

Professor Paul Geroski
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

3 March 2004

Dear Paul

Store Cards

On 5 November you wrote to request a variation of the terms of reference concerning your enquiry into store cards.

Following consultation with industry parties, we have decided to vary the terms of reference.

I enclose a copy of the varied terms of reference, issued today, and a statement of issues by the OFT which provides an explanation of the changes.

Yours ever

John

Sir John Vickers
Chairman



INVESTOR IN PEOPLE

Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London EC4Y 8JX
Switchboard: (020) 7211 8000
Direct Line: (020) 7211 8920
Fax: (020) 7211 8966
email: Chairman@oft.gov.uk

Terms of reference

The OFT, in exercise of its powers under section 131 of the Enterprise Act 2002, hereby makes a reference to the Competition Commission for an investigation into the supply of the following services (the reference services) in the United Kingdom:

(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.

The OFT has reasonable grounds for suspecting that a feature or a combination of features of the markets in which the reference services are supplied prevent, restrict or distort competition in connection with the supply of the reference services in the United Kingdom.

For the purposes of this reference:

- 'Store card' means a payment card issued with respect to the purchase of the goods, services or facilities of-
 - (i) only one retailer,
 - (ii) retailers who are members of a single group of interconnected bodies corporate,
 - (iii) retailers who belong to a store card network, or
 - (iv) retailers who trade under a common name,

and which (in each case) 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 to a specified period (subject to any contractual requirements with respect to minimum or fixed amounts of payment).

- 'Payment card' means a card, the use of which enables the person to whom it is issued ('the holder') to discharge his obligation to a supplier in respect of payment for the acquisition of goods, services or facilities.
- 'Issuer' means a person who contracts or proposes to contract with a

consumer for the issue of a store card.

- 'Store card network' means a network of retailers who accept the cards of a three-party (issuer, retailer, and holder) payment card system whose cards are: (i) marketed to consumers in association with retailers belonging to the network; and (ii) bear the brand(s) of one (or more) such retailer(s) (whether or not the issuer's brand also appears).



Sir John Vickers
Chairman
3 March 2005

Variation of Terms of Reference of store cards

March 2005

The OFT referred the supply of store card credit services to the Competition Commission on 18 March 2004. The reference was made under the market reference provisions of the Enterprise Act 2002.

On 5 November 2004 the Commission requested a variation to the Terms of Reference, so that network cards such as Style and Duet, which have similar features to store cards, and insurance taken out with store cards, fall within the scope of the enquiry.

Following consideration of the Commission's request, the OFT consulted on proposals to vary the Terms of Reference. It has decided to vary the terms of reference so as to include network cards and insurance associated with the provision of consumer credit through store cards.

The original and revised Terms of Reference and the OFT consultation paper, issued on 5 January 2005, are on the OFT website at www.offt.gov.uk/Business/Market+investigation+references/Store+cards.htm.

Network cards

The rationale for the inclusion of network cards is as follows.

A network card, while carrying the brand of a particular retailer, is also accepted as a means of payment by other retailers in the network which may not be part of the same corporate group or trade under a common name. Many retailers within a given network may have their brand on a network card. The card issuer's brand may also appear on the cards.

While the presence of the store card network may provide some additional benefits to both the retailer and the customer, in other respects the cards are similar to store cards limited to a single retailer. As with the cards of individual stores, settlement of

payments for network card transactions are made through a three-party settlement system, linking the customer, retailer and card provider. The network cards confer similar benefits on users and raise similar issues for investigation by the CC e.g. concerning the transparency of charges, the levels of interest charged, and the ease of comparison of those charges and benefits with charges for using conventional four-party credit cards such as VISA.

The network cards identified above are issued by some of the main store card providers identified by the OFT in its report (*Store cards*, March 2004, OFT 706, paragraph 4.75) and are subject to similar switching costs and incumbency advantages as apply to the supply of store card credit services to individual retailers.

Furthermore, if any remedies were considered appropriate, then an inability of the Competition Commission to apply remedies to these sorts of network cards would be likely to cause distortions in the supply of store card credit services and in the supply of consumer credit through store cards.

In making this variation the OFT has sought to retain the focus of consumer credit through store cards, and does not wish the Commission's remit to include credit provided through conventional four-party credit cards such as VISA and MasterCard.

The OFT proposal to vary the terms has not been opposed by the parties consulted.

Insurance

The rationale for the amendment concerning insurance is as follows. The Competition Commission believes that it is able to address certain aspects of the provision of insurance products associated with store cards, but wishes to be sure that it would have the ability to remedy any adverse effects arising from the provision of such insