programmes which must of necessity, it submitted, be phased due to the risk and complexity of shifting large numbers of existing accounts to lower price points at the same time as changes to the pricing of new accounts were implemented.

8.42 GECF also told us that it was in the process of trialling new lower-APR programmes with other retailers [redacted]. The trials involve:

- in the case of two retailers, [redacted], a selected number of new and existing customers being offered a store card (not an SBCC) with an APR of [redacted] per cent;
- for two other retailers, [redacted], a store card (not an SBCC) being offered to around [redacted] new, and [redacted] existing, customers to which a range of APRs would apply [redacted], the typical¹²⁷ APR anticipated to be 19.9 per cent;
- for a third group of retailers including [redacted], around [redacted] existing store card customers will be offered the opportunity to switch from a store card to an SBCC, with a range of APRs applying to new purchases using the SBCC of [redacted] per cent;
- GECF is conducting a trial with another retailer, [redacted], which commenced in [redacted] 2005 and involved offering around [redacted] existing customers the opportunity to have a [redacted] with a single price point of [redacted] on new purchases. GECF told us that the trial was still at the very early stages [redacted].

8.43 We considered whether the programmes with lower APRs that were launched during 2005 would be likely to inject a new competitive stimulus into the market and whether, if the trials referred to in paragraph 8.42 were converted into permanent new store card, SBCC or combined programmes, the cumulative effect of all these

¹²⁷It is a statutory requirement that the APR quoted in any advertisement for a credit card should be the highest rate that would be offered to at least 66 per cent of borrowers who were given credit as a result of the advertisement—termed the 'typical APR' (see paragraph 4.5 above). The rates charged to existing customers may differ from this 'typical' APR, which applies only to new customers on the basis just described.

programmes might be to force down APRs across the store card market as a whole. We took the following matters in particular into account:

- (a) All the initiatives referred to in paragraphs 8.37 to 8.42 took place some time after the start of our inquiry and following adverse publicity generated by the TSC report in 2003. The evidence suggests that providers had previously been unwilling to agree lower APRs with those retailers that requested them (see, for example, paragraphs 8.15, 8.16 and 8.29). We consider that the new programmes largely reflect the impact that the adverse press and other comment generated by these inquiries has had on providers, either directly, or through retailers putting pressure on them to provide a lower APR for their store card programmes.
- (b) As regards the lower-APR programmes that GECF has already launched, GECF and the retailers concerned will wish to review their performance and may well decide that changes need to be made. Such changes might involve adjustments to the different APR levels themselves (and on programmes with multi-tier APRs, new cardholders would not necessarily be aware of any such adjustments, since the ranges are not always included in marketing material¹²⁸) or to the relative proportions of customers offered the higher and lower APRs.
- (c) The outcome of the trials that GECF told us it was conducting with [redacted] and [redacted] is uncertain, [redacted]. We note that the [redacted] SBCC was trialled for as long as two years before being converted into an actual programme. At the end of the trial period for its new products, GECF or the retailers involved might decide not to convert or, if they chose to do so, might do so on amended terms.
- (d) It is not clear whether the other store card providers who maintain programmes with APRs at or around 30 per cent would be able or willing to respond by bringing about corresponding APR reductions for those programmes. Two of these providers, Creation and Style, run programmes whose store card APRs are among the highest in the market (see Appendix 3.1).
- (e) We note that GECF is the only provider that runs combined programmes with risk-based multi-tier APRs on the store cards as well as on the SBCCs in those programmes.
- (f) The introduction of risk-based pricing and multi-tier APRs on several store card (and SBCC) programmes may obscure customer and retailer perceptions of applicable APRs and limit the pressure that these programmes have on a potential tipping point. Moreover, to the extent that only the 'typical APR' appears on the relevant retailers' promotional literature for combined programmes, this may be misleading for consumers, since the typical APR in this case is derived from both the store card and SBCC APR rates. Thus the range of APRs from which any particular customer might be offered a store card in these circumstances would be neither transparent nor, indeed, available to customers.
- (g) We have seen that on some of the largest programmes [redacted] high proportions of store cardholders seem likely to remain on the highest APR levels at least until the end of 2006¹²⁹. As shown in paragraph 3.71 and Table 3.7, all the evidence suggests that the bulk of store card balances and active accounts still pay APRs

¹²⁸In such cases, individual cardholders would know only the rate that they had been offered, and not the other rates on such multi-tier APR programmes.

¹²⁹No provider submitted projections beyond the end of 2006. This may reflect the uncertainties associated with the outcome of those programmes which have only recently been introduced or which are in the early stages of trials.

above 25 per cent and that they are expected to continue to do so until at least up to the end of 2006. Excluding JLP and Marks & Spencer, which have historically had low APRs, more than 90 per cent of store card balances and active accounts are projected to continue to pay APRs of more than 25 per cent at the end of 2006. As discussed in paragraphs 3.22 to 3.24, some store cardholders have converted or are expected to convert their accounts to SBCCs. Although all of these SBCCs have APRs below 25 per cent (see Table 3.2), Table 3.7 also shows that, even including these conversions and again excluding JLP and Marks & Spencer, over 75 per cent of store card and SBCC active accounts are projected to continue to pay APRs of more than 25 per cent at the end of 2006.

- 8.44 The developments described in paragraphs 8.37 to 8.42 reflect the evolving nature of the store card sector, and are welcome as far as they go. In our view they are a response, first, to the increase in the level of attrition and bad debt rates for store cards since the end of 2002 and second, to the adverse publicity to which store cards have been subjected over the past two or so years, including that which has resulted from the TSC report and our own inquiry. In response to the first of these factors, one of the providers, GECF, has sought to adapt its business model by introducing multi-tier APRs with risk-based pricing across some of its store card and SBCC programmes. In response to the second, some retailers have put pressure on their provider for lower APRs and agreed corresponding changes to their contracts. As a result, store card APRs are being reduced for some new and existing customers. But these developments are not taking place across the store card market as a whole, nor have they yet become entrenched. Accordingly, it is still too early to know what the consequences will be over the next 12 to 24 months and whether there has been a fundamental change in the competitive conditions in which store cards operate.
- 8.45 Taking all these matters into consideration, while we acknowledge that some retailers and/or providers have recently taken steps to reduce store card APRs and that this is a welcome move in the right direction, we are not satisfied that the lower-APR programmes that they have launched are as yet sufficiently widespread, the proportions of customers on lower APRs sufficiently large, or the programmes themselves sufficiently firmly embedded, to allow us to conclude that there is an irreversible downward trend such that a tipping point in the market has been reached.

The lack of pressure on APRs from the upstream market

- 8.46 In Section 7, we concluded that the upstream market (for the supply of store card credit services to retailers) was competitive and that competition had increased in recent years. We would expect the principal beneficiaries of such increased competition to be the retailers, receiving larger payments from (or making smaller payments to) store card credit providers. If retailers were concerned to offer their store card customers lower APRs and were under competitive pressure to do so, then the more favourable terms that they have been securing from providers would have been passed on to those customers in the shape of lower store card APRs. An important implication of the competitiveness of the upstream market is that, when re-tendering their contracts, retailers have the ability to specify APRs if they choose to do so.
- 8.47 The various characteristics of the store card market that we have discussed in Sections 6 and 7 (including consumer insensitivity to store card APRs, and the fact that store cards do not come under competitive pressure from other store cards or from general credit cards), together with the respective motivations and interests of providers and retailers, discussed earlier in this section, provide the explanation as to why such upstream competition has—at least until very recently—had little effect at

the consumer level. Because of this lack of competitive pressures on their store cards, retailers have (at least until very recently) generally chosen to exert their increased power to obtain larger payments from providers rather than to secure lower APRs for their retail customers. To the extent that any pressure has been exerted by retailers on credit providers to lower APRs—and we have discussed recent examples earlier in this section (see paragraphs 8.37 to 8.42)—this has been a response more to adverse publicity and concern by retailers about perceived damage to their brand image (and hence in the medium term to their level of sales) than to competitive pressure from other store cards or credit cards.

Findings on the setting of APRs

- 8.48 In the preceding paragraphs, we have discussed the contractual provisions relating to how store card APRs are set, the respective incentives of retailers and providers, why APRs have until very recently largely remained clustered around 30 per cent, some recently introduced lower APR store card programmes, recent trials of combined programmes, whether a tipping point has been reached, and why increased competition in the upstream market has not brought about lower APRs. Before reaching our conclusions on the setting of APRs, however, we need also to take into account the evidence discussed in Section 6. In that section, we sought to determine the boundaries of the market in which store card programmes operated by considering what competitive pressures were exerted on store card APRs at the upstream and downstream levels. We concluded in particular that credit cards (and in particular, SBCCs, which we found to be the closest potential substitute for store cards) impose little or no competitive pressure on store cards and hence that store cards do not operate within a wider market that includes credit cards (see paragraphs 6.165 to 6.170). We would accordingly expect little or no pressure to be exerted on the setting of store card APRs by credit cards. We also concluded (paragraphs 6.171 to 6.177) that little or no competitive pressure is exerted on one store card by other store cards.
- 8.49 Taking into account all the matters set out in paragraphs 8.13 to 8.48, together with the evidence already referred to in Sections 6 and 7, we find that:
- (a) providers' incentives are unambiguously for higher APRs and they have a significant degree of control over this element of the service offering (paragraph 8.24);
 - (b) the only constraint on APRs has been provided by retailers' concern not to have what is regarded as an excessive APR, relative to other store cards. However, this same concern has not provided any consistent pressure to reduce APRs (paragraph 8.24);
 - (c) most store card programmes have had APRs that are clustered around 30 per cent, despite having widely differing revolve rates, bad debt rates and average balances (paragraph 8.25);
 - (d) the only, weak, pressure on APR levels has come from a few retailers with significantly lower store card APRs. This pressure, such as it is, has proved insufficient to bring about a general reduction in APRs for the great majority of store card programmes (paragraph 8.28);
 - (e) for providers who have multiple store card programmes, there has been an additional disincentive to lower the APR on any particular programme, namely that a provider which cuts the APR on one of its programmes risks pressure

being exerted by other retailers in its portfolio for a cut in their programmes as well—a domino effect (paragraph 8.29);

- (f) Creation (with one small exception), GECF and Style charged APRs that, at least until the end of 2003, were higher and within a narrower band of APRs than the rest of the store card sector (paragraph 8.36);
- (g) increases in competition for store card contracts upstream (see Section 7) have not translated into lower APRs downstream because:
 - (i) of the factors set out in (a) and (b) above;
 - (ii) most cardholders are insensitive to APRs (Section 6);
 - (iii) each store card is subject to little or no competitive pressure from credit cards (Section 6); and
 - (iv) each store card is subject to little or no competitive pressure from other store cards (Section 6); (paragraphs 8.46 and 8.47); and
- (h) while we acknowledge that some retailers and/or providers have recently taken steps to reduce store card APRs, we are not satisfied that the lower-APR programmes that they have launched are as yet sufficiently widespread, the proportions of customers on lower APRs sufficiently large, or the programmes themselves sufficiently firmly embedded, to allow us to conclude that there is an irreversible downward trend such that a ‘tipping point’ in the market has been reached (paragraph 8.45); and
- (i) because of the lack of competitive pressures on their store cards, retailers have (at least until very recently) generally chosen to exert their increased power to obtain larger payments from providers rather than to secure lower APRs for their retail customers where that option was available to them (paragraph 8.47).

We therefore find that there is little or no competitive pressure on the setting of APRs.

8.50 We now turn to consider whether APRs are above competitive levels.

Whether APRs are above competitive levels

Introduction

8.51 Prices are one indicator of the extent of competition in a market,¹³⁰ in particular the pattern of price changes over time and how prices adjust to changes in cost and demand conditions. In a market where competition is prevented, restricted or distorted, consumers might be expected to suffer adverse effects in respect of prices (as well as, possibly, in respect of quality, choice or levels of innovation in goods or services). Higher prices could result in higher profits or in higher-cost firms surviving in the market.

8.52 It is not the purpose of this section to identify exactly what would happen in a fully competitive market, merely to assess whether or not existing APRs are higher than they would be were conditions more competitive. We therefore did not seek to

¹³⁰See paragraphs 3.79 and 3.80 of CC3, the CC’s *Guidelines on market investigations*.

identify a single, precise level for 'competitive' pricing of consumer credit through store cards.

- 8.53 Any 'competitive' APR would be expected to emerge from the removal of those limitations on competition that we have already observed (in Section 6, between store cards themselves and between store cards and credit cards). If, for example, retailers were significantly more interested in the effects of store card APRs on their brand image, there could be pressure to undercut one another. It is not clear where this process would end up. According to economic theory, market prices under conditions of competition tend to be set at the highest marginal cost of any existing producer in the market. However, in those circumstances, the process of competition forces such higher cost producers to reduce their costs or leave the market—taking prices down towards the cost of the lowest-cost producer. We do not necessarily accept that retailers' concern for their brand image would work in the same manner as competition, no matter how much stronger those concerns became, and we therefore do not seek to identify which of these outcomes should be considered 'the competitive benchmark'. We have therefore generally considered prices against the average cost level in the *current* state of the industry.
- 8.54 When considering the likely prices that might emerge from more effective competition with credit cards, the benchmark is much clearer: the general price of credit on credit cards. However, it is important to note that store cards would be very different were they part of the same market as credit cards. For example, there could be more pressure on costs and the consumer offer on store cards might have to change significantly.
- 8.55 We therefore separately considered a number of benchmarks when assessing whether APRs were currently above competitive levels. We begin by considering store card APRs in relation to credit cards (paragraphs 8.56 to 8.58). We then turn to the relationship between APRs and costs (paragraphs 8.59 to 8.65); the profitability of store card credit providers (paragraphs 8.66 to 8.83); the relationship between acceptance rates and APRs (paragraphs 8.84 to 8.90) and finally discuss existing store card programmes with significantly lower APRs (paragraphs 8.91 to 8.101). We then summarize our findings on whether APRs are above competitive levels in paragraph 8.102. We set out our overall findings on APRs in paragraphs 8.103 to 8.105.

Credit card APRs compared to store card APRs

- 8.56 Credit card APRs are in general significantly lower than those on store cards. In this connection, we note that:
- most general credit cards quote typical¹³¹ APRs of between 10 and 20 per cent;¹³²
 - a weighted average of quoted APRs in March 2005 was about 16 per cent and the average APR actually paid on general credit cards (excluding balances benefiting from 0 per cent rates, these usually offered on transfers of balances from other providers) in that month was 15.75 per cent (see paragraph 2 of Appendix 8.3);

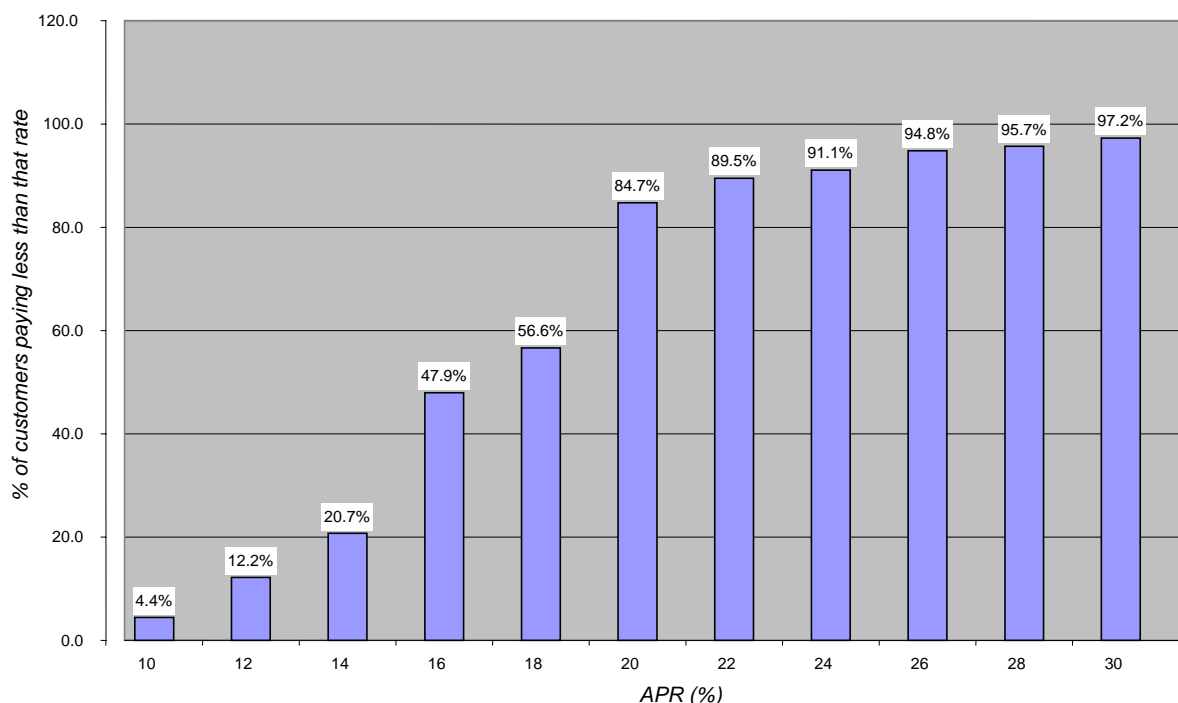
¹³¹See Footnote 127 in this section.

¹³²A search on *Moneyfacts* website during March 2005 showed 261 credit cards, of which 25 quoted standard APRs on purchases of less than 10 per cent; 230 quoted standard APRs on purchases of between 10 and 20 per cent; and six quoted standard APRs on purchases of between 20 and 30 per cent. Additionally, [X] told us of one other credit card (not mentioned by *Moneyfacts*) quoting typical APRs of 49.9 to 59.0 per cent.

- from a survey we conducted in December 2005 of major credit card providers, which together accounted for over 38 million active credit card accounts, representing in the region of two-thirds of the UK active credit card base, we found that approximately 85 per cent of credit card customers pay an APR of 20 per cent or less on their credit cards, almost 90 per cent pay an APR of 22 per cent or less, and almost 95 per cent pay an APR of 26 per cent or less (we discuss the distribution of general credit card APRs further in Section 10, in the context of remedial action). We show the distribution of APRs paid by credit card¹³³ customers as at December 2005 in Figure 8.3; and
- in particular, APRs on SBCCs (which may be the closest potential substitute for some store cards—see paragraph 6.178) can range from 13.9 to 22.9 per cent (as at December 2005). (As shown in Table 3.2, some SBCC programmes have a single APR, while others offer three or four different APRs.)

FIGURE 8.3

Cumulative distribution of rates paid by credit card customers



Source: CC analysis of data from major credit card providers.

8.57 Several parties have asserted that the difference in APR levels between credit and store cards reflects differences in the business models. Thus, [X] argued that retailer requirements for store card programmes were fundamental to the business model, and historically, and for good reason, this had resulted in a single APR product model with high accept rates, low balances and low utility, this last characteristic leading to high attrition.¹³⁴ Furthermore, store cards may also fail to benefit from economies of scale achieved by credit cards, as the fixed costs of providing credit cards are spread over larger average balances. There were a number of reasons, [X] said, why this model would generate higher APRs than those on credit cards or SBCCs. These, [X] said, were:

¹³³The figures include SBCCs.

¹³⁴[X] defined the attrition rate as 'the rate at which active accounts become inactive over the previous 12 months' (termed by [X]).

- (a) a lower balance per account, due to the limited utility of a store card, but with annual costs per account similar to credit cards;
- (b) the almost complete absence of fees (including interchange fees) from retailers as a revenue stream to card providers, so that the main source of income was interest;
- (c) a higher attrition rate on store cards, thus driving higher costs relative to credit cards;
- (d) the greater flexibility of credit cards to balance costs and risks through, for example, risk-based pricing (which was difficult to implement at point of sale and hence (at least hitherto) less suitable for store cards);
- (e) a higher acceptance rate on store cards meant that customers for store cards were on average higher risk than for credit cards; and
- (f) the more lenient policy of some store card providers over the charging of late payment fees meant that these providers were more reliant on revenue from interest than were credit card providers.

8.58 However, the factors cited by [redacted] in the previous paragraph do not, in our view, mean that this APR differential need be as large as it currently is, or (at least in some cases) would remain at all, were credit cards to place an effective competitive constraint upon store cards. Clearly, store cardholders who also held credit cards would not choose to pay the higher store card APR simply because the factors listed in the previous paragraph produced higher costs for store card providers than would otherwise have been the case. Moreover, most of the above costs are not apparent to store cardholders; the only cost that cardholders could in practice take into account in deciding whether to revolve their balance is the policy of store card providers sometimes to waive fees when payment is not made by the due date; however, as we show later (see paragraphs 8.114 to 8.121), we are not persuaded that customers taking out a store card, or cardholders revolving credit on a store card, are generally aware of any such policy, or weigh the total costs to them of one type of card against another in order to select the least costly card to use.

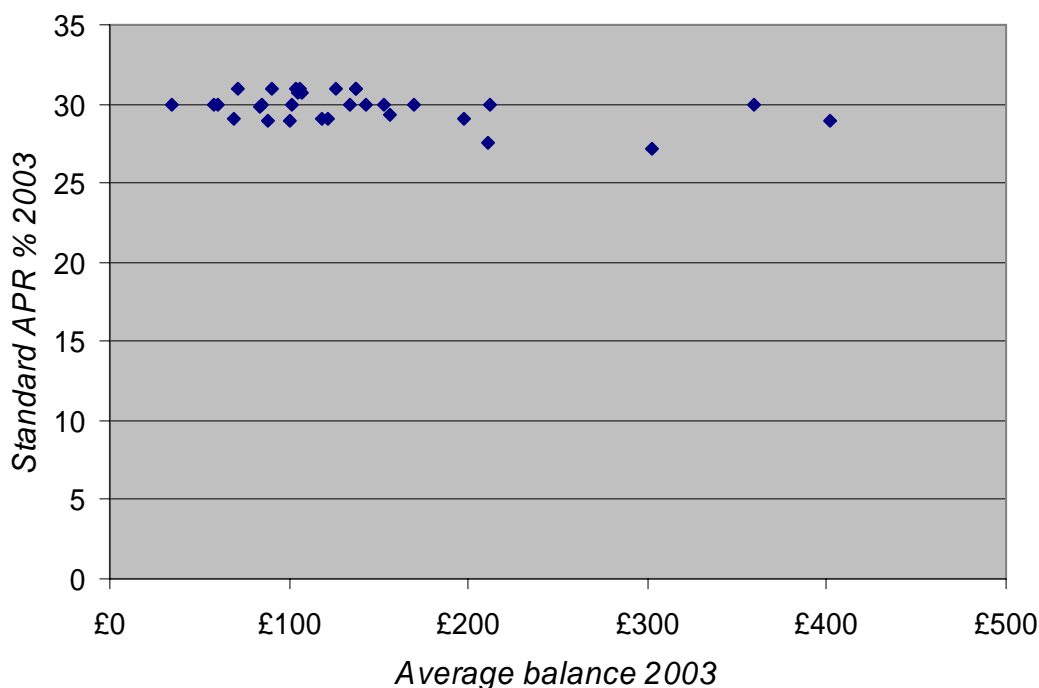
The relationship between APRs and costs

8.59 Some of the same arguments as to why credit card and store card APRs differ should, in principle, apply equally to different store cards—for example, the argument that there is an inverse relationship between APRs and average balances: the lower the balances and hence the lower the income, the more the need for high APRs, reflecting the higher costs. The evidence suggests, however, that there is no obvious relationship between store card APRs and average balances—see Figure 8.4, in which each data point represents (for 2003) a store card programme run by Creation, GECF, Ikano or Style. Were store card APRs subject to competitive pressures, either from lower-APR store cards or credit cards, we would expect to see a pattern of higher average balances being associated with lower APRs. However, we do not, in general, see such a pattern—although average balances on the store cards with the lowest APRs (JLP and Marks & Spencer, whose respective single store card programme data have been excised from Figures 8.4 to 8.7 for reasons of confidentiality) are [redacted]. Store cards from the same provider do not show an association between higher average balances and lower APRs, suggesting that prices do not reflect costs.

8.60 Clearly, the relationship between average balances and APRs is more complex than a simple comparison between store cards and credit cards would suggest. We note, however, that the same lack of variation across store cards from the same provider emerges when we examine the relationship between APRs and bad debts, APRs and revolve rates, and APRs and acceptance rates, respectively (see Figures 8.5 to 8.7—again, these use 2003 data). If, as GECF suggests, store card APRs reflect costs, we would expect to see different APRs across store card programmes.

FIGURE 8.4

Average balances and APRs*

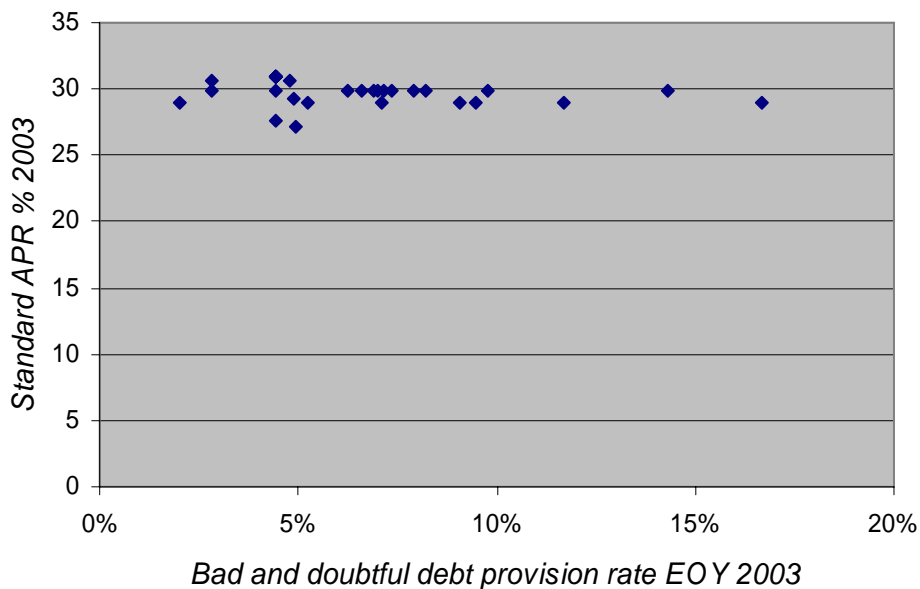


Source: CC, based on information supplied by the parties.

*Note: The chart includes the major store cards supplied by GECF, Creation, Style and Ikano. Data for the single store card programmes of Marks & Spencer and JLP have been excised for reasons of confidentiality.

FIGURE 8.5

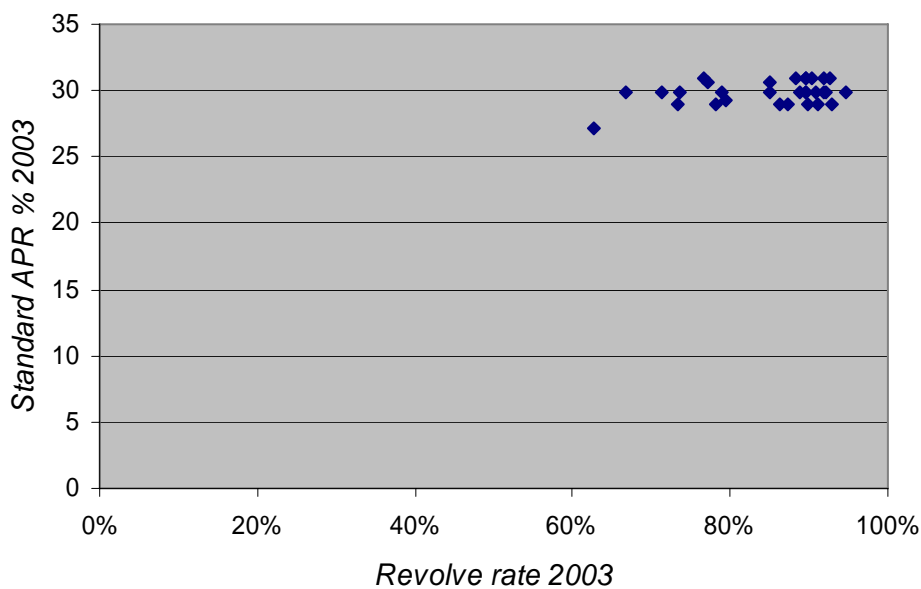
Bad debt provision rates and APRs*



Source: CC, based on information supplied by the parties.
*Note: The chart includes the major store cards supplied by GECF, Creation, Style and Ikano. Data for the single store card programmes of Marks & Spencer and JLP have been excised for reasons of confidentiality.

Figure 8.6

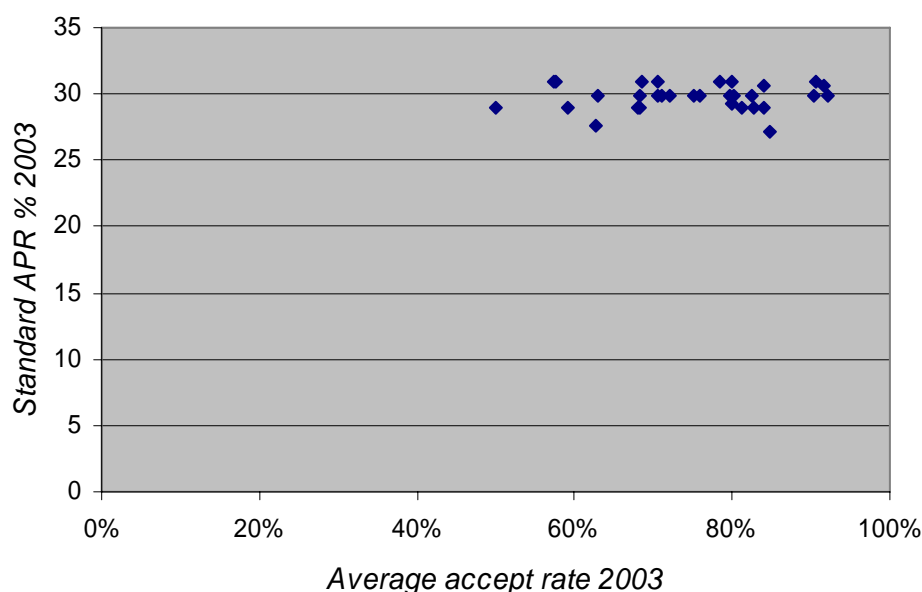
Revolve rates and APRs*



Source: CC, based on information supplied by the parties.
*Note: The chart includes the major store cards supplied by GECF, Creation, Style and Ikano. Data for the single store card programmes of Marks & Spencer and JLP have been excised for reasons of confidentiality.

FIGURE 8.7

Accept rates and APRs*



Source: CC, based on information supplied by the parties.

*Note: The chart includes the major store cards supplied by GECF, Creation, Style and Ikano. Data for the single store card programmes of Marks & Spencer and JLP have been excised for reasons of confidentiality.

8.61 We also considered store card APR levels in relation to cost trends.

8.62 From the mid-1990s until very recently, APRs on most store cards remained unchanged despite falls in funding costs (as measured for example by base rates¹³⁵). The APR margin over base rates of a sample of store cards on which we have data increased by 3.0 percentage points (see Table 8.1 below). The base rate is just one component of the cost of providing a store card and total costs will therefore have fallen only by a similar absolute amount, not by a similar proportion. However, a 1 percentage point fall in base rates should result in a slightly greater fall in cost-reflective APRs (because there is a fall in the cost of funding transactors' balances on which no interest is received.)¹³⁶ The APR margin should therefore have fallen by more than 3.0 percentage points. Over a longer period, base rates have fallen substantially, and store card providers have potentially benefited both from an increase in the margin over base rate and from a reduction in the cost of funding the balances of transactors (see Table 1 in Appendix 8.3¹³⁷). This suggests that margins increased, unless there were countervailing movements in other costs.

¹³⁵We use base rate as a proxy for funding costs which we recognize will vary for each provider.

¹³⁶About 85 per cent of balances pay interest: consequently a 1 percentage point reduction in base rates may be expected to reduce cost-reflective APRs by about 1.18 percentage points.

¹³⁷Table 1 in Appendix 8.3 shows a decline of 5.8 percentage points in base rates over the period since around 1990, which may be expected to reduce cost-reflective APRs by about 6.8 percentage points (see previous footnote), while for example the Debenhams/Burton store card APR declined by 3.7 percentage points.

Table 8.1 Store card margins over base rate

	<i>per cent</i>		
	<i>May 1994</i>	<i>July 1999</i>	<i>August 2003</i>
Base rate	5.125	5.000	3.500
<i>Credit card and JLP and Marks & Spencer store card margins over base rate</i>			
Credit card quoted average	16.7	14.7	10.7
JLP	12.9	11.0	9.5
Marks and Spencer*	19.3	21.0	15.4
<i>Other store card margins over base rate†</i>			
Debenhams/Burton	23.8	24.9	26.4
B&Q (Timecard)	19.8	26.9	23.3
Harrods	23.8	23.9	25.4
House of Fraser	23.8	24.3	25.8
Jaeger	21.7	24.8	23.5
Laura Ashley	24.7	25.7	27.2
Sears/Creation	21.8	25.9	27.4
Selfridges	19.8	22.6	24.1
Bhs/Mothercare (Storehouse card)	23.9	24.0	25.5
Viyella	<u>21.7</u>	<u>24.8</u>	<u>26.3</u>
Average for these cards‡	22.5	24.8	25.5

Source: Moneyfacts issues for June 1994, September 1999 and September 2003.

*Rate for payment by methods other than direct debit and for balances below £1,000.

†Rate for payment by methods other than direct debit.

‡The margin over base including Marks & Spencer and JLP was 21.4 per cent for May 1994, 23.3 per cent for July 1999 and August 2003.

Note: this table includes all store cards listed in the June 1994 issue of Moneyfacts except those of Next (which we do not consider to be a store card) and Fortnum & Mason (the APR on which fell from 16.8 per cent in May 1994 to 15.3 per cent in August 1999; the APR was also 15.3 per cent in August 2003).

8.63 GECF put it to us that in competitive markets, prices did not necessarily move in line with each and every cost component; that funding costs were only one element of cost; and that we should exercise caution in concluding that credit card APRs had moved with base rates during the period under discussion. [X] and [X] also claimed that they had increased acceptance rates in response to the base rate fall but we note that the timing of those acceptance rate increases does not noticeably match the falls in base rate. In any event, increasing acceptance rates in response to a fall in costs does not indicate anything about competitive conditions. In theory, both a monopolist and a competitive firm would each respond in this way, although possibly to different degrees.¹³⁸

8.64 One provider, [X], also argued that it had experienced countervailing cost movements during the period in which base rates had fallen. It pointed to higher attrition rates over the period 2003 to 2005 (rising from [X] per cent in November 2003 to [X] per cent at the beginning of 2005), declining in-store sales on store cards, declining balances and increasing bad debts, with corresponding increases in the costs of collection. However, the first three of these factors would have affected

¹³⁸In textbook economics, if the marginal cost curve shifts down, a profit-maximizing monopolist's output will increase (although the increase is less than a competitive industry would achieve). In store card practice, if the cost of borrowing falls, it makes sense to accept a few more risky customers as the cost of bad debts is less.

[X] revenues rather than its costs. We also note that, in discussing the decline in merchant fees (for both credit cards and store cards), [X] referred to ‘the falling costs of information technology and telecommunications’. We consider that the falling costs of information technology and telecommunications are relevant to APRs as well as merchant fees, and may be one reason for the decline in credit card APRs.

- 8.65 We note that one provider’s, [X], bad debt expenses—the principal factor relating higher acceptance rates to higher costs—fell rather than rose from 2000 to 2003, although we acknowledge that this has been a benign economic period and the costs created by less creditworthy customers show up mainly when the economy is weaker. Bad debt rates increased in 2004 over 2003 and earlier periods for almost all providers. Finally, we note that, in any case, a change on acceptance policies will be slow to affect the expected bad debts of the overall cardholder base for a store card. Changing acceptance policies only affect the creditworthiness of the new customers accepted. The new acceptance policy would not be fully reflected in the customer base until no customer accepted before the new policy came into effect remained. (We discuss the relationship between acceptance rates and APRs in paragraphs 8.84 to 8.90 below.)

The profitability of store card credit providers

- 8.66 An important indicator of the extent of competition in a market is the levels of profits of the firms involved. A competitive market is likely to generate significant variations in profit levels between firms as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of those firms. At particular points in time, the profits of some firms may exceed what might be termed the ‘normal’ level. Reasons for this could include, for instance, cyclical factors, transitory price or other initiatives, the fact that some firms may be more efficient than others and the fact that some firms may be earning profits gained as a result of past innovation. However, competition should put pressure on profit levels, so that they move towards the cost of capital in the medium to long run. A situation where, persistently, profits are substantially in excess of the cost of capital for firms that represent a substantial part of the market could be an indication of limitations in the competitive process.¹³⁹ Accordingly, we made an assessment of providers’ profitability for the years 1999 to 2004.
- 8.67 We based our assessment on providers’ accounting profit prepared in line with generally-accepted accounting practice in the UK, but with certain adjustments. Our aim was to estimate the profits of each provider had they been a stand-alone store card operator. Thus, we formed a view on a typical stand-alone provider’s capital employed and capital structure; and on an appropriate cost of debt and equity for this activity. There were no significant issues in identifying the relevant revenue streams (principally interest, late payment fee and insurance income) and, on the whole, we accepted the providers’ own cost allocation methods and accounting practices in allocating corporate overhead costs to their store card operations, as adopted in their management accounts. We therefore made few adjustments to the profit and loss data submitted to us by store card providers. We did, however, adjust the reported interest expense to reflect our assumptions about the capital structure and cost of debt of a stand-alone provider. We also used the standard UK rate of corporation tax for each provider. We estimated the book value of equity capital employed of a stand-alone store card provider based on regulatory requirements, and we made an allowance for intangible assets involved in store card operations but not included in

¹³⁹See the CC’s guidelines for market references (CC3, June 2003), paragraph 3.82.

providers' accounts. Further details of our methodology for assessing profitability are set out in Appendix 8.4.

- 8.68 To assess profitability, we looked at rates of return on equity earned by providers, calculated as profit after interest and tax as a percentage of equity capital employed (as adjusted for intangible assets). GECF argued strongly that return on equity was not the correct measure and that, if an accounting approach were to be adopted, return on total capital employed should be used. We considered GECF's arguments very carefully but decided there were sound reasons to prefer the return on equity approach in this inquiry. In particular, we took the view that, for a store card credit provider, both the borrowing and lending decisions were core business operations and that return on equity was a more meaningful measure of profitability than return on capital. We also noted that most providers are regulated by the FSA, which specifies minimum capital requirements, and considered that determining a typical capital structure was relatively straightforward. Furthermore, GECF itself uses return on equity both in its [redacted] and in its [redacted]. Our reasoning is set out in more detail in Appendix 8.4.
- 8.69 We compared the rates of return on equity with the cost of equity capital calculated in accordance with the capital asset pricing model. We measured profits (or losses) after interest charges, after tax and after a charge for equity capital employed, based on our mid-point estimate for the cost of equity of 10.1 per cent. We also conducted a sensitivity analysis around this midpoint (see paragraph 8.76 and Appendix 8.4). We refer to profits after interest charges, tax and a charge for equity capital as profits in excess of the cost of capital.
- 8.70 GECF said that accounting profits were a misleading indicator of underlying economic profits.¹⁴⁰ It said that, if profits were to be analysed, the analysis must be over the lifecycle of a store card programme, since there were large accounting losses in the early stages of a programme and high attrition rates, which providers incurred in the anticipation of future returns. It said that these losses were analogous to an investment. However, this provider argued, since these investments were expensed in providers' accounts, rather than being capitalized, the true investment was understated and the return on equity calculation misleading. It stated that accounting returns therefore vastly understated the profitability when a portfolio was young and overstated it when the portfolio was mature. This provider favoured its own method of profitability assessment based on a model that employed an internal rate of return (IRR) approach to estimate the profitability of groups of store card accounts over a period of time. It said that IRR calculations based on cash flows after interest and tax would avoid any distortions created by accounting rules. We discuss this approach in further detail in paragraph 8.72 and Appendix 8.9. One provider [redacted] disagreed with our overall approach to profitability assessment and said that it was likely to inhibit competition in most markets by deterring new entrants. Other providers had objections to our calculation of the cost of equity and of the equity base but called for modifications within the generally accepted accounting framework rather than rejecting that framework altogether. We carefully considered the evidence from all parties including those who did not accept our approach. As a result we revised our approach in several respects, as described in the following paragraphs.
- 8.71 We rejected GECF's view that profitability analysis based on accounting data was necessarily misleading. We consider that the use of accounting data as a measure of periodic performance is integral to the way in which companies are managed and

¹⁴⁰See the discussion of these issues on the CC website—Store Card Inquiry: Evidence on Profitability and Evidence/Emerging Thinking/Responses to CC's Emerging Thinking/GE Consumer Finance Ltd (Annexes 6 and 7).

report to shareholders, and the way in which the latter, and the financial community, evaluate them. Accounting measures are used because, although imperfect, they are the best available for assessing the performance of a business on an ex-post basis. If they are used with an awareness of their limitations and with adjustments to make them as suitable as possible for the purpose in hand, we believe they can be used as an indicator of the extent of competition in a market. We accept that accounting measures should not be regarded as giving definitive answers, and we therefore err on the side of caution in our approach and in our interpretation of the data. Appendix 8.5 sets out our detailed analysis of each provider's profits.

- 8.72 We considered the approach advocated by GECF. This provided an assessment of four of its larger store card programmes using a model that employed an IRR approach to estimate the profitability of groups of store card accounts over a period of time. We acknowledge the theoretical framework behind the use of IRR in profitability assessment. Financial theory underlying investment decision-making, valuation and related matters focuses on the amounts and timing of the cash flows of the activity and leads to the conclusion that the most satisfactory basis for assessing rate of return is a calculation of the IRR on a discounted cash flow (DCF) basis. The IRR is generally used for ex-ante project appraisal, and less commonly for ex-post evaluation of completed projects. It is a particularly useful management tool for allocating financial resources between new projects competing for investment capital. Its use in examining the profitability of an on-going business is less common and has its own problems including data availability and the estimation of opening and closing asset values.¹⁴¹ In this inquiry we did not accept that the model advocated by GECF was inherently superior to an assessment based on accounting returns, with appropriate adjustments. However, we accepted the model as illustrative of GECF's argument that each store card programme involved customer acquisition costs which in the early years had not been capitalized, leading to an understatement of equity investment, and consequently to accounting rates of return higher than the IRR. Whilst we did not accept the model prepared by GECF as evidence of the level of these costs, we did make our own assessment of the adjustment required to equity capital to take account of them. Thus, our assessment remains based on accounting returns but with an adjustment to equity capital to reflect intangible assets in the form of customer acquisition costs not recorded in the providers' financial statements. The adjustment we made is equivalent to 10 per cent of the net receivables balances of each provider. We conducted a sensitivity analysis on this adjustment (see paragraph 8.76).
- 8.73 Appendix 8.6 contains our comparative analysis of providers' profits. Table 2 of Appendix 8.6 shows rates of return on equity for the store card operations of each provider from 1999 to 2004. Historic data on this period was submitted by all providers. In paragraph 8.83, we consider projected data for 2005. We found that three providers [X] had made consistently positive rates of return on equity, and two [X] had made consistently negative rates of return. Rates of return had been variable for the other two providers [X]. One provider's (GECF's) rates of return had consistently exceeded the cost of equity by a factor of between [X]. Its rates of return were considerably higher than those of the provider earning the next highest rates of return [X]. The latter had exceeded the cost of equity in each year between [X], and had done so by a factor of between [X] and [X] in four years out of the five. However, it did not meet the cost of equity in [X]. [X] had made rates of return in excess of the cost of equity in [X] out of six years between 1999 and 2004. In only one year was its rate of return substantially in excess of the cost of equity. One

¹⁴¹Further details of the data requirements for this type of analysis are described in the OFT discussion paper 'Assessing Profitability in Competition Policy Analysis', OFT 657.

provider [X] met or exceeded the cost of equity in each year between [X] and [X] but had not done so in [X] and [X], and only in one year out of the five years we analysed had it earned a rate of return that was substantially in excess of the cost of equity. Three providers [X] did not meet the cost of equity in any year.

- 8.74 Table 3 of Appendix 8.6 sets out the profits and losses after interest, tax and equity capital charges of store card providers over the six-year period between 1999 and 2004. We calculated that four providers¹⁴² representing 80 to 90 per cent of the market had together generated profits in excess of the cost of capital totalling £350 million over the six-year period, equating to around £500 million pre-tax or over £80 million per year), and three providers had made losses (after deducting capital charges) totalling £81 million over the six-year period. As a whole, therefore, the store card sector had generated net profits of around £270 million in excess of the cost of capital during the six-year period 1999 to 2004. To the extent that there was a transfer of profits from providers to retailers through contractual profit-sharing arrangements, commission payments and other such means, and these payments had been deducted from providers' profits, the profits of store card providers as described in the previous paragraph understate the profitability of store card programmes as a whole.
- 8.75 The distribution of profits across providers has been uneven over the period 1999 to 2004. GECF, whose 2004 market share was in the range 50 to 70 per cent depending on which measure is used,¹⁴³ generated a substantial proportion [X] of the total profits in excess of the cost of capital of £350 million, equivalent to around [X] per year on average. The three other profit-making providers [X] earned the remaining [X] (although [X] represented a large share of this). The absolute level of profits in excess of the cost of capital earned by the other two profit-making providers ([X]) was small, a total of £[X] million over the six-year period. The three loss-making providers ([X]) made losses of £81 million between them.
- 8.76 We performed two sensitivity analyses on our calculations of profits in excess of the cost of capital. First, we considered the implications of varying the cost of equity within the range set out in Appendix 8.4. Second, we examined profits if the intangible assets were doubled—that is, if they were taken as 20 per cent of average net receivables. These sensitivities did not alter our conclusions.
- 8.77 From all the evidence available to us, we consider that GECF, the largest provider, earned profits that were persistently and substantially in excess of the cost of capital between 1999 and 2004. The other six providers had variable profits which in some years were less than, or not greatly in excess of, the cost of capital. (Indeed, three of these providers did not earn the cost of capital in any year.) We conclude that none of these six providers earned profits that were persistently and substantially in excess of the cost of capital between 1999 and 2004.
- 8.78 We considered that GECF's ability to earn higher returns in comparison with other providers was due to a number of factors. We noted that GECF had been in the market longer than many other providers and had various advantages that were attributable to its greater size. These factors might well have enabled it to achieve greater efficiencies both in terms of lower costs and higher income-generation capabilities. GECF told us that any particular benefits it had obtained, by reference to the rest of the industry, arose from its very early entry into the market and its subsequent operating efficiencies.

¹⁴²[X].

¹⁴³Based on information supplied on a consistent basis by each of the main providers (see Table 3.3).

- 8.79 GECF objected to our accounting calculations of profits in excess of the cost of capital. It said that they: (a) assumed too few intangibles (10 per cent when 20 per cent would be close to the actual results of market transactions); (b) inappropriately ignored amortization of intangibles over the life of a typical contract; (c) ignored compensation for 'non-systematic' retailer-specific risks that were not reflected in our estimate of the cost of capital; and (d) accorded insufficient weight to GECF's significant efficiency relative to competitors. GECF argued that, given the effectiveness of competition among providers and the fact that only GECF was found to earn profits in excess of the cost of capital, the most compelling explanation of any observed profitability differences was its superior efficiency.
- 8.80 As our Guidelines say, at points in time the profits of one or more firms might exceed a level commensurate with those firms' cost of capital, and one reason for this might be their greater efficiency, in the shape of lower costs, compared with others in the market. That may be true of GECF. However, in a competitive market we would expect competition to result in pressure on profit levels towards the cost of capital in the medium to long term. This has not happened in the store card market and GECF's excess profitability is further evidence of a lack of competitive pressure on store card APRs. Moreover, to the extent that there is the same lack of competitive pressure on the other the other revenue sources for store cards (late payment fees and insurance, discussed below) as we have found to be the case in respect of interest income, this may have resulted in the establishment of market price levels at which it was possible for a number of other smaller and, relative to GECF, high cost providers to survive in the market.
- 8.81 We considered that it was important not to look at profitability in isolation but rather in the context of the overall assessment of the competitive conditions of the market. We considered whether the evidence on profitability was consistent with our conclusions on the competitiveness of the upstream and downstream markets. In Section 7 we concluded that the upstream market for the provision of store card credit services, including insurance services, to retailers was competitive. We found that competition in this market had increasingly operated to re-allocate some of the benefits of store card programmes from providers to retailers but, as discussed earlier (see paragraph 8.47 in particular), such competition had not generally resulted in pressure from retailers for lower APRs (or, as we discuss later, other charges). This competition in the upstream market, which is leading to downward pressure on providers' profits as those in excess of the cost of capital are transferred to retailers through competitive bidding processes between providers, is thus consistent with there being profits in excess of the cost of capital for the store card sector as a whole. There is evidence that the providers' profitability from contracts signed in the more recent past (eg [redacted]) is considerably less than it was under their previous contracts, and that payments to retailers, in particular profit share payments, have increased markedly in the last five years (see Appendix 7.10). However, providers continue to benefit from the terms of contracts signed in earlier years.
- 8.82 In summary, the evidence on profitability between 1999 and 2004, and in particular the persistently high profitability of one provider representing a substantial part of the market, is consistent with, and indicative of, a lack of competitive pressure on APRs, late payment fees and insurance charges in the store card sector (see the discussion of these fees and charges below).
- 8.83 Some providers told us that they were projecting lower profits for 2005, due in many cases to higher bad debt rates. We took into account these projected results for 2005, which were prepared during that year (see Appendix 8.6). Although they showed a reduction in profitability from previous years in the market as a whole, they did not cause us to change our findings. We particularly note that GECF's projected

profits, calculated using the methodology set out in paragraph 8.69, remain substantially in excess of the cost of capital.

The relationship between acceptance rates and APRs

- 8.84 A number of store card credit providers put it to us that the high acceptance rates demanded by retailers on their store cards led to store card programmes having cardholders with a higher likelihood of default than those with credit cards accounts. This was one of the many reasons, they argued, why APRs needed to be higher than those for credit cards. [redacted], for example, argued that retailer requirements for high acceptance rates meant that [redacted] accepted less creditworthy consumers than would those credit card providers with APRs at levels between 9 and 15 per cent. To ensure that the 'marginal' customer was not loss-making, a higher APR was required, [redacted] said, to cover the greater exposure to bad debts that arose from accepting that customer.
- 8.85 Our survey evidence showed that about 90 per cent of store cardholders also held at least one general credit card (see paragraph 3.26), and that relatively few store card revolvers who did not have a credit card said they had ever been refused a credit card (see paragraph 3.28). Nonetheless, we recognized that it was possible that a proportion of store cardholders did not meet the acceptance criteria for general credit cards (or met the criteria only for credit cards with higher APRs than store cards). We accordingly addressed the argument that high acceptance rates required, or at any rate justified, higher APRs.
- 8.86 The relationship between APRs and acceptance rates is complex. Retailers tend to want as many of their cardholders as possible to take up their store card; in other words they tend to want a high acceptance rate. On the other hand, store card credit providers aim to set the acceptance cut-off point at the level that includes all profitable cardholders and excludes those for whom the expectation of default is such that bad debts exceed expected income net of other costs. Consequently, a retailer's desire for a high acceptance rate may potentially require a store card credit provider to accept some applicants who would not otherwise be accepted.
- 8.87 Where a retailer wishes to maintain a high acceptance rate, however, this does not mean that the provider must increase the APR to the level at which all successful applicants at that high acceptance rate are profitable. A high acceptance rate can be achieved by the retailer and provider explicitly or implicitly agreeing a minimum required rate. Negotiations between retailer and provider would need to take account of the complex factors affecting acceptance rates, including the profile of the applicants, the type of goods being sold by the retailer and the extent of promotion of the card in-store. Retailers and providers appear able to agree on acceptance rates. One provider [redacted] told us that it was often 'expected or contractually required to maintain a certain accept rate'. To the extent that relatively unprofitable applicants are accepted in order to meet retailers' acceptance requirements, providers' net costs are higher and profitability lower than they otherwise would be. However, our cost and profitability analysis, which covers all cardholders, takes account of any costs of accepting such unprofitable cardholders. The profits shown in Appendices 8.5 and 8.6 would accordingly be greater if unprofitable cardholders were excluded.
- 8.88 We note also that two retailers with significantly lower APRs on their store cards (JLP and Marks & Spencer) had acceptance rates ([redacted] per cent and [redacted] per cent respectively) that were not greatly different from those of other store cards.¹⁴⁴ It was

¹⁴⁴[redacted]

put to us, by a provider, that this may be due to customer demographics, the nature of the retail offering leading to higher balances on those programmes and the quality of the customers that these retailers attract.

8.89 Appendix 8.2 sets out the information we obtained on the extent to which rates of default, bad debt and interest payable differed between those cardholders who, at the time of acceptance, were least creditworthy and other cardholders. The information suggests that the least creditworthy cardholders have higher bad debt than other cardholders and that this is not fully offset by higher interest payable due to higher balances. The information does not enable us to establish whether or not the least creditworthy cardholders are profitable. However, we made a rough estimate of the average extent to which the least creditworthy cardholders are less profitable than the other groups. The difference (in bad debts net of interest payable) between the least creditworthy group of cardholders and the next least creditworthy group,¹⁴⁵ on average, represents about 1.0 per cent of total interest-bearing balances, which is equivalent to 1.25 per cent on the APR (see Appendix 8.2).

8.90 In summary, we find that:

- (a) a retailer's desire for a high acceptance rate may potentially require a store card credit provider to accept some applicants who would not otherwise be accepted;
- (b) retailers' desire for high acceptance rates may lead to providers' profits being lower than they otherwise would be. It is uncertain if there is such an effect; but, if so, it is already included in our analysis of the profits of providers;
- (c) a retailer's preference for a high acceptance rate can be achieved by the retailer and provider explicitly or implicitly agreeing the acceptance rate. It does not require the APR to be raised to cover the expected net costs of the 'marginal' least creditworthy cardholder.

Existing and prospective store card programmes with lower APRs

8.91 Finally, in considering whether store card APRs are above competitive levels, we discuss our earlier observation (paragraph 8.26) that there are existing and planned store card programmes with APR levels well below those exhibited by, to use GECF's terminology, the 'traditional store card business—or pricing—model'.

8.92 GECF told us that APR levels of around 30 per cent were a function of the traditional store card business model, with its low balances and lack of recovery of costs from either annual or late payment fees or other charges. The low APR credit card model was, GECF said, dependent in part on charges, which delivered nearly [~~3~~] times the revenue per active account than was the case for the traditional store card. GECF submitted that meeting retailer requirements for lower APRs other than by offering an SBCC could be achieved through such means as:

- (a) adjustments to the store card business model, reduced accept rates and 'credit card-type' fee charging mechanisms (although this approach provided limited prospects for rebalancing and tended to encounter retailer resistance);
- (b) flexible structures to manage risk;
- (c) cross-selling; and

¹⁴⁵Each group accounts, on average, for 13 per cent of store card customers.

(d) lowering payments to retailers by reduced commissions and contributions to marketing expenses.

- 8.93 We accept that lower APRs could be achieved through such modifications to the traditional store card model as just described. In addition, we note that the store card business relies upon a proportion of store cardholders—those who revolve their balances—bearing the costs of the whole programme. They need not necessarily do so; it would be possible to spread the cost across all cardholders, for example by charging an annual fee for the card (though we recognize that annual fees may encounter resistance from cardholders). It seems reasonable also to add the possibility of providers or retailers accepting lower returns on their store card operations. We also note that GECF's recently introduced combined programmes provide examples of the use of multi-tier APRs with risk-based pricing across store cards and SBCCs to enable lower APRs to be offered to some cardholders.
- 8.94 These alternatives are not simply theoretical but are illustrated, in our view, by several store card programmes with APR levels below 25 per cent. In some cases, these programmes are long-established (notably JLP and Marks & Spencer, but also Liberty and Fortnum & Mason). In others, they represent relatively recent new programmes (for example, ASDA's combined programme with a range of store card APRs at lower levels). Some recently renegotiated contracts include a significant reduction in store card APRs from previous levels (notably Ikea, River Island, Monsoon, New Look and Harvey Nichols) and GECF has recently introduced combined programmes for Debenhams and Mothercare under which customers can apply for either a store card or an SBCC, and are allocated one or the other type of card, and a level of APR, depending on their particular risk profile. We note also that these programmes span a range of different retailer types, and different retailer and store card programme scales. In particular, Debenhams, JLP and Marks & Spencer have been among the largest programmes in the market, while those, for example, of Liberty and Fortnum & Mason are comparatively small.
- 8.95 Because of these differences across store card programmes, it cannot be assumed that what is possible on one programme can simply be applied wholesale to another. In particular, we note that the JLP and Marks & Spencer programmes both operated in stores that did not accept credit cards until relatively recently.¹⁴⁶ Perhaps as a consequence, penetration rates, average spend on the card and average balances have been higher than they might otherwise have been. It might also be argued that these retailers faced a particularly strong need to provide a relatively low APR to preserve their brand image and promote sales, because customers' use of alternative credit instruments in their stores was limited.
- 8.96 Relatively soon after these two retailers began accepting credit cards, they also made significant changes to their store card programmes. Both introduced SBCCs, and their remaining store card programmes—although still substantial—are expected to decline as SBCCs account for a greater share of total cardholders.
- 8.97 It could be argued that these lower-APR products were not sustainable once credit cards were accepted as payment, and therefore that they do not constitute evidence that APRs on other store card programmes could fall. Furthermore, even if they were considered sustainable, [redacted]. Finally, within the range of changes to the 'traditional' business model outlined in paragraph 8.92 above, the two programmes might be unusual: [redacted].

¹⁴⁶JLP began to accept credit cards in 1999, Marks & Spencer in 1999/2000.

- 8.98 We do not accept that the programmes were not sustainable. Both have now been outsourced to HSBC. [X]. Overall, we conclude that, while these retailers are somewhat unusual and their approach is unlikely to be replicable precisely by a rival, that approach is not so exceptional as to be irrelevant to the question of whether other APRs are too high.
- 8.99 The recent introduction by GECF of combined programmes in Debenhams, ASDA and Mothercare also suggests that such programmes, which involve at least some store cardholders being offered lower APRs than before, are regarded as commercially viable.
- 8.100 Taking all the above evidence into account, it is clear that a few lower-APR store cards already exist and some new ones have recently been introduced. Such are the differences between the types and circumstances of the retailers that have opted for lower APRs that it is impossible to draw firm conclusions as to how many other store card programmes would be viable with APRs at the level of, say, the JLP store card.¹⁴⁷ Nevertheless, [X] clearly considers that lower APRs (that is, under 25 per cent) may be sustainable, and viable store card programmes built on them, even where retailers have cardholders with relatively small balances: for example, the average balance on a [X] store card under its new programme is forecast to be around £[X]—about the average balance for this provider.
- 8.101 In summary, different types of retailer can and do have store card programmes with APRs significantly below the 30 per cent ‘traditional’ model, where they have wanted these. Furthermore, some providers are prepared to accommodate requests for such programmes when contracts come up for re-tender.

Findings on whether APRs are above competitive levels

- 8.102 Taking into account all the matters set out in paragraphs 8.51 to 8.101, we find that:
- (a) Credit card APRs are in general significantly lower than those on store cards; in particular, approximately 80 per cent of general credit card customers pay an APR of less than 20 per cent and almost 90 per cent pay an APR of less than 22 per cent; and APRs on SBCCs (which may be the nearest substitute for some store cards) are in the range 13.9 to 22.9 per cent (paragraph 8.56).
 - (b) There is no obvious relationship between store card APRs and average balances, bad debts, revolve rates and acceptance rates. If store cards reflected costs, we would expect to see different APRs across store card programmes. (paragraphs 8.59 and 8.60).
 - (c) From the mid-1990s until very recently, APRs on most store cards have remained unchanged, despite falls in funding costs (paragraph 8.62).
 - (d) As a whole, the store card sector generated net profits in excess of the cost of capital over the period 1999 to 2004 of around £270 million (paragraph 8.74).
 - (e) The largest provider earned profits that were persistently and substantially in excess of the cost of capital between 1999 and 2004 (paragraph 8.77).
 - (f) The evidence on profitability, and in particular the persistently high profitability of one provider representing a substantial part of the market, is consistent with, and

¹⁴⁷Until the end of 2005, 14 per cent, and raised to 15.5 per cent from February 2006.

indicative of, a lack of competitive pressure on APRs, late payment fees and insurance charges in the store card sector (paragraph 8.82).

- (g) Retailers' desire for high acceptance rates can be achieved by agreement between retailer and provider. It does not require the APR to be raised to cover the expected net costs of the 'marginal' least creditworthy cardholder (paragraph 8.90).
- (h) Different types of retailer can have store card programmes with APRs significantly below the 30 per cent 'traditional' model, where they have wanted these. Furthermore, providers are prepared to accommodate requests for such programmes when contracts come up for re-tender (paragraph 8.101).

We therefore find that store card APRs are above competitive levels.

Overall findings on APRs

8.103 The evidence discussed so far in this section—relating to how APRs are set and whether APRs are above competitive levels—has led us to make a number of findings and two main findings, namely (a) that there is little or no competitive pressure on the setting of APRs (see paragraph 8.49) and (b) that APRs are above competitive levels (see paragraph 8.102). Taken as a whole, these findings have led us to conclude that store card APRs are insulated from the competitive pressures that would otherwise be brought to bear on them from general credit cards and, in particular, SBCCs.

8.104 We therefore considered whether this insulation might be attributable to any feature (as defined in section 131(2) of the Act and summarized in paragraph 8.2) of the downstream market, either alone or in combination. In our consideration, we took into account not only our findings so far in this section, but also those resulting from our analysis of the market in Section 6 (as summarized in paragraph 6.190). We identified a number of such features either of structure or conduct (as defined by the Act) that in our view have together brought about or contributed to the insulation, and we set these out below:

- (a) providers and retailers structure the store card offer in such a way that many store cardholders take out such cards to obtain the retail benefits they offer rather than the credit available on them;
- (b) most retailers offering store cards do not exert competitive pressure on store card APRs; and
- (c) most retailers' customers do not exert competitive pressure on store card APRs (either at the take-up stage or when they take credit) because their sensitivity to them is low.

We return to these features later when addressing the statutory questions in Section 9.

8.105 We now consider the two other main revenue sources for store card providers,, namely late payment fees and card-related insurance. We turn first to late payment fees.

Late payment fees

Introduction

8.106 Store card providers impose charges on their cardholder customers when, for example, they fail to make payments by the due date or exceed their credit limit. By far the most important of these charges in terms of the revenue they bring to providers are late payment fees¹⁴⁸ and we confine our discussion in this part of Section 8 to such fees. As with APRs, we are concerned with whether, and if so to what extent, there are competitive pressures operating to keep late payment fees at competitive levels.

8.107 We begin by describing briefly the setting, pricing and levying of late payment fees and the policies underlying their application by credit providers (paragraphs 8.108 to 8.112). (A more detailed description of these matters is in Appendix 8.7.) We then consider the role of retailers in the setting and levying of these fees (paragraph 8.113 and customer awareness of, and sensitivity to, them (paragraphs 8.114 to 8.121). We touch briefly on cost issues (paragraphs 8.122 and 8.123) before reaching our findings in paragraphs 8.124 to 8.126.

The setting and pricing of late payment fees

8.108 Late payment fees may be levied on store card cardholders who miss one or more payments. They take the form of a flat fee. The levying of late payment fees is subject to regulation under the UTCCRs (see paragraphs 4.8 and 4.21).

8.109 Providers have a variety of fees and fee-charging policies for late payment and in 2003 there was a range of fees of between £5 and £25. One provider [X] did not levy these fees on its store card from 1999 to 2003 and [X] did not do so until 2002. Table 1 in Appendix 8.7 sets out the fees of the main providers from 1999 to 2003.

8.110 Over the period from 1999 to 2003, all the providers that levied late payment fees increased their total revenue from such fees. Asked why charges had risen, providers typically said that this was because of previous under-recovery of costs and the fact that their costs associated with late payments had risen.

Late payment fee application policies

8.111 During the period under review (1999 to 2003), providers had a range of different policies for levying late payment fees. The precise approach differed in each case (see Appendix 8.7), but for most providers the imposition of a fee could be waived or varied in particular circumstances (for example, on the first occasion when a cardholder who usually paid off the balance on time missed a payment), usually at the discretion of the provider's staff.

8.112 The decision made by some providers to waive late payment fees in certain circumstances means that the total costs to be recovered through these fees must be recovered from a smaller number of cardholders.¹⁴⁹

¹⁴⁸There appears to be no standard terminology in the store card sector, the terms 'late payment charges' and 'late payment fees' being used interchangeably. In this report, we adopt the term 'late payment fees' to describe the fees imposed on cardholders when they miss the due payment date. The OFT's current investigation of credit card default charges (see paragraph 4.21) includes late payment fees.

¹⁴⁹Although certain administrative costs might be saved through levying fewer charges.

Retailers' role in the setting and levying of late payment fees

8.113 Unlike APRs, late payment fees do not, typically, feature in the negotiations between providers and retailers. For example, we were told by one retailer [X] that the fee for late or missed payments on its store card was a matter determined by [X] and was not a negotiable matter. Another retailer [X] told us that policy on late payment fees was a matter decided by [X]; and that although this retailer had discussed levels of late fees with its provider, it was not a high priority by comparison with other matters relating to the provision of the card. A third retailer [X] also told us that the collection of late payment fees had not been part of the contractual arrangements between itself and its provider. A fourth retailer [X] told us that it had no control over late payment fees, which were set by [X]. A fifth retailer, [X], told us that it was anxious to enforce its own wording on the letters that went to cardholders to levy late payment fees, because complaints about these were often made to the retailer, rather than to the provider itself. But the weight of the evidence suggests that the level of the fees and the policy on the levying of those fees are generally matters decided by the provider.

Awareness of late payment fees by retailers' customers and store cardholders

8.114 Two providers, Style and GECF, told us that late payment fees were fully transparent and cardholders were made fully aware of them. Barclaycard told us that most cardholders would be aware of the existence of late payment fees even if they could not remember the exact level of those fees. Moreover, it said, the tariff of fees was set out clearly for customers at the point of sale and was also shown in the summary box on the agreement. Arcadia and GECF thought that cardholders would take account of the level of late payment fees, particularly when having to choose to make payments from limited resources. Arcadia and Bhs thought that cardholders were likely to be aware of the relative leniency on the part of some providers in levying these fees and would regard this as a selling point in respect of a particular store card.

8.115 We considered what information about the level of late payment fees, and the provider's policy on levying them, was available to retailers' customers before they took out a store card, and to cardholders when they received their monthly statement. So far as the level of fees is concerned, we accept that the tariff is usually set out clearly in the agreement signed by customers when they take out a card, including in the summary box. However, this information is not generally shown on the monthly statements sent to cardholders, or at any rate is not generally brought specifically to the attention of cardholders by being given particular prominence on the face of the statement (see Appendix 4.1, which sets out the information that providers currently include on monthly statements to cardholders). Moreover, to the extent that the provider has a policy of applying leniency on the levying of late payment fees in certain circumstances, the precise circumstances are not made available to cardholders as a matter of course. Very often, it is left to the discretion, within broad guidelines, of call centre staff to forgo late payment fees in individual cases.

8.116 Survey evidence of store cardholders shows low awareness of late payment fees. The NOP survey conducted on behalf of the OFT¹⁵⁰ found that fewer cardholders were aware of late payment fees than were aware of the APR. Only 30 per cent said that they were told about, or that the printed information they were given mentioned,

¹⁵⁰The results of this survey are available on the CC website at:
www.competition-commission.org.uk/inquiries/current/storecard/nop_report.htm.

late payment fees. 50 per cent said that they were not given any information and 20 per cent said they did not know what the fee was. The ORC quantitative survey conducted on behalf of the CC¹⁵¹ found that 73 per cent of revolvers and 90 per cent of non-revolvers were unaware of the amount of the late payment fee. A survey of cardholders conducted by one provider [X] found that around two-thirds of revolvers were unaware of the late payment fee. Of the remainder, 12 per cent had a rough idea of the amount of the charge, 11 per cent had a fairly accurate idea, and 14 per cent knew the value exactly.

- 8.117 We do not have survey evidence on whether cardholders are aware of providers' specific policies on the application of late payment fees. Even if cardholders were aware of the policy on the application of these fees as set out in the terms and conditions, some providers have told us that their written policies, which are not made available to all customers as a matter of course, are interpreted by call centre staff on a case by case basis. Indeed, (as we said in paragraph 6.84), we think it unlikely that retailers' customers (when deciding whether to take out a store card), or cardholders (when deciding whether to use it to pay for goods) consider late payment fees, since they are unlikely at either of those stages to foresee themselves incurring these fees. If cardholders take late payment fees into account at all, it is more likely that they do so when deciding whether to pay off balances, but we consider that they would only do this in the limited circumstances where they had sufficient funds to make the minimum payment on either a store card or a credit card, but not on both. They would also need to know the relative level of fees on each card, either from memory¹⁵² or by referring to the terms and conditions they received on taking out the card, as this information is not displayed prominently on statements.
- 8.118 Notwithstanding the above, we accept that there may be some weak constraints on the level of these fees. If for example a store cardholder has in the past been charged a fee for late payment and regarded this as disproportionately high or unfair in other respects, such a cardholder might consider using another payment method next time, for example a credit card. The cardholder might even consider using another store if he or she were sufficiently disaffected.
- 8.119 GECF put it to us that any absence of competitive constraint in charging late fees would be neither meaningful nor relevant to our concerns in the inquiry since (a) late fees on store cards were lower than those levied on credit cards, which the CC acknowledged were subject to ample competitive constraints; and (b) the sums payable were limited by law by reference to the costs arising from contractual breach. So far as point (a) is concerned, the CC has taken no view on the question whether credit cards are, or are not, subject to ample competitive constraint. We have, however, already noted (paragraph 3.59 and Table 3.5) that the proportion of income derived from late payment fees is similar for both credit card and store card providers (the store card average being 9 per cent and the credit card average being 8 per cent), although of course the absolute income from such fees reflects the considerably larger balances on credit cards than on store cards. This is not, in any event, a matter that store cardholders consider when taking out or deciding whether to revolve on a store card (see next paragraph). As regards point (b), we accept that the level of late payment fees is constrained to some extent by law, but we do not consider that this affects our findings as regards the degree of competitive constraint on store cards since strong competitive constraints might, among other effects, force providers to look for ways of reducing their costs.

¹⁵¹The results of this survey are available on the CC website at:
www.competition-commission.org.uk/inquiries/current/storecard/surveys.htm.

¹⁵²However, as noted in paragraph 8.116, surveys have shown that the majority of consumers do not know how much the late payment fee is.

8.120 A number of parties mounted a similar, but slightly broader argument, namely that store cards competed with other credit facilities against a range of value criteria, including (but not limited to) APRs. For example, GECF argued that store cardholders weigh up the costs and benefits of store cards compared with the costs and benefits of other kinds of payment and credit instrument. These costs and benefits, it said, included the quality of service, the size of up-front discounts, acceptance rates, other benefits and promotions associated with a credit offering, and various non-APR price elements associated with the offering (for example, late fees and other charges). Cardholders were able, GECF said, to make informed and rational choices to pay small amounts of interest at a higher APR rather than to risk being exposed to what it called 'aggressive' late fees and other charges imposed on credit cards that might have lower APRs. GECF said that this was illustrated by the following example: a store cardholder revolving on a balance of £300 for a period of up to 12 months at a 28 per cent APR incurred a lower cost (£342) than on a 15 per cent APR credit card with one late £20 fee (£343).

8.121 We acknowledge that some store cardholders may be well aware of the options open to them when they elect to revolve on higher APR store cards rather than lower APR credit cards in the circumstances described in the previous paragraph. Some may do so for the reasons given, others out of inertia or because of a wish to compartmentalize their borrowing. However, GECF's examples (cited in the previous paragraph) are of cardholders with average outstanding balances: a balance of £300 is considerably lower than the £800 average balance of store cardholders who make the minimum payment or less each month (see paragraph 3.31). For cardholders with balances above £300, the results would be less favourable: thus, in the example cited in the previous paragraph, a cardholder with a balance of £500 paying 28 per cent over 12 months would pay £570, as against £558 on a 15 per cent credit card plus one £20 late fee. (And the cardholder with a balance of £800 would pay even more relative to the holder of a credit card.) But in any event, as already noted (paragraph 8.115), we have seen no evidence to suggest that cardholders in general decide to incur interest-bearing balances on store cards because of the relative leniency of the late payment fees policy on those cards as compared with other types of credit. In particular, there is no evidence that cardholders compute some kind of 'total cost' of using a store card, trading off high APRs against low late payment fees or other charges. Indeed, it might be expected that borrowers who intend to pay their debts would prefer low APRs and high late payment fees.

For all these reasons, we find that most retailers and store cardholders exert little or no competitive pressure on the level of late payment fees.

Costs attributable to late payment fees

8.122 We observed in paragraph 8.7 that store card costs are largely common costs; for this reason we did not consider it appropriate to examine separately the cost-reflectiveness of each of the three main revenue streams, of which late payment fees is one. To the extent possible, we have analysed the income and costs of the store card providers in Appendix 8.1. This shows that, in 2003, the proportion of operating costs recovered through late payment fees varied from 10 to 41 per cent for those larger providers in the market that levied these fees.

8.123 We note that the OFT is investigating default charges levied on credit and store cards (see paragraph 4.21). It is examining, among other matters, how the 'reasonableness' of late fees should be calculated and, in particular, how to establish that any such fees are a reasonable pre-estimate of the loss suffered by the party (a requirement of the UTCCRs). This investigation was in progress when we published our report.

Findings on late payment fees

8.124 Our findings on late payment fees are as follows:

- (a) the level of late payment fees and the policy on the levying of those fees are generally matters decided by the provider (paragraph 8.113);
- (b) while information about the level of late payment fees may be readily available to customers at the time they enter into a store card agreement, such information is generally not brought to cardholders' attention when they receive their monthly statement; nor is the provider's policy on applying leniency in some circumstances generally made available to cardholders as a matter of course (paragraph 8.115);
- (c) awareness of the amounts charged by way of late payment fees is low among store cardholders, who do not take such fees into account when either taking out a store card or when deciding to take credit on the card, (paragraph 8.116 and 8.117);
- (d) there may be some weak constraints on the level of these fees (if for example a store cardholder has in the past been charged a fee for late payment and regarded this as disproportionately high or unfair in other respects) (paragraph 8.118); and
- (e) there is no evidence that cardholders compute some kind of 'total cost' of using a store card, trading off high APRs against low late payment fees (paragraph 8.121).

Hence, overall we find that there is little or no competitive pressure on the levels of late payment fees from either retailers or cardholders.

Overall findings on late payment fees

8.125 The evidence considered in paragraphs 8.108 to 8.121—relating to late payment fees—has led us to make a number of findings, and an overall finding that little or no competitive pressure is exerted by either retailers or cardholders on the levels of late payment fees. Taken as a whole, these findings have led us to conclude that such fees are insulated from the competitive pressures that would otherwise be brought to bear on them.

8.126 We therefore considered whether this insulation might be attributable to any feature (as defined in section 131(2) of the Act and summarized in paragraph 8.2) of the downstream market, either alone or in combination. We identified two such features, either of structure or conduct (as defined by the Act), that in our view have together brought about or contributed to the insulation, and we set these out below:

- (a) most retailers offering store cards do not exert competitive pressure on the level of, or the provider's policy in relation to, the levying of late payment fees; and
- (b) most retailers' customers do not exert competitive pressure on the level of late payment fees levied on store cards because their sensitivity to them is low.

We return to these features later when addressing the statutory questions in Section 9.

The sale of insurance with store cards

Introduction

- 8.127 The third main revenue source for providers is card-related insurance. In this part of Section 8, we consider whether insurance purchased in association with the provision and use of store cards is subject to competitive pressure.
- 8.128 We have described briefly in Section 3 the kinds of insurance offered, particularly PPI,¹⁵³ and how it is sold; further details are in various appendices to Section 3. We are concerned here primarily with PPI, since this is the type of cover offered with store cards and which has typically been offered in store at the same time as the consumer has taken out a store card (or at a later stage, often by telemarketing). We consider first the arrangements for store card insurance provision between providers and retailers (paragraphs 8.129 to 8.141) and then consider the offer of insurance to cardholders (paragraph 8.142 to 8.156). Our findings on insurance are at paragraphs 8.157 to 8.159.

Arrangements between credit providers and retailers

- 8.129 We consider first what competitive pressures appear to be exerted on providers as regards the pricing of store card insurance premiums to cardholders.
- 8.130 In paragraphs 6.24 to 6.27, we considered the boundaries of the market for providing insurance services within store card programmes and concluded that these were co-extensive with upstream store card credit services more generally. In particular, we said that we saw little possibility of substitution outside the market for store card services, as retailers tended to accept the insurance supplier engaged by the store card provider, rather than reaching out to ‘third-party’ insurers.
- 8.131 We found (see paragraph 6.24) that retailers benefit both directly and indirectly from the sale of store card insurance to their retail customers. They may benefit directly through payments made to them by providers in the form of commission-sharing or periodic payments conditional on targets, such as insurance penetration, being met. Retailers also benefit indirectly, since the revenue from insurance contributes to the funding by providers of retailers’ marketing schemes for the store card; and as the card programme becomes more profitable as the result of insurance income, the retailer would expect a better deal when re-tendering the contract than would otherwise have been the case. In our view, therefore, retailers benefit from insurance being sold as part of the store card offer and have a disincentive to seek alternative provision for their customers. Although we noted a few examples where retailers had made their own insurance arrangements, we concluded that these were exceptional.
- 8.132 We noted, however, in the course of our discussion of the market definition of insurance services associated with store cards that retailers may be concerned about the price of the insurance offered to their retail customers to the extent that this threatens their brand image (see paragraph 6.24). We now discuss this aspect more fully, with a view to examining the extent, if any, to which such concern puts any downward pressure on PPI premiums to cardholders.
- 8.133 We were told by two providers [redacted] that PPI was included as part of the tender negotiation between the provider and the retailer and was subject to the same

¹⁵³As explained in paragraph 3.46, we use the abbreviation PPI to mean payment protection insurance, whether offered with or without purchase protection and/or price protection insurance.

competitive pressures as other aspects of store card operations. Retailers had increasing power, we were told, to decide on the insurance arrangements. GECF told us that retailers had a direct interest in the insurance offering to their customers and used their strong negotiating position, in a bidding market, to influence it. This, it said, was because, first, the insurance element of the store card offer gave retailers' customers the incentive to use the store card over other means of payment, including credit cards; and second, the price protection element was an incentive to those customers to make an immediate purchase with the store card rather than wait in the hope that the item would be reduced in a sale. To the extent, therefore, that any competitive pressure is to be exerted on insurance provision, we would expect it to come from retailers.

- 8.134 [X] pointed to examples of direct retailer involvement in the nature and scope of the insurance offer: thus, it said that [X] had requested a particular, basic payment protection product that was in line with its [X] policy; that the [X] insurance policies were limited to payment protection at the specific request of those retailers; and that two [X] retailers had chosen to retain one of [X] previous policies ([X]) which was more in keeping with their brand positioning rather than take up its newer insurance package offering enhanced cover at a higher price. [X] also said that some retailers had stopped offering PPI at the point of sale altogether because of the ICOB rules governing the sale of such insurance (see paragraph 4.13).
- 8.135 We considered these points carefully. With respect to GECF's argument that retailers have a direct interest in the sale of products (particularly price protection insurance) that encourage customers to make an immediate purchase using their store card, we do not doubt that this is the case. We are not, however, persuaded that retailers are, in general, concerned with the absolute price of such cover. While we acknowledge that there are examples of retailers that are particularly concerned about the pricing of the insurance offer with their store card, because they do not want that element of the offer to appear out of line with their more general pricing stance, the evidence submitted to us suggests that most retailers are content to allow their store card credit provider to set the premiums for PPI. It is significant that they do so, notwithstanding the increasing negotiating power of retailers to which providers drew our attention (see paragraph 8.133) at the upstream level (see Appendix 7.10).
- 8.136 Thus, one retailer [X] told us that store card insurance was provided and set by its provider [X]; although there might be discussions between the parties, the position was similar to that on APRs, namely, that [X] controlled the price of both. A second retailer [X] told us that the price of insurance was set by reference to the prices of its main competitors; the predominant consideration for this retailer was comparability with those competitors. A third retailer [X], which told us that store cards were an important part of its retail offer, said that the insurance element of the negotiations with its provider had been simply one element of the contractual package and had not been of great interest or concern to it; from this retailer's point of view, it was enough that the product was 'low maintenance' (in the sense that the underwriting and administration were carried out by the provider), was provided by a trustworthy supplier and provided this retailer with ancillary benefits (via the revenue stream it generated for the provider). None of this retailer's customers had raised the question of store card insurance with it as a matter of concern. A fourth retailer [X] told us that its insurance protection package was provided and priced by its provider [X]; it was there if the customer wanted it, but this retailer did not 'push' it.
- 8.137 From these and other submissions from retailers, it is clear to us that, for the most part, retailers view insurance as an integral part of the services offered by the provider, and the revenues generated from its provision as part of the provider's overall revenues, used to fund the retailer's store card programme and ultimately

benefiting the retailer to a greater or lesser extent. So long as cardholder premiums are not out of line with those of their retail competitors and customers do not complain to them about premium levels (and we received no evidence that they do complain), retailers appear generally content to surrender responsibility for insurance entirely to their provider. Because they benefit directly or indirectly from the insurance revenues flowing to the provider—either through the marketing benefits which these revenues fund, or through income share arrangements—retailers have little incentive to seek to drive premiums down, or (in most cases) to seek to de-couple insurance provision from the provision of store card credit.

- 8.138 There are exceptions—some retailers want their insurance offer to be seen as consistent with their more general retail strategy (see paragraphs 8.132 and 8.134)—but for the most part retailers’ approach to insurance appears to mirror that of their attitude to APRs; that is, they want prices to be competitive with those of retail competitors, but have little incentive to undercut them. As we have already noted, providers have every incentive to maximize their margins on insurance provision and are constrained in the setting of premiums only to the extent that their retail clients have a contractual right to be consulted on the level of those premiums and the negotiating strength to influence them. Indeed, in 2003 two providers, [redacted], increased their charge for the majority of their retailers by 50 per cent, from 1 per cent to 1.5 per cent of account balances. While these providers did also increase the insurance cover offered, insurance gross profit margins have not declined and this suggests that their insurance profit per customer taking insurance increased further as a result of the price increases.
- 8.139 One provider, GECF, also put it to us that retailers could, and did, specify that third-party insurers were to provide the cover, with the store card provider acting as agent. This provider argued that third-party insurance providers could enter into agreements with retailers if they saw a profitable opportunity; and since the retail market was competitive, and value passed back to retailers, there was no reason to think that this process was not effective.
- 8.140 We have already found that there is little possibility of substitution outside the market for store card insurance services on the demand side, because retailers have little incentive to look wider and accept the insurance supplier engaged by the store card provider. We noted (paragraph 6.26) that examples of retailers making their own store card insurance arrangements were exceptional. For the reasons set out above—together with the consumer insensitivity we have already identified—retailers have little incentive to use their enhanced negotiating power to extract better terms for their retail customers. On the supply side, entry by third-party insurers is made more difficult because of the nature of the store card business. This would place obstacles in the way of the de-coupling of PPI provision from the provision of store card credit itself and hence to the opening up of this service to more competition were third-party insurers to see scope profitably to undercut existing PPI premiums. The entry of third-party insurers would be hampered for a number of reasons. First, premiums (covering all the components of the PPI package) are charged as a fixed percentage of the outstanding balance on a cardholder’s monthly statement (rather than, for example, by way of a fixed charge per period for discrete components of the package) and neither the retailer nor a third-party insurer has access to these balances. Entrants would need sufficient information about the customer base, lending volumes and patterns, the existing penetration rates and the profitability of the current scheme in order to assess the costs and risks on which their prices would be based. Second, under the current arrangements, insurers have an advantage that their product is offered at the point of sale, at the time the customer takes out a store card. PPI is a secondary product, taken out only after a decision has been made to obtain a store card, and so the insurance package offered with the card is more likely

to be taken up by the cardholder than similar cover offered separately at a later date. We were also told by both providers and retailers that administrative difficulties for the retailer and potential confusion for the customer would be caused if suppliers of PPI were different from the suppliers of the store card itself.

- 8.141 We therefore find that, so far as arrangements between credit providers and retailers for the provision of store card insurance are concerned, there is little or no competitive pressure on the pricing of insurance premiums to cardholders.

The offer of insurance to cardholders

- 8.142 We now consider whether store cardholders exert any competitive pressure on the price of store card insurance or on the terms and conditions under which it is provided to them. We address first the selling of different kinds of insurance as a 'bundled' package; then we discuss the circumstances under which such insurance is sold in store.

Bundling

- 8.143 As we have seen, consumers taking out a store card are typically offered store card insurance in a PPI package consisting of either three elements (payment, purchase and price protection insurance), or two of these three components (generally payment and purchase protection), at an all-in price.
- 8.144 GECF said that offering insurance to customers through a PPI package was popular and valued by them. The customer benefited from being able to select insurance cover that was a simple, comprehensive package, focused on his or her store card. Consumers were, GECF said, generally happy with the bundled package, as evidenced by its relatively high market penetration.
- 8.145 GECF also pointed to the evolution of PPI as a package—'bundling', it argued, was both commercially rational and economically efficient. There were other models, but attempting to implement unbundled offerings or different pricing for the purchase and price components in the current regulatory and marketplace environment might actually reduce consumer choice, GECF said, create different pricing inequalities and result in many consumers paying more for their cover than was currently the case. There was no perfect basis for charging, GECF told us, and a fixed annual fee for insurance cover also had inequities. GECF also argued that unbundling the PPI package could result in reduced consumer choice at the point of sale, as it was likely not to be possible to offer important elements of the unbundled product (that is, purchase and price cover) separately at the point of sale. GECF added that there was a strong risk that changing the current pricing mechanism would lead inexorably to the loss of the primary, and essential, route to market for the elements of cover that became unbundled, thereby negatively impacting on consumer choice.
- 8.146 We have considered these points and in particular whether the bundling of the different elements of store card insurance outweighs the disadvantages for cardholders. To the extent that any of the elements—payment, purchase or price protection insurance—are packaged together and are not individually available, cardholders have no choice but to purchase all the (two or three) elements covered under the package even if they want or need only one or two of them. Moreover, the pricing of each element lacks transparency. This is particularly important, since the nature of the risk arising from the separate elements is different. The risk covered by payment protection insurance is related to the balance outstanding each month, but the risk covered by purchase and price protection insurance is related to the value of

the transaction. As a consequence, some customers who revolve their store card balance will continue to pay for elements of the package that they no longer require or which no longer provide them with cover. This is because price and purchase protection last only for a given period, typically 90 days; so a customer who revolves existing credit beyond that date, and makes no further purchases, continues to pay for these elements after the period of protection has come to an end. Indeed, whereas transactors pay just once for purchase and price protection on a particular transaction, revolvers pay many times, as they carry on paying the bundled premium until they have paid off the balance of that particular transaction.

8.147 The FLA¹⁵⁴ put it to us that, so far as revolvers' continuing to pay for insurance they no longer required or were entitled to receive was concerned (see previous paragraph), the proportion of the premium relating to those risks was minimal, and so it would make very little difference if they were split out; moreover, it would increase costs if each cover was administered separately. The FLA added that it was possible that the market had already found the most efficient means of providing effective store card insurance cover: consumers were able to protect themselves with the minimum of effort; premiums were collected automatically and 90 per cent of claims were accepted; and the benefits automatically reduced cardholders' store card debt. Two insurance underwriters, [X] and [Y], said that bundling meant that consumers were offered the products effectively at a discount. Other parties argued that offering insurance as separate elements would be confusing and expensive.

8.148 We accept that there could be cost implications if each element of PPI were offered separately, although we note that some retailers, for example, JLP and Marks & Spencer, already offer payment protection insurance alone. However, the current upstream arrangements between retailer and provider for the provision of insurance reduce choice for consumers and may inhibit the development of competition for the individual elements of the bundled product. Given the lack of pressure exerted on the price of PPI cardholder premiums upstream, this means that the scope for alternative and potentially more competitive offers to cardholders is limited. Moreover, we do not accept, as the FLA argues, that the proportion of the premium attributable to elements of PPI that revolvers continue to pay for, even when they no longer enjoy or are entitled to receive the benefits, is minimal. Premiums charged to cardholders for the bundled PPI product are considerably greater than those for payment protection alone. Thus, the typical charge for PPI (which includes protection for payment, price and purchase) is 99p to £1.50 per £100 of balance; this compares with 70p to 80p for payment protection insurance offered on its own (see Appendix 3.4).

8.149 We therefore find that the bundling of insurance deprives cardholders of choice, in that it forces them to buy products they might not need or want, and contributes to a lack of transparency, given that the price of the individual elements of the package is not available to them.

The sale of store card insurance in store

8.150 The second area of concern relates to the circumstances under which store card insurance is sold to consumers in store. Since customers' main purpose in visiting the store will be the purchase of goods or services, it may not always be easy for them to absorb the important features of an insurance policy offered at the same time as they take out a store card, itself a secondary product. There are a number of key terms and conditions that consumers need to understand before committing themselves to the PPI package; our attention was drawn in particular to matters such

¹⁵⁴The FLA represents some 95 per cent of the store card sector (see Glossary).

as exclusions (on age or other status grounds), limitations on the duration of the cover, and the question of how much of the outstanding balance would be paid by the insurer in the event that the insured cardholder could not meet his or her monthly payments. It is for reasons such as these that the ICOB rules on the selling of insurance have been introduced (see paragraphs 4.13 and 4.14 and paragraphs 8.154 and 8.155 below).

- 8.151 GECF argued that offering insurance at the point of sale was fundamental to the efficient and effective take-up of insurance on store cards. The provider benefited, GECF argued, from the reduced marketing and administrative costs available through the infrastructure being shared with the basic store card product; and the retailer benefited from being able to offer an insurance solution that promoted the consumer's use of its store card. It was at this stage, it said, that customers were taking decisions on the overall package they wanted and were, consequently, considering the value of insurance to them. GECF told us that store card insurance sold on a subsequent telemarketing or direct mail basis was both disadvantageous for cardholders, who could not readily be reached through outbound telemarketing, and who would therefore lose the opportunity to have the product if they could not purchase it at the point of sale, and commercially more costly for providers. [REDACTED].
- 8.152 Survey evidence, however, suggests that purchasers of store-card-related insurance have a weak understanding of why they buy it and the nature and extent of the cover it provides. Responses to the OFT survey showed that less than half of respondents with PPI gave a specific reason for taking out the insurance, while a majority (52 per cent) gave the response that it was sensible to have insurance 'just in case'. It was put to us by Barclaycard and GECF that much insurance is taken out for precisely this reason and did not indicate consumer insensitivity. The CC's quantitative survey suggested that those who paid for insurance had given relatively little consideration to other ways of covering themselves against the relevant risks: a quarter said they had never thought of other ways and a further quarter answered 'Don't know'. Only 14 per cent mentioned income protection insurance (other alternatives mentioned included mortgage protection, critical illness, health and life insurance). This survey also asked respondents what were the main risks covered by the insurance: 15 per cent of those who paid for insurance answered 'don't know' and less than half (49 per cent) mentioned insurance against loss of job or involuntary unemployment.
- 8.153 The evidence from the surveys carried out by CC and OFT also supports the view that consumers do not always understand the circumstances under which they would be able to make a successful claim. The CC's quantitative survey found that over 70 per cent of respondents admitted to not knowing what percentage of their balance would be paid each month by the payment protection element of the cover if they lost their income.¹⁵⁵ A further 13 per cent thought (wrongly) that 100 per cent of the balance would be paid. Moreover, the survey evidence suggests that not all cardholders understood their cancellation rights in respect of the insurance they had taken out with their store card. Our survey also found that 38 per cent of respondents thought that they could not cancel the insurance agreement without cancelling the store card agreement. A survey of customers with PPI conducted by one provider, [REDACTED], produced results that were broadly consistent with the CC and OFT surveys so far as consumer knowledge of their cancellation rights and knowledge of policy exclusions was concerned. This survey nevertheless found that a high proportion of respondents said that they had a good understanding of the features and benefits of cover and that sufficient information was given at the time the insurance was taken

¹⁵⁵We set out in Appendix 3.4 a summary of the cover provided by each of the provider's insurance packages. It will be seen that the extent of the cover provided by payment protection varies by policy, but a number of policies limit cover to a maximum amount per month.

out. However, we note that only one-third of those respondents were aware of what percentage of their balance would be paid each month if they lost their income.¹⁵⁶

- 8.154 One provider [§] put it to us that the new obligations and responsibilities placed on those involved in selling store card insurance were very considerable. This provider pointed out that the ICOB rules required insurance intermediaries to ask specifically whether a customer already had cover for the risks the policy was intended to cover, and to go through the policy in some detail with the customer, pointing out matters such as exclusions and limitations on the duration of the cover. In short, the ICOB rules were designed to address our concerns about possible lack of transparency in the insurance offer. Another provider, [§], provided us with detailed information describing how it intended to meet the new obligations surrounding the offer of store card insurance in store.
- 8.155 The ICOB rules may well offer consumers greater protection in purchasing store card insurance in store, increase transparency and hence raise consumer awareness. They have already had an impact: thus, most providers have told us that they no longer intend to offer store card insurance in store. However, the ICOB rules do not address our main concerns discussed above: first, the bundling of store card insurance and hence the lack of choice of product available to cardholders; second, that revolvers may be paying for cover they no longer require or for elements of the package that no longer provide them with cover; and third, the problem that there is a lack of competitive pressure on this aspect of the provision of store card services to cardholders, attributable both to the lack of any downward pressure by retailers on store card insurance premiums upstream and the lack of consumer awareness and price sensitivity downstream.
- 8.156 We find that, as with APRs and late payment fees, little pressure is brought to bear on the level of store card insurance premiums by store cardholders in the downstream market, because cardholders are insensitive to the price of such insurance and have a poor understanding of the cover they are purchasing.

Findings on insurance

- 8.157 Our findings in relation to store card insurance are:
- (a) So long as cardholder premiums are not out of line with those of their retail competitors and customers do not complain to them about premium levels, retailers appear generally content to surrender responsibility for insurance entirely to their provider (paragraph 8.137).
 - (b) Third-party insurance providers cannot readily compete to offer more competitive terms to store card credit providers because premiums (covering all the components of the PPI package) are charged as a fixed percentage of the outstanding balance on a cardholder's monthly statement and neither the retailer nor a third-party insurer has access to these balances (paragraph 8.140).
 - (c) So far as arrangements between credit providers and retailers for the provision of store card insurance are concerned, there is little or no competitive pressure on the pricing of cardholder premiums (paragraph 8.141).
 - (d) To the extent that any of payment, purchase or price insurance are packaged together and are not individually available, cardholders have no choice but to

¹⁵⁶We have already noted the limitations on cover in these circumstances—see previous footnote.

purchase all the elements covered under the package even if they want or need only one or two of them; and some customers who revolve their store card balance will continue to pay for elements of the package (purchase and/or price) that they no longer require or which no longer provide them with cover (paragraph 8.146).

- (e) The bundling of insurance deprives cardholders of choice, in that it forces them to buy products they might not need or want, and contributes to a lack of transparency, because the price of the individual elements of the package is not available to them (paragraph 8.149).
- (f) Purchasers of store-card-related insurance have a weak understanding of why they buy it and the nature and extent of the cover it provides (paragraph 8.152 and 153); therefore, little pressure is brought to bear on the level of store card insurance premiums by cardholders, who are insensitive to the price of such insurance and have a poor understanding of the cover they are purchasing (paragraph 8.156).
- (g) The ICOB rules are likely to offer consumers greater protection in purchasing store card insurance in store, and may increase transparency and hence raise consumer awareness. Moreover, they have already had an impact on the extent to which store card insurance continues to be sold in store. However, these considerations do not address our basic concerns: first, the bundling of store card insurance and hence the lack of choice of product available to cardholders; second, that revolvers may be paying for cover they no longer require or for elements of the package that no longer provide them with cover; and third, the problem that there is a lack of competitive pressure on this aspect of the provision of store card services to store cardholders (paragraph 8.155).

We therefore find that little or no competitive pressure is brought to bear on the elements, or the pricing, of insurance sold with store cards.

Overall findings on insurance

- 8.158 The evidence discussed in paragraphs 8.129 to 8.155—relating to the competitive pressures brought to bear on the price and offering of store card insurance to cardholders in the downstream market—has led us to make a number of findings and a main finding that little or no competitive pressure is brought to bear on the types of products offered, or the pricing of insurance sold, with store cards. Taken as a whole, these findings have led us to conclude that store card insurance is insulated from the competitive pressures that would otherwise be brought to bear on it.
- 8.159 We therefore considered whether this insulation might be attributable to any feature (as defined in section 131(2) of the act and summarized in paragraph 8.2) of the downstream market, either alone or in combination. We identified a number of such features, either of structure or conduct (as defined by the Act), that in our view have together brought about or contributed to the insulation, and we set these out below:
- (a) many providers combine different insurance products into packages (that is, payment protection insurance with one or both of purchase protection insurance and price protection insurance) which they sell in association with store cards;
 - (b) most retailers offering store cards do not exert competitive pressure on providers to lower their insurance premiums to cardholders, or to offer the components of their insurance package separately; and

- (c) most retailers' customers do not exert competitive pressure on premiums for insurance purchased in association with the provision and use of store cards because their sensitivity to the price of such insurance cover is low and they have a poor understanding of the terms of the cover they are purchasing.

We return to these features later when addressing the statutory questions in Section 9.

Information on cardholder statements

- 8.160 In Section 4 and Appendix 4.1, we noted varied practice among six providers (Arg Card Services, Creation, GECF, HSBC, Ikano and Style) as regards the information they included on their monthly statements to cardholders (as at mid-2005—see paragraph 4.19). In particular, we noted that only one provider stated the APR (and two others provided the monthly interest rate). Only two stated the level of interest charged on outstanding debt when only the minimum amount was repaid, one giving a detailed explanation. Three included a 'wealth warning'. Four included the levels of insurance charges. Only one routinely listed the levels of late payments or other charges, although most of the others indicated that such charges could be payable in principle or showed the level if the charges had been applied. Finally, none of the providers included information on cancellation rights and methods on their statements, although one provided a telephone number for inquiries. At a later stage of the inquiry¹⁵⁷ we also raised with the parties the question of what information should be provided on store card statements about the possibility of paying by direct debit, since such a facility would assist those cardholders who might otherwise revolve unintentionally.
- 8.161 Two store card providers told us that they already voluntarily applied the APACS Best Practice Guidelines for monthly statements by credit card providers; another said that it was intending to do so. A further two providers indicated that they were reviewing the information carried on their monthly statements. Appendix 4.1 sets out the extent to which providers' practices would be affected if the APACS Guidelines were fully applied, and also charts the likely impact of the changes relating to monthly statements mooted by the OFT and the provisions of the Consumer Credit Bill.
- 8.162 We considered whether this lack of transparency on statements might contribute to, or reinforce, cardholders' lack of sensitivity to APRs, late payment fees and insurance costs and hence to the total costs of revolving on a store card. We note that the providers accepted the desirability of giving cardholders full information about their account, although some warned of the dangers of overloading the statement with too much information, which could be counterproductive.
- 8.163 We acknowledge that the providers are taking steps to improve the amount and clarity of the information included on their store card statements. However, taking all the evidence into account, including the evidence of consumer insensitivity to store card APRs and other charges that we have already discussed (see for example paragraphs 6.100 to 6.115 and 6.126 to 6.142, and our findings on late payment fees and insurance earlier in this section), we find that providers do not include sufficient information on their store card statements, contributing to a lack of transparency in the provision of store card credit and thereby to cardholders taking credit or insurance on terms which are not clear to them.

¹⁵⁷At the provisional findings stage and again in our Provisional Decisions on Remedies.

Overall findings

- 8.164 Our finding in the previous paragraph, together with our other findings (see paragraphs 8.103, 8.125, and 8.158 above) have led us to conclude that store credit and insurance provision are insulated from the competitive pressures that would otherwise be brought to bear on them from general credit cards and, in particular, SBCCs.
- 8.165 We therefore considered whether this insulation might be attributable to any feature (as defined in section 131(2) of the Act and summarized in paragraph 8.2) of the downstream market, either alone or in combination with other features identified above (see paragraphs 8.104, 8.126 and 8.159). We identified one additional conduct feature (as defined by the Act) that in our view has brought about or contributed to the insulation, namely that providers do not include sufficient information on their store card statements, leading to a lack of transparency in the provision of store card credit and card-related insurance, and thereby to cardholders taking credit or insurance on terms which are not clear to them. We return to this feature later when addressing the statutory questions in Section 9.

Cost-reflective APRs

- 8.166 We have discussed the competitive position in relation to the three main revenue streams for store cards, namely APRs, late payment fees and store card insurance. Before setting out formally our answers to the statutory questions, we address the question of how cost-reflective APRs might look across all store card programmes and for different card programmes given their different characteristics. During our inquiry, and using data for the period 1999 to 2003 (subsequently updated for 2004 and 2005—see paragraph 9.11 and Appendix 9.1), we constructed a model of the economics of store cards (which we shared with providers and retailers) showing how different cost and revenue drivers interact to affect the store card programme's profitability. We used the model to show the levels of charges to customers, if those charges were to reflect costs including a return on capital—that is, removing all profits in excess of the cost of capital. Our methodology and results are set out in more detail in Appendix 8.8.
- 8.167 Our model includes as the principal cost components: operating costs, cost of capital and bad debts. These costs are those incurred in providing credit and associated services (insurance) with a monthly-billed card and do not include transfers of a profit-sharing nature between retailers and providers. This is because we were concerned to establish the size of the 'cake' to be divided between retailer and provider (however that might be done), not with the transfers between them. We discuss this approach further in Appendix 8.8, as it was challenged by one of the providers [X], which argued that our calculations did not adequately reflect retailers' costs.
- 8.168 We then used inputs, based on weighted averages across all providers, to calculate cost-reflective APRs. These inputs included the cost of capital, which we based on our own assumptions about funding cost and the cost of intangible assets (set out in Appendix 8.4). Our calculations are set out in Table 1 of Appendix 8.8.
- 8.169 We are unable to separate providers' insurance-related costs from their operating costs generally. This is because, although we know the payment made by the provider to the insurance underwriter and hence the gross profit (that is, the revenue from the cardholder less the premium) on insurance to the provider, we do not know what proportion of the costs included in operating costs should be allocated to the insurance business. Therefore, as will be seen from Table 1 of Appendix 8.8, we

made two alternative assumptions about the providers' insurance costs: first, that the insurance costs are equal to the full net revenue from insurance charges; and second, that the insurance costs are equal to half of the insurance net revenue. As regards late payment fees, we assumed that the related costs were equal to the full revenue from such fees.

8.170 Depending on which of the alternative treatments of insurance costs is adopted, our calculations imply a cost-reflective APR of 22 to 24 per cent. These calculations reflect a weighted average of costs and non-interest income across all providers and programmes.

8.171 We note three important points about our estimated cost-reflective APRs:

(a) The results of our model depend on the inputs and, as with any exercise of this nature, there is a degree of uncertainty about them. As we acknowledge in paragraphs 8.67 to 8.76, and as detailed in Appendix 8.4, our assessment of the cost of equity and of intangibles is subject to a range of uncertainty. Operating costs may fluctuate from year to year (although we consider that the effect of such fluctuations is minimized by taking a five year average), and there may be elements of cost and/or relevant income that have been omitted from our estimate.

(b) Operating costs are based on a weighted average of actual costs across all providers. To the extent that a provider's operating costs are above the weighted average, its cost-reflective APRs will be above the cost-reflective APRs given in paragraph 8.170. Conversely, to the extent that a provider's operating costs are below the weighted average, whether for efficiency or other reasons, its cost-reflective APR will be below those shown in that paragraph.

(c) The data we have used reflects weighted averages across all store card programmes. Individual store card programmes differ in respect of inputs such as average balances, bad debt and revolve rates: some will have lower cost-reflective APRs than the weighted average and others will have higher. However, where a programme has a higher cost-reflective APR, this does not necessarily need to result in cardholders paying a higher APR—a lower APR could be supported by payments (for example merchant fees) from the retailer to the provider.

8.172 As well as calculating cost-reflective APRs on the basis of a weighted average across all programmes, we have also looked at cost-reflective APRs on the basis of a variety of different assumptions about average balances, bad debt rates, revolve rates, operating costs and the cost of capital (see Table 2 of Appendix 8.8). For example, in the case where insurance costs are equal to full insurance income and using our central estimate for the cost of capital:

(a) an average balance of £100 to £200 per active account implies a range for the cost-reflective APR of 20.5 to 25.2 per cent (the lower APR being associated with the higher average balance);

(b) a bad debt rate of 2.5 to 6.0 per cent implies a range for the cost-reflective APR of 19.9 to 24.9 per cent (the lower APR being associated with the lower bad debt rate);

(c) a revolve rate of 75 to 90 per cent implies a range for the cost-reflective APR of 20.0 to 24.5 per cent (the lower APR being associated with the higher revolve rate); and

(d) a cost per active account of £12.50 to £17.50 implies a range for the cost-reflective APR of 20.6 to 25.3 per cent (the lower APR being associated with the lower cost).

Conclusions

8.173 We found in paragraph 8.103 that APRs are above competitive levels; in paragraphs 8.49, 8.125 and 8.158, respectively, that there is little or no competitive constraint on store card APRs, late payment fees or insurance purchased in association with the provision and use of store cards at the downstream level; and in paragraph 8.163 that providers do not include sufficient information on their store card statements, contributing to a lack of transparency in the provision of store card credit. These findings led us to conclude that store card credit and insurance provision are insulated from the competitive pressures that would otherwise be brought to bear on them from general credit cards and, in particular, SBCCs. Having considered whether there are any features (as defined in section 131(2) of the Act) of the downstream market to which such insulation might be attributable, either alone or in combination, we concluded that there were a number of such features and we have set these out in paragraphs 8.104, 8.126, 8.159 and 8.165. We consider in Section 9 whether those features, taken alone or in combination, prevent, restrict or distort competition in the downstream market, and discuss the need for remedial action.

9. Findings and conclusions

- 9.1 We now address the statutory questions set out in Section 5, namely whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK, or a part of the UK, and hence whether there is an adverse effect on competition (paragraphs 9.2 to 9.8); and whether any detrimental effect on customers has resulted, or may be expected to result, from any such adverse effect on competition (paragraphs 9.9 to 9.14). In paragraphs 9.15 to 9.18, we consider the need for remedial action.
- 9.2 The relevant markets for the purposes of this inquiry are (a) store card credit services to retailers and services, including insurance services, related thereto (identified in Section 6 as the ‘upstream market’); and (b) consumer credit services through store cards and insurance purchased in association with the provision and use of store cards (identified in Section 6 as the ‘downstream market’).
- 9.3 As we noted in paragraph 5.1, a reference to a feature of the market in the context of a market investigation is to be construed as a reference to: the structure of the market concerned or any aspect of that structure; any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.¹⁵⁸ ‘Conduct’ includes any failure to act (whether or not intentional) and any other unintentional conduct.¹⁵⁹
- 9.4 During the course of this inquiry we have received a very large amount of evidence,¹⁶⁰ the treatment of which we have described earlier in this report. All that evidence has been carefully considered in accordance with our procedures described in Section 1.¹⁶¹ It has included submissions or responses made in writing or at hearings and other meetings. We have given all parties the opportunity to comment on the issues which we identified as our inquiry progressed. These issues and parties’ responses, together with our findings, are set out in earlier sections. At the end of Sections 6 and 7 (see paragraphs 6.190 and 7.64), and in paragraphs 8.103, 8.125, 8.158 and 8.164, we have drawn together those findings which we regard as relevant to our assessment of the competitive position in these markets and which led us to our conclusions on the issues. These findings led us to identify the features (within the meaning of section 131(2) of the Act) which we have set out in paragraphs 8.104, 8.126, 8.159 and 8.165. In reaching our conclusions, we have, of course, analysed and assessed the totality of the evidence that we received, and have taken into account the findings of fact that we have made on the evidence.
- 9.5 As regards the upstream market (see paragraph 9.2 above), we have found no feature which prevents, restricts or distorts competition and we have concluded that the upstream market is competitive (see Section 7 and, in particular, our finding in paragraph 7.64).
- 9.6 We now turn to our conclusions on the downstream market, that is the market for consumer credit services through store cards and insurance purchased in

¹⁵⁸Section 131(2) of the Act.

¹⁵⁹Section 131(3) of the Act.

¹⁶⁰Much of this was posted on the CC’s website—see Appendix 1.5. In Appendix 1.6, we list the parties who submitted evidence to the CC during the inquiry.

¹⁶¹We set out an account of the conduct of our inquiry in Appendix 1.4.

association with the provision and use of store cards, and which is hereinafter referred to as the relevant market.

9.7 In accordance with the approach described in paragraph 9.4, we conclude that the features of the relevant market set out in paragraph 9.8, and which are those identified in paragraphs 8.104, 8.126, 8.159 and 8.165, have the effect, when taken in combination, of:

- (a) insulating consumer credit services provided through store cards from the competitive pressures that would otherwise be brought to bear on them from credit cards, including SBCCs (which we regard as the closest potential substitutes for some store cards); and
- (b) insulating insurance purchased in association with the provision and use of store cards from the competitive pressures that would otherwise be brought to bear on such insurance.

We therefore conclude that, by so insulating these credit and insurance services in the relevant market, the combination of features prevents, restricts or distorts competition. Accordingly, we find that there is an adverse effect on competition within the meaning of section 134(2) of the Act.

9.8 The following are the features of the relevant market which we have concluded, when taken in combination, have the effects specified in paragraph 9.7:

- (a) providers and retailers structure the store card offer in such a way that many store cardholders take out such cards to obtain the retail benefits they offer rather than the credit available on them (see paragraph 8.104);
- (b) most retailers offering store cards do not exert competitive pressure on store card APRs (see paragraph 8.104);
- (c) most retailers' customers do not exert competitive pressure on store card APRs (either at the take-up stage or when they take credit) because their sensitivity to them is low (see paragraph 8.104);
- (d) most retailers offering store cards do not exert competitive pressure on the level of, or the provider's policy in relation to the levying of, late payment fees (see paragraph 8.126);
- (e) most retailers' customers do not exert competitive pressure on the level of late payment fees levied on store cards because their sensitivity to them is low (see paragraph 8.126);
- (f) many providers combine different insurance products into packages (that is, payment protection insurance with one or both of purchase protection insurance and price protection insurance) which they sell in association with store cards (see paragraph 8.159);
- (g) most retailers offering store cards do not exert competitive pressure on providers to lower their insurance premiums to cardholders, or to offer the components of their insurance package separately (see paragraph 8.159);
- (h) most retailers' customers do not exert competitive pressure on premiums for insurance purchased in association with the provision and use of store cards

because their sensitivity to the price of such insurance cover is low and they have a poor understanding of the terms of the cover they are purchasing (see paragraph 8.159); and

- (i) providers do not include sufficient information on their store card statements, leading to a lack of transparency in the provision of store card credit and card-related insurance (see paragraph 8.165).

Detrimental effects on customers

9.9 We identify the following detrimental effects on customers which have resulted from or may be expected to result from the adverse effect on competition identified in paragraph 9.7:

- (a) most store cardholders who take credit pay higher prices for that credit than would be expected in a competitive market;
- (b) most store cardholders have less choice in relation to the individual elements of insurance cover sold in association with the provision and use of store cards than would be expected in a competitive market;
- (c) some customers who revolve their store card balance will continue to pay for elements of the insurance package (purchase and/or price protection) that they no longer require or which no longer provide them with cover; and
- (d) lack of transparency in the provision of store card credit and insurance leads to cardholders taking credit or insurance on terms which are not clear to them.

9.10 We sought to estimate the scale of the detriment in broad terms, by considering excess prices paid by cardholders who pay interest and insurance charges on store cards. This does not necessarily capture the total customer detriment but it does provide an indication of how material the detrimental effects might be. One way of doing this was to compare the prices actually paid by cardholders with what prices would have been if they had reflected costs, including the cost of capital. Using this general approach, we estimated the detriment in two ways, one using cost-reflective APRs and the other excess profits. We calculated both on a pre-tax basis, as we consider that this is the appropriate method for calculating the customer detriment.

Estimate using cost-reflective APRs

9.11 We had complete data on a consistent basis for the period 1999 to 2003. Using this data, we calculated that in broad terms actual store card APRs were on average some 10 to 20 per cent above what they would have been had they reflected providers' costs across the sector as a whole, including the cost of capital; thus average sector APRs have averaged some 26.5 per cent compared with our calculation for cost reflective APRs of some 22 to 24 per cent. As a result, cardholders made excess payments, across all programmes and all providers, of an average of about £80 million a year between 1999 and 2003. This increases to £105 million a year if we exclude certain programmes where actual prices were less than cost-reflective prices. We considered the effect of extending the period over which the cost-reflective APRs were calculated up to 2005, using available data for

2004 and providers' estimates for 2005.¹⁶² We found that the result of extending the period from 1999 up to 2004 was to increase the weighted average cost-reflective APR to a range of 22.3 to 24.5 per cent and to reduce the estimated annual excess paid by cardholders to about £75 million, or £100 million if certain programmes are excluded. The result of extending the period up to 2005 was to increase further the weighted average cost-reflective APR to a range of 22.9 per cent to 25.5 per cent and to reduce the estimated annual excess paid by cardholders to £65 million, or £90 million if certain programmes are excluded. Our methodology and the basis of our calculation are provided in Appendix 9.1.

Estimate using excess profits

- 9.12 We estimate that the relevant market as a whole, including profit-making and loss-making providers, generated a net profit in excess of the cost of capital totalling about £380 million pre-tax, an average of £63 million a year, during the six-year period between 1999 and 2004. The four profit-making providers generated profits in excess of the cost of capital estimated at £500 million pre-tax, an average of £83 million a year, during the same period. Details are provided in Appendix 8.6. As we also noted in paragraph 8.74, we consider that the profits of store card providers have understated the profitability of store card programmes as a whole, due to the transfer of profits from providers to retailers through profit sharing arrangements. For these reasons, we consider that the level of excess profits of providers in the sector that we found during the period 1999 to 2004 is likely to have understated the total customer detriment in those years. When projected results for 2005 are included, for the seven-year period between 1999 and 2005, providers as a whole, including those making profits as well as loss makers, generated a net profit in excess of the cost of capital totalling about £395 million pre-tax, an average of £56 million a year. This compares with the £63 million referred to above for the six-year period. Over the seven-year period, three providers made net profits in excess of the cost of capital. The equivalent figure for these three profit-making providers together is £525 million, or £75 million a year.
- 9.13 Although the addition of the 2005 figures has resulted in a slight fall in the average annual excess profits for the market as a whole, the excess remains substantial. Furthermore, and in any event, in a market inquiry such as this, we consider that it is appropriate to base our assessment and conclusions on economic, financial and market conditions over a number of years, in this case six or seven, so as not to be unduly influenced by short term factors.

Finding on the customer detriment

- 9.14 We therefore conclude, based on all the evidence, that the detriment to customers in terms of the excess prices paid has been substantial. Based on all the figures set out in paragraphs 9.11 and 9.12, we estimate that over the six or seven year period, the customer detriment has been at least £55 million a year and possibly significantly more.

¹⁶²It should be noted that we did not have full information for 2004 or 2005; in particular, we did not have revolve rates for some providers and programmes (see Appendix 9.1). Moreover, with one exception providers' estimated information for 2005 was made early in 2005 and might not reflect the outturn for the year.

The need for remedial action

- 9.15 Because we have found that there is an adverse effect on competition, we are required by the Act¹⁶³ to decide whether action should be taken (or whether we should recommend action to be taken by others) for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned, or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition; and, if action should be taken, what that action should be and what is to be remedied, mitigated or prevented. In deciding these questions we must have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effects on customers so far as resulting from the adverse effect on competition.¹⁶⁴ Further, in considering the appropriateness of remedial action we also take into account the current and expected market conditions in which our remedies would be introduced.
- 9.16 We have already discussed the customer detriment (see paragraphs 9.9 to 9.14). As to the market conditions in which our remedies would take effect:
- (a) We are satisfied that store cards will continue to be used by retailers as one of their marketing tools, and by providers as a route to market for their financial products, even if the number of active store card accounts continues to decline. It follows that the adverse effect on competition we have identified may not be expected to be remedied over the next 12 to 24 months by virtue of the substantial replacement of store cards by SBCCs or credit cards (see in particular paragraphs 3.14, 3.19 and 3.20).
 - (b) While there has been—and there is the potential for further—new entry and expansion, and while these could lead to more competition for existing store card contracts in the upstream market, we do not consider that such enhanced competition might, of itself, be expected to mitigate or remove the lack of competition in the relevant market (see in particular paragraphs 8.46 and 8.47).
 - (c) Although some lower-APR products were introduced, or trials launched, by GECF during 2005 that may to some extent mitigate the detrimental effects on cardholders that we have identified, we are unable to form an expectation that such initiatives are likely over the next 12 to 24 months to move the relevant market to the tipping point necessary to remove the adverse effect on competition that we have identified (see in particular paragraphs 8.37 to 8.45).
 - (d) Current and prospective measures, whether regulatory or self-regulatory, may not be expected to address all the detrimental effects on cardholders that we have identified. In particular, existing self-regulatory measures relating to the inclusion of certain key information on store cardholder statements is not sufficient to address such effects, while prospective subordinate legislation under the Consumer Credit Bill (when it becomes law) relating to post-contractual information on credit card statements (including store card statements) seems unlikely to go as far as we consider necessary for adequate transparency. While the Bill is expected to receive Royal Assent in the first half of 2006, there is as yet no timetable for the implementation of its various provisions. Some of these will require secondary legislation for which the timetable could extend into 2007 or

¹⁶³Section 134(4).

¹⁶⁴Section 134(6).

2008 (see paragraph 4.9). In addition, the new insurance regulations, while introducing welcome protection for consumers in terms of the sales process, do not address our concerns about the bundling of store card insurance and lack of choice for cardholders or the lack of competitive pressure on such insurance.

- 9.17 Taking the above matters into account, we consider that recent and prospective developments in the store card market are unlikely in themselves to bring about change in the competitive environment over the next 12 to 24 months sufficient to remove the features that together have combined to give rise to the adverse effect on competition that we have identified. Many of the changes in the market that we have noted, in particular the introduction of programmes either with lower single APRs or (by GECF) multi-tier APRs with risk-based pricing, have been relatively recent; and the trialling of programmes with lower APRs by one provider, GECF, with some of its retailers is not yet complete. Indeed, many of the changes have taken place either shortly before our inquiry (some possibly reflecting adverse publicity following the TSC report) or during the course of our inquiry, and that report and our inquiry are likely to have been factors in bringing certain matters into sharper focus for both the retailers and the providers. Accordingly, it is too soon to know what the consequences of such changes might be, even in the next 12 to 24 months, let alone thereafter, even assuming that those changes already introduced are continued and those which are planned but are not yet in place are fully implemented. Further, we believe that neither current and prospective statutory and self-regulatory measures that would increase transparency for credit cardholders, including store cardholders, nor the regulation of the sale of insurance in connection with store cards that was introduced early in 2005, although bringing benefits to the relevant markets, would fully address the adverse effect on competition that we have identified even when taken together with the changes and potential changes referred to above.
- 9.18 Therefore, we conclude that the adverse effect on competition identified in paragraph 9.7 is unlikely to be remedied without appropriate action over and above regulatory and self-regulatory measures already in place or in contemplation, or developments recently initiated by participants in the store card market. We therefore turn in Section 10 to the remedial action that we consider necessary to address the adverse effect on competition and its detrimental effects.

10. Remedies

Overview

- 10.1 We now turn to consider measures to remedy, mitigate or prevent the adverse effect on competition (AEC), or resulting detrimental effects on customers, as set out in our findings and conclusions in Section 9 of this report. This section considers the framework for decisions on remedies and general responses on remedies before considering each individual remedy in detail. Our decisions on remedies are then set out at the end of the section (from paragraph 10.77).
- 10.2 On 14 September 2005, we issued a Remedies Notice which invited comments on the actions that might be taken to remedy, mitigate or prevent the AEC, or resulting detrimental effects on customers, as identified in its provisional findings of the same date. A copy of the Remedies Notice is enclosed as Appendix 10.1. In the following months, we received a large number of responses to the Remedies Notice, held further hearings and staff meetings with parties and undertook further analysis of possible remedies. In the light of this evidence, we published a Statement of Provisional Decisions on Remedies on 20 December 2005 (Provisional Remedies) which set out our provisional decisions on remedies together with our supporting reasoning. A copy of the Provisional Remedies is displayed on the CC's website. We subsequently consulted parties on a number of more detailed issues relating to our proposed remedies. This section of the report takes account of the responses to the Provisional Remedies and the other evidence on remedies that we received during this stage of our inquiry.

Framework for decisions on remedies

- 10.3 Under section 134 (4) of the Enterprise Act (the Act), if the CC¹⁶⁵ has decided that there is an adverse effect on competition, it should decide the following additional questions:
- (a) whether action should be taken by it for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from the adverse effect on competition;
 - (b) whether it should recommend the taking of action by others for the purpose outlined in (a) above; and
 - (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.
- 10.4 In choosing appropriate remedial action, the Group has a statutory obligation to 'achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effect on customers so far as resulting from the adverse effect on competition'.¹⁶⁶
- 10.5 It follows from the above that appropriate remedies should be effective in addressing, within a reasonable timescale, the feature or features giving rise to the AEC and/or the detrimental effects. Consideration of effectiveness includes considering the

¹⁶⁵Acting through the Group—see paragraph 1.5.

¹⁶⁶Section 134 (6).

feasibility of implementation and the practicability of monitoring and enforcing compliance.

- 10.6 In seeking to achieve a solution that is reasonable, the Group ‘will aim to ensure that no remedy is disproportionate in relation to the adverse effect on competition and any adverse effects on customers’ and in ‘choosing between two remedies which it considers would be equally effective, it will choose the remedy that imposes the least cost or that is least restrictive’.¹⁶⁷
- 10.7 The Group will also have regard to the effects of any remedial action on any relevant customer benefits within the meaning of section 134(8) of the Act arising from the adverse feature or features of the market concerned. Such benefits comprise lower prices, higher quality or greater choice of goods or services or greater innovation in relation to such goods and services. To qualify within the meaning of section 134(8), the Group should consider that the benefit would be unlikely to accrue without the relevant feature or features.
- 10.8 In this inquiry the Group was not presented with evidence that led it to believe that there were significant, relevant customer benefits arising within the meaning of section 134(8) of the Act¹⁶⁸.
- 10.9 In considering the various issues identified in the course of this inquiry and, in particular, in considering any possible remedies as our investigations progressed, we have had regard not only to our national legislation but also to the requirements and provisions of relevant EU legislation. The EU legislation with which we have been most concerned includes Articles 81 and 82 of the Treaty and their application in the context of, and also the provisions of, the EU Modernisation Regulation, Council Regulation 1/2003. Whilst it is the OFT that has been designated by the UK as the national authority responsible for the application of Articles 81 and 82 (by virtue of the provisions of Article 35 of Regulation 1/2003), we have had regard to the relevant requirements of that Regulation in considering and adopting appropriate remedies in the context of our findings and conclusions. In doing so, we have carefully considered the interrelation of Article 3 of Regulation 1/2003 and our duties under the Act. We are satisfied that Regulation 1/2003 does not affect the exercise by us of our duties under section 134(1) of the Act and, in our extensive consideration of any possible remedies, we have borne in mind the provisions of Articles 81 and 82 and the relevant provisions of Regulation 1/2003. We are satisfied that the approach we have adopted and the conclusions we have reached on the remedies are in compliance with the applicable legislation and consistent with its objectives.

General issues raised in response to proposed remedies

- 10.10 Several parties commented that the Group should not consider the impact of its proposed remedies in isolation from changes in the broader regulatory framework applying to this sector such as the impact of the APACS Best Practice Guidelines, the Consumer Credit Bill and the Insurance Conduct of Business Rules. We are aware of the nature of these changes as set out in Section 4 of this report and have taken them into account in Section 9 in considering the need for remedies.
- 10.11 Several parties expressed the view that remedial action, such as disclosure requirements or constraints on the sale of insurance, should not be implemented beyond that which is current practice for credit cards, otherwise there would be a risk

¹⁶⁷CC3—Market Investigation References: Competition Commission Guidelines—paragraph 4.10.

¹⁶⁸To the extent that any benefits exist, we have taken them into account in our decision on the APR warning remedy (see in particular paragraph 10.33) and our decision on the remedy relating to insurance unbundling (see paragraphs 10.69 to 10.76).

of creating market distortions. We note that we are under an obligation to remedy the AEC arising in the market that has been referred to us and therefore should not be constrained to conform to practices in other markets. However, we have sought to minimize potential distortions in considering remedial action.

- 10.12 The view has been expressed to the Group that the proposed remedies might result in less profitable store card providers exiting the market with the result that competitive pressures on store card provision might reduce. We recognize that where remedies are implemented, such as those contemplated in this case, which seek to enhance transparency and competitive forces, then there is a possibility that some providers might choose to exit if they were unable to adapt to more competitive market conditions. However, it does not follow that this will reduce competitive constraints in store card provision. The competitive pressure provided from outside the store card market (by, for example, the credit card market) is likely to increase, as is the pressure provided by store card customers and retailers, given greater transparency and information as a result of the remedial measures. In addition, the store card programmes of exiting providers may be taken over by other providers wishing to expand or by entrants with different business models.
- 10.13 We received submissions suggesting that we should consider remedies that regulated the acquisition of new store card customers at point of sale. However, as noted in paragraph 3.34, we received no evidence that led us to believe that inappropriate influence was exerted by sales staff on their customers to take out a store card. In addition, as noted in paragraph 4.6, new regulations have been implemented from 31 May 2005 that enhance disclosure in pre-contract information and consumer credit agreements. Thus we concluded that this was not a relevant feature requiring remedial action in the form suggested.

Consideration of specific remedies

- 10.14 We now turn to considering each remedy proposed in the Remedies Notice in the following order:
- (a) full information on statements;
 - (b) APR warning on statements;
 - (c) provision and prominent display of the facility to pay outstanding balances by direct debit; and
 - (d) separate offer of payment, purchase and price protection insurance.

In the following sections we review, for each remedy, the responses to our proposals, and then set out the reasoning which has led us to our decision on each remedy.

Full information on statements

- 10.15 In the Remedies Notice, the Group proposed a requirement that every store card statement should provide full information to enable store card customers to make informed decisions regarding use of store card credit and the extent of their card-related insurance cover. It was proposed that each statement should prominently display:
- (a) the annual percentage rate (APR) applicable to outstanding balances;

- (b) an estimate of interest payable in the event that the cardholder only makes a minimum payment;
- (c) the level of late payment fees;
- (d) a 'wealth warning' outlining the consequences of only making minimum payments; and
- (e) the level of insurance charges and type of insurance cover purchased, if applicable, and contact details for amending or cancelling cover.

The remedy would also require disclosure on the statement of:

- (a) the assumptions used in calculating the interest estimate;
- (b) the policy for charging late payment fees; and
- (c) the basis of insurance charges and cancellation rights in relation to insurance cover.

10.16 The proposed remedy seeks to address the following features contributing to the AEC (see paragraph 9.8) and the detrimental effects expected to result from the AEC (as set out in paragraph 9.9)):

- (a) Most retailers' customers do not exert competitive pressure on store card APRs (either at the take-up stage or when they take credit) because their sensitivity to them is low (paragraph 9.8(c)).
- (b) Most retailers offering store cards do not exert competitive pressure on the level of, or the provider's policy in relation to the levying of, late payment fees (paragraph 9.8(d)).
- (c) Most retailers' customers do not exert competitive pressure on the level of late payment fees levied on store cards because their sensitivity to them is low (paragraph 9.8(e)).
- (d) Most retailers' customers do not exert competitive pressure on premiums for insurance purchased in association with the provision and use of store cards because their sensitivity to the price of such insurance cover is low and they have a poor understanding of the terms of the cover they are purchasing (paragraph 9.8(h)).
- (e) Providers do not include sufficient information on their store card statements, leading to a lack of transparency in the provision of store card credit and card-related insurance (paragraph 9.8(i)).

10.17 In general, store card providers and retailers responding to the proposed remedies supported the inclusion of most of the additional information on store card statements proposed in the Remedies Notice. However, some concern was expressed that the statements should not become overloaded with information. We agree that information should be appropriately focused and displayed to ensure that key messages are shown clearly and are not obscured by excessive detail.

10.18 A repeated theme of respondents was that the disclosure requirements should be no more onerous than those for credit cards and should reflect credit card standards. APACS has developed a set of best practice guidelines for the credit card industry,

now incorporated in the Banking Code, which requires disclosure of details in a standard summary box format as follows:

APR	
Other interest rates	
Interest free period	
Interest charging information	
Allocation of payments	
Minimum repayment	
Amount of credit	
Fees	
Charges	
Default charges	

The guidelines are designed to comply with the Consumer Credit Act. The FLA, which includes most store card providers amongst its membership, has also introduced a summary box for its members, which is consistent with the above. Given the amount of detailed information required to be disclosed in the summary box, most providers show the box on the reverse side of the statement.

10.19 The Group supports the use of a consistent format summary box across store cards, SBCCs and credit cards to aid comparison by customers and minimize costs for providers. However, given that the summary box is generally sited on the reverse side of statements and contains much detailed information, the Group has decided that it is essential, in order for this remedy to be effective, for certain key items of information to be prominently displayed on the front page of store card statements and not be obscured in the detail on the reverse side. These items are as follows:

- (a) the current annual percentage rate (APR) applicable to purchases (shown in bold);
- (b) an estimate of interest payable next month in the event that the cardholder only makes the minimum payment;
- (c) a 'wealth warning' outlining the consequences of only making minimum payments;
- (d) the basis of insurance charges, for example, pence per £100 of outstanding balance, alongside each insurance charge appearing in the transaction box; and
- (e) a reference to the reverse side of the statement for details of how to pay and contact details to amend or check insurance cover.

The font size of the above details should be no less than the largest font size used for transaction and balance details. One provider [X] felt that disclosure of a monthly interest rate was more appropriate than an APR. The Group considers that disclosure of an APR¹⁶⁹ is more appropriate than a monthly interest rate as it provides a better basis for comparison with rates charged on other credit. However, if providers wish to show a monthly interest rate on the front of a statement in addition to an APR, then we require that this must not be shown in a greater font size than the APR and must not be in bold type.

¹⁶⁹ An APR will be the same as an annual interest rate if there are no other charges imposed on cardholders such as an annual fee.

10.20 The Group has decided that other details that should be shown on the statement (but may be displayed on the reverse side either in a summary box format or elsewhere) are as follows:

- (a) late payment or default charges and the policy for levying these charges (as illustrated in Appendix 10.2);
- (b) the basic assumptions used in calculating the estimate of interest payable next month;
- (c) other interest rates, if applicable, for example, rates chargeable on cash withdrawals;
- (d) a 'how to pay' section and contact details for setting up or amending a direct debit, prominently displayed within the 'how to pay' section; and
- (e) contact details for amending or cancelling insurance cover sold with the store card and a brief summary of insurance cover. The said summary must inform customers that they should refer to their policy of insurance for full details of their insurance protection and of any applicable exclusions.

10.21 An illustration of a statement format that embodies the above requirements is shown as Appendix 10.2. This is similar in most respects to an example statement developed by one store card provider [X] in response to our Remedies Statement. We understand from our discussions with store card providers that amending the format of store card statements is neither complex nor particularly costly. We have received estimates of costs from providers that show that amending store card statements is not a major expense compared to the overall costs of card administration. Monitoring compliance with this remedy would be relatively straightforward.

10.22 The Group considers that providing information on store card statements in the manner described above will enable customers to make more informed decisions regarding store card credit and card related insurance. However, the Group considers that this remedy would not directly address the feature that 'most retailers offering store cards do not exert competitive pressure on APRs' (see paragraph 9.8(b)).

APR warning on statements

10.23 The Remedies Notice proposed a requirement that, where a store card APR exceeded a specified threshold level, the provider would be required to display a prominent warning notice on each regular statement informing cardholders that the APR on the store card might be high compared to alternative sources of credit available to them. For illustration, the wording proposed was:

The rate of interest charged on your xxxxx store card of xx per cent APR may be higher than other sources of credit available to you. It may be costly for you to leave balances owing on your store card after the end of the interest free period.

10.24 It was envisaged in the Remedies Notice that the threshold level could be linked to base rate and the remedy would remain in force for a limited period. The OFT would then review whether the threshold should remain in force after a period of three years. Views were particularly sought on the appropriate level of the threshold and the period for which it should apply.

- 10.25 As in the ‘full information on statements’ remedy above, this proposal seeks to address the features listed in paragraph 10.16 (a) and (e) (and the resulting detrimental effects) by ensuring that all store card customers are consistently well placed to take informed decisions regarding use of store card credit. In addition, it addresses the feature that most retailers offering store cards do not exert competitive pressure on APRs (see paragraph 9.8(b)), by creating an incentive for retailers to negotiate lower APRs with providers in order to avoid any adverse reputational effects they consider would result from the warning notice. The warning thus seeks to address the adverse effect (set out in paragraph 9.7) that store card credit services are insulated from the competitive pressures of credit cards; and to do so both by bringing influence to bear on retailers to negotiate lower APRs and inviting customers to compare the cost of credit on store cards with the cost of credit from alternative sources.
- 10.26 Most responses from retailers and providers to this proposed remedy claimed that a warning notice was either not necessary, on the basis that transparency measures were sufficient, or was disproportionate, as it would act as a price cap and create significant resultant harm in the ways discussed in the following paragraphs. As already outlined in paragraph 10.22, the Group does not believe that transparency measures alone would be sufficient to address the AEC effectively in respect of APRs. The parties’ argument that the warning notice would act as a price cap and create consequential harm has three main elements, each of which we will examine in turn:
- (a) most providers and retailers will seek to avoid the warning notice and reduce APRs below the threshold level;
 - (b) providers will be forced to respond to the reduction in APRs by reducing the customer acceptance rates of their store card programmes; and
 - (c) customers excluded from store card programmes will suffer loss due to paying higher APRs on alternative forms of borrowing and being excluded from store card benefits.
- 10.27 The warning notice is intended to fulfil a quite different purpose from that of a rate cap and will operate in a very different manner from such a cap. By providing relevant information to customers and retailers in particular circumstances, its effectiveness will depend on their competitive responses to that information. It will not operate as a specific prohibition, as would be the case with a rate cap. This can clearly be seen from the wording now required for the warning (see the example statement in Appendix 10.2 and in paragraph 10.57) which is moderate and encourages cardholders to consider alternatives rather than imposing a prohibition.
- 10.28 The response of retailers to the APR warning will depend on their sensitivity to being associated with a product that may be perceived as having uncompetitive pricing. Some providers [redacted] have argued that retailers will create such major pressure to reduce APRs below the warning level that the warning will effectively operate as a rate cap. However, one provider [redacted] told us that it was uncertain whether its retail clients would press for APRs below the level set for an APR warning notice. Although retailers have generally agreed that they would be concerned about the reputational effects of the APR warning notice and some [redacted] told us that they would seek to avoid a warning notice appearing on their statements, others [redacted] have argued that they have little influence over APRs except when the contract with the store card provider is in or approaching renegotiation. Overall, on the evidence we have received, the Group considers that the warning notice will be effective in creating pressure on retailers—thereby addressing the feature that ‘most retailers offering store cards do not exert competitive pressure on APRs’—and that some programmes

will respond to this stimulus. However, we believe that some rates are likely to remain above the threshold level.

10.29 Another point that has been made to us is that providers and/or retailers with APRs below any threshold might increase them to just below the threshold (ie the threshold would act as an APR floor). It has been put to us that the threshold will be regarded as being 'officially sanctioned' and therefore that it will be both acceptable and possible for providers to price up to that level. The Group does not consider this plausible given increasing visibility of APRs and ease of comparison with other credit products as a result of other remedies. In paragraph 8.18 we note that customers appear to be more sensitive to increases than reductions in APRs. We also note that those retailers with low store card APRs (for example, Ikea, JLP and Marks & Spencer) have decided to maintain a relatively low level of APR despite the absence of significant market pressure to do so, and we see no reason why their motivation should change because an APR warning is now required at a much higher level of APR. In addition, the wording of the warning notice will not mention the level of the threshold; and it could not therefore appear to cardholders as an officially sanctioned rate.

10.30 Providers have argued that if, as a result of retailers' and their own concerns, they have to reduce APRs below the threshold level, then they will have to reduce the acceptance rates of their store card programmes significantly. The Group does not consider that reductions in APRs will necessarily result in significant reductions in acceptance rates as:

(a) providers, in conjunction with retailers, are able to revise the business model of the store card programme, for example by using cross selling rights, obtaining greater retailer commitment to marketing the programme or reducing retail benefits;

(b) providers may accept a lower level of profitability on particular programmes; and

(c) throughout this inquiry, retailers have emphasized their need for high customer acceptance rates on their store card programmes. It is possible that retailers will wish to adjust other contractual terms (for example, profit-sharing arrangements, contract renewal premiums) rather than accept a significant reduction in acceptance rates that might endanger customer goodwill, especially if applied to existing store cardholders.

It is particularly noteworthy that most store card programmes that have recently announced reduced APRs have not been subject to significant reductions in acceptance rates [X]. We do not therefore consider that providers and retailers will necessarily respond to lower APRs by reducing acceptance rates; and furthermore the evidence in our view suggests that, if there is any reduction in acceptance rates, it is unlikely to be significant overall.

10.31 We now turn to the consequences for any applicants for store cards who are rejected as a result of lower acceptance rates. It is likely that such cardholders would either use alternative sources of finance or would forego the purchases which would otherwise be financed by borrowing on a store card.

10.32 The evidence in the NOP survey—carried out for the OFT—and the CC's survey suggests that the decision to take out a store card is, in most cases, a spontaneous one driven by applicants' desire to obtain store card benefits (rather than the desire to obtain credit) and that this applies as much to less creditworthy applicants as to other applicants. In the light of this, and our survey evidence that the vast majority of store cardholders have at least one credit card (some 80 to 85 per cent of credit

revolvers—see paragraph 3.28), it seems likely that, if there are additional rejected store card applicants, some would be able to finance their purchases from existing cash resources or lines of credit, while others would simply not make the purchases they would have done if they had had a store card. We therefore do not accept the suggestion by some parties that such applicants would resort to borrowing at very high APRs. (We consider further the costs of alternative credit sources to store card customers in the following section on the appropriate threshold for the APR warning.)

- 10.33 We agree that any applicants who do not receive a store card will be likely to experience some detriment as they will lose the store card benefits they would otherwise have received. But we consider that the total size of any such detriment is likely to be small relative to the benefits that the majority of cardholders would receive from lower APRs. The detriment from loss of card benefits is difficult to quantify precisely but, assuming a discount of 10 per cent off the initial purchase on opening a store card account and subsequent rewards equivalent to 1 per cent of card spend, we estimate the detriment from loss of card benefits to be equivalent to about £4 a year per active account.¹⁷⁰ This suggests that, even if new applicants totalling as many as 5 per cent of all existing cardholders were to be rejected as a result of reductions in APRs, the total detriment would be no more than about £2.3 million a year.¹⁷¹ However, we do not consider that any changes in acceptance criteria are likely to be applied to existing cardholders; hence the detriment in the first year would be no more than £1million.¹⁷² By contrast, on similar assumptions, the benefit to continuing cardholders from reducing APRs to below 25 per cent on all programmes with current APR's above this threshold would be of the order of £45 million a year.¹⁷³
- 10.34 In conclusion, the Group considers that while it is possible that a number of store card programmes will reduce APRs to avoid including a warning notice on statements, it does not follow that providers of most of these programmes will significantly reduce customer acceptance rates as a result. To the extent that such acceptance levels are reduced, it is likely that any detriment to customers excluded from holding store cards would be small relative to the gains to the majority of customers from lower APRs.

APR warning—the appropriate threshold

- 10.35 The Remedies Notice invited comments on the appropriate level of the threshold. There were two main types of response, first, those that favoured no threshold or a very low threshold so that the warning would apply to all store card programmes irrespective of APR and second, those that favoured a high threshold that would apply to a limited number of such programmes with particularly high APRs.
- 10.36 We consider the question of the threshold in two stages. Firstly we discuss whether a threshold should be used or whether, as suggested by some respondents, all store cards should bear a warning. Secondly, if it is desirable to use a threshold, we consider what the most appropriate level might be.

¹⁷⁰Table 1 in section 3 of this report implies 2004 average spend per active account was £264 per year suggesting rewards equivalent to £2.64 per active account (assuming rewards of 1 per cent of spend). Spend per transaction averages £40, with the value of the initial discount being 10 per cent of £40, ie £4.00 (we note that account opening spend might exceed the average per transaction but also that not all account openings benefit from a 10 per cent discount). Account openings are about one-third of the total number of active accounts, so the long run total per active account is $\text{£}\{2.64+4.00/3\}=\text{£}3.97$.

¹⁷¹Based on projected 11.4 million store cardholders at end 2005.

¹⁷²Up to 0.2 million accounts would not be opened ($11.4/3*0.05$) and would lose the initial discount of £4.00 and rewards of £1.32 (on average each account is open for half the year and gets rewards equivalent to half of £2.64).

¹⁷³Based on projected balances at end 2005 of £1.8 billion on programmes with APRs in excess of 25 per cent.

Whether a threshold should be used or not

10.37 The advantages of not using a threshold are:

- (a) the maximum number of store card customers receive the warning notice; and
- (b) no issue arises regarding the choice of an appropriate basis for the threshold.

10.38 On the other hand, the absence of a threshold would have major disadvantages:

- (a) the absence of a threshold removes any particular pressure on retailers or providers with high APRs to reduce APRs, as the warning is required irrespective of the level of APR;
- (b) the warning may be irrelevant for many of the additional cardholders receiving a warning where there is no threshold as compared with a situation where a threshold is used. For low-APR store card schemes (such as the Ikea and JLP programmes), a high proportion of customers may receive an irrelevant warning as they do not have access to lower-cost alternatives;
- (c) a general warning applied across all store card programmes is likely to lack impact. It may simply be interpreted or portrayed by providers and retailers as very general advice to consider alternatives as opposed to being a focused warning dealing with high-APR card programmes; and
- (d) a general warning may discourage new entrants providing low-APR store cards from expanding their operations.

10.39 It was put to us by one provider [§] that the CC did not have the necessary information to determine appropriate levels of threshold as this would effectively require a detailed calculation of cost-reflective APRs for individual programmes. Other providers [§] indicated that the level of threshold should vary with the circumstances of each store card programme. We believe these comments reveal a misunderstanding of the purpose of the APR warning and the basis on which it would be implemented. The intention is not to develop detailed constraints based on the characteristics of each store card programme. The warning seeks to provide information to customers and create incentives for retailers. Both of these will stimulate competitive forces.

10.40 The recent reductions in store card APRs for some schemes maintaining single APRs (see Table 10.1) suggest that significant changes in APRs are feasible:

TABLE 10.1 **Changes in store card APRs**

	<i>per cent</i>	
	<i>APR</i>	
	<i>March 2005</i>	<i>Current</i>
Harvey Nichols	28.9	21.9
Monsoon	29.9	18.9
New Look	29.9	25.9
Principles	29.9	24.6
River Island	29.9	17.9

Source: CC research.

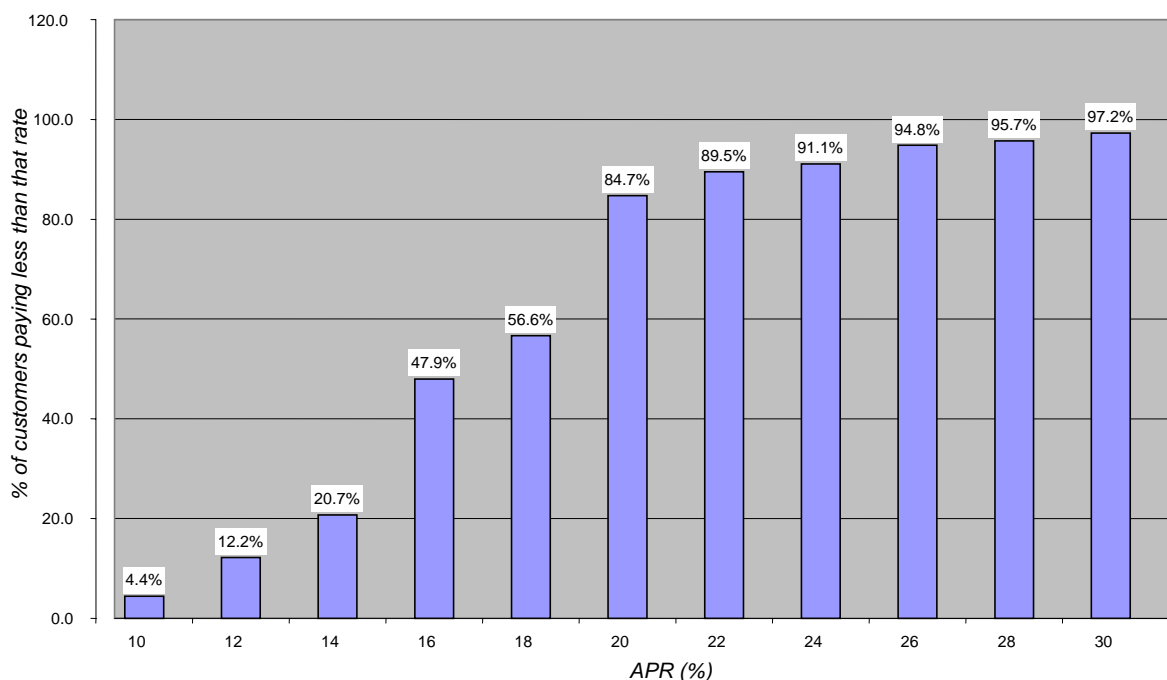
- 10.41 Moreover, as noted earlier, GECF has also recently introduced lower APRs for store cards in certain combined programmes employing multi-tier APRs with risk-based pricing (see Table 3.6).
- 10.42 In the light of the above, we have decided that use of a threshold is both feasible and preferable to requiring the warning notice for all store cards. We consider next at what level the threshold should be set.

The level of the threshold

- 10.43 The judgement regarding the appropriate level of threshold should be driven by what is most likely to be effective in addressing our identified features or the resulting adverse effects. The effectiveness of a threshold is largely a function of:
- (a) the likelihood of providing a reliable signal to store cardholders regarding the availability of cheaper forms of credit and the coverage of customers receiving such a signal; and
 - (b) the likelihood that retailers will exert pressure on providers to reduce APRs to more competitive levels.
- 10.44 With regard to providing a reliable signal to store cardholders, we are aware from our survey evidence (see paragraph 3.28) that the vast majority of store cardholders as a whole, and some 80 to 85 per cent of revolvers, have at least one credit card. Relatively few (about 9 per cent) of those revolvers not having a credit card said that they had ever been refused a credit card. A majority of revolvers (about 60 per cent) are in socio-economic groupings ABC1. Store cardholders who are likely to be credit-constrained appear to constitute a very small proportion of the total. For example, only around 1 per cent of store cardholders use home credit. We also note that most store card customers may also have access to unsecured loans and these loans may have lower APRs than on credit cards or store cards.
- 10.45 As noted in paragraph 8.56, the average effective credit card APR was around 16 per cent in March 2005, by contrast with a typical store card APR approaching 30 per cent. From a survey we conducted of major credit card providers (including providers of SBCCs) in December 2005 (as outlined in paragraph 8.56 and as depicted in Figure 8.3, reproduced below as Figure 10.1), it is apparent that approximately 85 per cent of those providers' credit card customers pay an APR of 20 per cent or less on their credit cards, almost 90 per cent pay an APR of 22 per cent or less and almost 95 per cent pay an APR of 26 per cent or less. We have no reason to believe that our sample of credit card providers is biased towards lower APR credit card customers compared with credit card providers overall, as it includes providers that are actively engaged in the sub-prime market (where higher APRs would be expected). It would therefore appear likely that a warning threshold set at an APR of 20 per cent or above would create a reliable signal to most store card customers that at least one other form of credit (namely, credit cards) would be less costly.

FIGURE 10.1

Cumulative distribution of rates paid by credit card customers



Source: CC analysis of data from major credit card providers

10.46 We therefore next considered how likely it was that retailers would succeed in exerting pressure on providers to bring APRs down to more competitive levels, and in particular to levels that would make a warning threshold in the region of 20 per cent a reasonable one.

10.47 In paragraph 8.170 we indicated a range for cost-reflective APRs, based on average industry data from 1999 to 2003, of 22 to 24 per cent. We updated this calculation and estimated that if the period was extended from 1999 to 2004 and 2005 respectively, the ranges would (subject to the caveats on the incompleteness of the information and the timing of the providers' estimates for 2005 that are noted in paragraph 9.11 and paragraph 7 of Appendix 9.1) increase from 22.3 to 24.5 per cent (1999 to 2004) and 22.9 to 25.5 per cent (1999 to 2005). These figures provide a broad indication of the level below which pressure to reduce APR's by retailers is unlikely to be effective *unless* retailers were willing to bear significant costs through having a store card programme. However, the use of a threshold below the cost-reflective APR for a particular programme, but above 20 per cent, would still be appropriate. This is because the warning, namely that other sources of credit are likely to cost less, would remain valid for most cardholders.

10.48 Taking the considerations in paragraphs 10.43 to 10.47 into account, the Group considers that an APR warning notice with a threshold as low as 20 per cent APR could in principle be justified in terms of providing most customers with relevant indications of the existence of lower cost alternatives. However, we have also taken into account the degree of commercial flexibility available to retailers and providers in practice to make reductions sufficient to bring their APR to below a 20 per cent threshold. In paragraph 10.30, we outlined various means by which providers and retailers might adjust their commercial terms to enable a reduction in APRs to be achieved without a significant reduction in acceptance rates. We acknowledge that such means will be progressively exhausted, the further that APRs are brought down

from their existing levels. It follows that retailers are likely to be more effective in securing modest, although still very significant, reductions in APRs through the exertion of pressure on their providers than if they pressed for much greater reductions. For these reasons, if the threshold APR were set at 20 per cent, the gap between such a threshold and most store card APRs is likely to be so large that it would fail to provide the incentive for most retailers and providers to reduce APRs.

- 10.49 The Group has therefore decided that the appropriate APR threshold is 25 per cent and that store card APRs at or above this level will require an APR warning. From the evidence of recent changes to APRs on some store card programmes and the responses to our provisional findings, we are satisfied that a threshold of 25 per cent will give providers and retailers both sufficient flexibility, and appropriate incentives, to reduce APRs and avoid having to display a warning notice. We are also satisfied that such a threshold will provide a reliable signal to store cardholders regarding the availability of cheaper forms of credit as, based on our sample of providers, over 90 per cent of credit cardholders pay an APR of less than 24 per cent.
- 10.50 We considered next how the threshold should be applied to risk-based programmes. It was put to us that use of an APR warning was inappropriate where a store card programme had multi-tier APRs with risk-based pricing. Certain retailers also indicated that credit limits on the upper tiers of their risk-based programmes were relatively low (in certain cases £400 or less) and argued that *de minimis* principles should be applied.
- 10.51 In the Provisional Remedies we had proposed that where a store card programme used risk-based pricing it needed to apply warning notices only to those interest tiers that were above the warning threshold. In addition, we had proposed that, where the average APR of a risk-based store card programme (excluding any SBCC programme with which it was combined) was less than the threshold level, then a warning notice would not be required for tiers of the programme which exceeded the threshold if the maximum credit limit for cardholders on such tiers did not exceed a *de minimis* level of £400.
- 10.52 In response to the Provisional Remedies, one provider [redacted] proposed that the relevant average APR of a risk-based programme should include SBCC APRs where the programme was a combined programme offering both store cards and SBCCs. The Group notes that SBCCs have APRs that are in line with those of general credit cards and occupy a range that is generally substantially lower than the APRs typically available currently on store cards. An average APR based on a combination of SBCC and store card APRs is therefore likely to be an inappropriate and misleading criterion for applying a warning to store card statements. We note that our remedies are necessarily restricted to the store card market.
- 10.53 It was also put to us that if a risk-based store card programme did not have to display a warning notice provided that the average APR for the programme was below the threshold, then providers would have a significant incentive to place customers in lower APR tiers, wherever feasible, in order to avoid the notice. Moreover, it was argued that our proposal that a warning notice should not be required for tiers above the threshold, provided that the maximum credit limit did not exceed £400 (see paragraph 10.48), could undermine this incentive. It was also put to us that such a credit limit appeared to be arbitrary and might significantly distort the supply of store card credit to higher-risk customers.
- 10.54 We considered all these points very carefully. In our view, where risk-based pricing is rigorously applied, store card customers may be less likely to receive a meaningful indication of lower cost alternatives from a warning notice than they would in programmes using a single APR, since they will have been allocated an APR that is

more tailored to their credit risk. When combined with low credit limits, this could significantly reduce the expected gain to customers from acting on the APR warning. Our objective is to create the maximum incentive for providers and retailers to reduce the APRs of cardholders who revolve credit on risk-based store card programmes, in order to address the features and detriments previously identified. The Group has therefore decided that, where the average store card APR charged on a risk-based programme is less than 25 per cent, there will be no requirement for the provider to display an APR warning notice in respect of any tier of the programme. The Group considers that this requirement will provide strong incentives for card providers to introduce lower-APR tiers and to place more customers in those tiers. We have also decided that where the average APR of a risk-based programme is 25 per cent or more, providers will be required to display a warning notice in respect of all tiers that have APRs of 25 per cent or more. Further, we have accepted the arguments in paragraph 10.53 that it is inappropriate to introduce any exemption related to specific credit limits.

10.55 We next considered how the average APR for a multi-tier programme should be calculated. There appeared to be two principal alternative methods for the calculation, the first using the number of active accounts and the second using the levels of interest-bearing balances. It was put to us that the average APR for a multi-tier programme should be calculated using the number of active accounts for each tier rather than the interest-bearing balances for each tier, as this would provide a more predictable result and arguably, therefore, a stronger incentive for the parties to arrange APR tiers and the distribution of customers within them so that the average was less than the threshold. We considered this argument carefully. However, while we accept that the outcome of calculating an average using active accounts may be more predictable than one using interest-bearing balances, we do not accept that this will adversely affect incentives. It could equally be argued that a degree of uncertainty would act as an incentive to providers to arrange APR tiers and the distribution of customers within them so that the average APR was a margin below 25 per cent, and that this uncertainty could therefore act as an incentive to instigate greater reductions in APRs than where the outcome was more predictable. In addition, we note that if active accounts rather than interest-bearing balances were used for calculating the average then this might create significant incentives for providers to move non-revolving customers¹⁷⁴ to lower APR tiers while leaving revolvers on higher tiers. It is only customers who revolve their store card credit that are subject to the detriment (see paragraph 9.9(a)) of paying higher prices for that credit. Therefore using active accounts to calculate the average APR would be likely to result in the APR warning addressing the identified detriment less effectively than where the average was calculated using interest-bearing balances.

10.56 The Group has therefore decided that the average APR for a store card programme with multi-tier APRs will be calculated by weighting each store card APR tier by the aggregate interest-bearing balances within that tier in relation to the total interest-bearing balances for the store card programme. Interest-bearing balances will exclude any balances that are within an interest-free period. To ensure that the APR warning is based on data that is reasonably up-to-date and therefore as relevant to cardholders as possible, the average will be calculated at regular intervals of no more than three months, using the most recent data on interest-bearing balances available to the provider. Such calculations should also be undertaken on a consistent basis on each occasion.

¹⁷⁴That is transactors, who use their store cards predominantly for payment purposes rather than credit.

APR warning—other implementation issues

- 10.57 The Group considers that the APR warning should be prominently displayed, as illustrated in Appendix 10.1, on the front page of the statement above the transaction box, in bold lettering and in a font size no smaller than the largest font size used for transaction and balance details. In the light of responses received we have decided that the wording of the warning should be slightly revised from that appearing in the Remedies Notice and will now be as follows: **‘The rate of interest charged on your account may be higher than on other sources of credit available to you. It may be costly for you to leave balances owing on your account after the interest free period’**. The warning must be separate from all other text.
- 10.58 We proposed in the Remedies Notice that the APR warning remedy should remain in force for a limited period and suggested that the OFT should review the remedy after three years. Some parties suggested a shorter duration in view of the degree of change and reduction in APRs that they currently perceive in the market. The Group notes that to the extent that APRs fall below the threshold level then the warning notice will cease to apply. The Group has decided that the remedy will remain in force for three years from the date of the applicable order. We recommend that at the end of this period, its continuance should be reviewed by the OFT during which time it would remain in force. Following this review, the OFT would advise the CC on whether to remove it or keep it in place for a further period, at the end of which period we recommend that there should be a further review by the OFT.
- 10.59 We suggest that the OFT, in conducting its review, may wish in particular to consider whether market developments indicate that store cards are no longer significantly insulated from credit cards and other comparable credit markets. In particular, it will be appropriate to consider the extent to which store card APRs have converged towards APR levels typical of general credit cards in order to justify removal of the warning.
- 10.60 In the Remedies Notice, the Group considered the possibility of linking the level of the warning threshold to a formula, for example base rate. Some parties questioned the basis of this linkage and others proposed that a more elaborate formula should be applied. The Group has now decided that the threshold should not be based on a formula but should remain at the same level and on the same basis unless and until it is removed in accordance with paragraph 10.58 above. A formula is not warranted given the general nature of the warning; moreover, a stable threshold will provide certainty and reduce costs of implementation as compared to a situation in which the threshold is subject to change. We note that major changes of circumstances could be dealt with through an application for variation of the applicable order.
- 10.61 We do not expect the operational costs of implementing the APR warning remedy to be significant as this is just one further element of redesign of store card statements as considered under the ‘full information on statements’ remedy considered above. As noted in paragraph 10.21, we have received estimates of costs from providers which show that the redesign of store card statements will not be a major expense. Monitoring compliance with this remedy would not be unduly onerous.

Provision and prominent display of facility to pay outstanding balances by direct debit

- 10.62 The Group considers that one of the detrimental effects which has resulted, or may be expected to result, from the AEC is that most store cardholders who take credit pay higher prices for store card credit than would be expected in a competitive market (see paragraph 9.9). The Group therefore considered measures which aim to reduce the proportion of cardholders revolving credit inadvertently, through inertia, or

as a result of a lack of awareness of APRs and payment terms. The Group is also seeking to address the absence of pressure from customers on store card APRs and late payment fees by providing an avenue by which customers can easily choose to avoid incurring these costs.

- 10.63 The Group therefore proposed in the Remedies Notice that all store cardholders should be given the option of paying outstanding balances in full, or paying a fixed monetary limit,¹⁷⁵ by direct debit and that this option should be prominently displayed on the front page of each regular statement and in initial contractual material when customers apply for store cards. Many store card programmes already offer a facility for paying by direct debit but such a facility is not always readily apparent.
- 10.64 One provider [X] challenged the legal basis for this remedy as it considered that it did not directly address features leading to the AEC finding. However, as noted in paragraph 10.4 above, the remedy seeks to deal with the AEC and any detrimental effects on customers, and we consider that this remedy is appropriate for that purpose and within the CC's jurisdiction. Most providers noted that they already provided direct debit facilities and had no significant objections to our proposal regarding disclosure, although they favoured prominent disclosure of the facility on the reverse rather than on the front of monthly statements. The same provider [X] pointed to certain practical disadvantages of specifying direct debits for fixed amounts as suggested in the Remedies Notice and the Provisional Remedies. The Group accepts this reasoning and no longer considers that card providers should be required to provide a facility to set up direct debits for fixed amounts.
- 10.65 The Group has decided that, in the interests of avoiding excessive wording on the front of statements (see paragraph 10.17) providers need not show the direct debit option on the front page provided (a) that this option, together with contact details for setting up or amending a direct debit, is prominently displayed as the first item within a 'how to pay' section on the reverse side of the statement and (b) that there is a prominent reference to the 'how to pay' section on the front of the statement. These disclosures are illustrated in the example statement shown in Appendix 10.2.
- 10.66 It has been put to us that cardholders who set up a direct debit to pay the minimum on their account each month may, through inertia, pay the maximum amount of interest. Indeed, the generally accepted wording for the 'wealth warnings' on store cards and credit cards draws attention to the undesirability of making only the minimum payment. Certain parties [X] do not make direct debit facilities available when issuing store cards other than on a minimum payment basis. We consider that store card providers should be required to provide a direct debit facility that enables customers to pay off the whole outstanding balance and should not be permitted to limit the provision of direct debit to the making of minimum payments only. In addition, the wealth warning regarding minimum payments should be provided with direct debit mandates and also communicated to customers when they set up a direct debit by telephone.
- 10.67 One provider [X] considered that providing a direct debit mandate with the card application form was too complex and costly and that customers could set up a direct debit mandate by contacting the provider's call centre. This was in contrast to the experience of other parties [X] who provide a direct debit mandate routinely with the initial application form.
- 10.68 The Group considers that it is necessary, if this measure is to be effective, for customers to be provided with documentation to set up a direct debit with their initial

¹⁷⁵As specified by the cardholder.

contractual information. This requirement may be satisfied by providing a direct debit mandate either with the initial store card application form or in a welcome pack sent to each new store card customer. However, in the latter case, the application form must prominently display the question 'Do you want the option of paying amounts owing on your card by direct debit?' which must be ticked 'yes' or 'no' by the customer to ensure that this possibility has been brought to the customer's attention. In this case the application form must also inform the customer that a direct debit mandate will be available in their welcome pack or can be set up by phone.

Separate offer of payment, purchase and price protection insurance

- 10.69 The Remedies Notice proposed a requirement that if providers offer 'packages' of two or more elements of payment, purchase and price protection insurance (PPI), they should offer each element to store card customers separately. The purpose of this proposed remedy was to provide greater choice for customers in selecting insurance products to match their needs and to enable each element of the insurance package to be compared with competitor offerings.
- 10.70 This remedy seeks to address the following features contributing to the AEC (as noted in paragraph 9.8(f) to (h)) and resulting detrimental effects:
- (a) Many providers combine different insurance products into packages (that is, payment protection insurance with one or both of purchase protection insurance and price protection insurance) which they sell in association with store cards.
 - (b) Most retailers offering store cards do not exert competitive pressure on providers to lower their insurance premiums to cardholders, or to offer the components of PPI separately.
 - (c) Most retailers' customers do not exert competitive pressure on premiums for insurance purchased in association with the provision and use of store cards because their sensitivity to the price of such insurance cover is low and they have a poor understanding of the terms of the cover they are purchasing.
- 10.71 By addressing the AEC the remedy would also aim to address the resulting detriments, namely that:
- (a) most store cardholders have less choice in relation to the individual elements of insurance cover sold in association with the provision and use of store cards than would be expected in a competitive market;
 - (b) some customers who revolve their store card balance will continue to pay for elements of the package (purchase and/or price) that they no longer require or which no longer provide them with cover.
- 10.72 Although store card providers and insurers agreed in their responses that it would be possible to offer some elements of the PPI package separately, they also said that the offer of individual components of cover, either separately or alongside a packaged offering, potentially would have the following significant commercial consequences:
- (a) the offer of individual components of cover could increase costs for both card and insurance providers as a percentage of premiums. This increase in costs might result in an increase in the premiums paid by customers for single elements of the PPI package or, in some cases, withdrawal of elements. It was noted that such an increase in costs would come on top of the additional costs that had

resulted from the ICOB rules that came into effect in January 2005, and that these had resulted in all but one store card provider exiting from sale of insurance at the retail point of sale;

(b) the offer at the point of sale of separate policies would be complex. It could potentially become more confusing for customers and might present regulatory issues that would lead to a reduction of the insurance cover available to consumers at the point of sale as providers either offered only one insurance product at point of sale or withdrew completely and switched to telemarketing; and

(c) various concerns were mentioned as to whether unbundling should or should not be required in respect of insurance sales after the retail point of sale (for example, by tele-marketing).

10.73 One store card provider [X] submitted that limited unbundling would be feasible, involving the offer of the price and purchase elements together in a single package, and the payment protection element being offered separately. In this case, the provider indicated that the premium for payment protection insurance would be calculated in relation to the outstanding balance, while purchase and price protection could be based on the value of the retail transactions covered. At the same time, however, based on the views of insurance providers [X] and one retailer [X], the Group is also aware that providing price or purchase protection as separate stand-alone items may not be viable due to cost or adverse selection by customers with a high likelihood of making a claim. Requiring separate provision of price or purchase protection in such circumstances could result in price and/or purchase protection insurance being withdrawn from the packaged product and not being provided separately. To that extent, requiring full unbundling of the price and purchase elements of the package could produce a disbenefit for cardholders.

10.74 It has also been put to us that we should consider prohibiting the sale of insurance at point of sale since the advantages of selling insurance at the same time as the store card is offered prevents the emergence of competition from other supply options. The Group notes that the incumbent provider's advantage in the form of exclusive access to customer, transaction and outstanding balances data is similar at point of sale and post-point of sale. Therefore prohibition of sale at point of sale would not be expected to provide a greater opportunity for competition to emerge, given the low premium amounts involved in store card PPI, than the unbundling and disclosure measures that we are considering. The Group is therefore satisfied that such a prohibition is inappropriate in the context of PPI sold with store cards.

10.75 Taking all the above factors into account, the Group has decided that where store card providers offer insurance packages containing payment, price and purchase protection, they must also offer, as separate items, payment protection cover alone and a package of price and purchase protection. In addition, the Group has decided that where store card providers offer a package of payment and price protection or payment and purchase protection, they must offer payment protection alone as a separate item. In this case, there will be no requirement to offer either purchase or price protection insurance as separate elements, as we acknowledge that these elements do not currently have readily available alternatives on the open market. Moreover, we accept the views of retailers and providers that a requirement for full unbundling would also significantly increase the costs and complexity of implementation such that any benefits cardholders might gain through increased choice might be outweighed by higher costs to them. Our remedy, as specified above, should however provide greater opportunity for customers to tailor the insurance on offer to their requirements whilst reflecting the potential lack of viability of price and purchase protection as stand-alone elements. As a result of these

arrangements, customers would be able to compare payment protection cover more readily with alternative offers of income protection cover in the open market.

- 10.76 PPI packages are sold at point of sale and post-point of sale. Any remedy that addresses the unbundling of elements of the package should in principle apply to both channels. The Group believes that it would be difficult to justify a different approach to unbundling in the two channels given that the incumbent provider's advantage in the form of exclusive access to customers, transaction and outstanding balances data is similar for both channels. The Group has therefore decided that the proposed unbundling should apply equally to PPI sold at point of sale and post-point of sale.

Decisions on remedies

- 10.77 The Group's decisions on remedies are set out below. They should be read in conjunction with the reasoning and further detail set out in the earlier parts of this section.

Full information on statements

- 10.78 Certain key items of information must be prominently displayed on the front page of store card statements and the font size employed for these details must not be less than the largest font size used for transaction and balance details. These items are as follows:

- (a) the current annual percentage rate (APR) applicable to purchases (shown in bold);
- (b) an estimate of interest payable next month in the event that the cardholder only makes a minimum payment;
- (c) a 'wealth warning' outlining the consequences of only making minimum payments;
- (d) the basis of insurance charges shown alongside each insurance charge appearing in the transaction box; and
- (e) a reference to the reverse side of the statement for details of how to pay and contact details to amend or check insurance cover.

If providers wish to show a monthly interest rate on the front of a statement in addition to an APR, then we require that this must not be shown in a greater font size than the APR and must not be in bold type.

- 10.79 Other details that must be shown on the statement (but may be displayed on the reverse side either in a summary box format or elsewhere) are as follows:

- (a) late payment or default charges and the policy for levying these charges;
- (b) the basic assumptions used in calculating the estimate of interest payable next month;
- (c) other interest rates, if applicable, for example rates chargeable on cash withdrawals;

- (d) a 'how to pay' section and contact details for setting up or amending a direct debit, prominently displayed within the 'how to pay' section; and
- (e) contact details for amending or cancelling insurance cover sold with the store card and a brief summary of insurance cover. The said summary must inform customers that they should refer to their policy of insurance for full details of their insurance protection and of any applicable exclusions.

APR warning on store card statements

- 10.80 An APR warning must be prominently displayed on the front page of each monthly statement for store card programmes using a single APR for purchases where the APR is 25 per cent or more. An APR warning is not required where the APR is less than 25 per cent.
- 10.81 For store card risk-based programmes using multi-tier APRs, the APR warning is required on all statements for tiers where the APR is 25 per cent or more if the average APR for the store card programme as a whole is also 25 per cent or more. An APR warning is not required on a store card programme with multiple APR tiers if the average APR for the store card programme as a whole is less than 25 per cent. The average APR for a store card programme with multi-tier APRs will be calculated by weighting each APR tier by the aggregate interest-bearing balances within that tier in relation to the total interest-bearing balances for the store card programme. This average must be calculated at regular intervals of no more than three months and undertaken on a consistent basis on each occasion, using the most recent available data on interest-bearing balances.
- 10.82 The required wording of the APR warning is as follows: **'The rate of interest charged on your account may be higher than on other sources of credit available to you. It may be costly for you to leave balances owing on your account after the interest free period'**. The warning must be displayed on the front page of the statement above the transaction box in bold lettering and in a font size no smaller than the largest font size used for transaction and balance details. The APR warning remedy will remain in force for a minimum period of three years from the date of the applicable order implementing this measure. We recommend that at the end of this period, its continuance should be reviewed by the OFT during which time it would remain in force. Following this review, the OFT would advise the CC on whether to remove it or keep it in place for a further period, at the end of which period we recommend that there should be a further review by the OFT.

Provision and prominent display of facility to pay outstanding balances by direct debit

- 10.83 Store card providers must provide an option for all store cardholders to pay the account balance on their cards by direct debit. This option should be displayed in monthly statements as set out in paragraph 10.65.
- 10.84 Customers should also be provided with documentation to set up a direct debit with initial contractual information. This requirement may be satisfied by providing a direct debit mandate either with the initial store card application form or in a welcome pack sent to each new store card customer. However, in the latter case, the card application form must prominently display the question 'Do you want the option of paying amounts owing on your card by direct debit?' which must be ticked 'yes' or 'no' by the customer to ensure that this possibility has been brought to the customer's attention. In this case the application form must also inform the customer that a direct debit mandate will be available in their welcome pack or can be set up by phone. The 'wealth warning' regarding minimum payments should be provided with direct debit

mandates (paragraph 10.66) and also communicated to customers when they set up a direct debit by phone.

Separation of payment protection insurance from the PPI package

10.85 Where store card providers offer insurance packages containing payment, price and purchase protection, they must also offer, as separate items, (a) payment protection cover alone and (b) a package of price and purchase protection. Where store card providers offer a package of payment and price protection or payment and purchase protection, they must offer payment protection alone as a separate item. There will be no requirement, in those circumstances, to offer either price or purchase protection as separate elements.

Recommendations for action by others

10.86 In view of the measures outlined above, the Group does not consider that it is necessary to recommend the taking of action by others to address the AEC.

Implementation

10.87 The Group intends to pursue implementation of the measures by order rather than undertakings. Parties to the inquiry have indicated timescales of between six months to one year to implement most of the various measures outlined above. Having considered the arguments put forward, the Group has concluded that an implementation period of nine months is reasonable for all the above measures from the date when an order is made. The Group expects that the period between publication of this report and the date of making an order may be in the region of three to four months. This period will be available to parties to prepare for implementation of the CC's requirements.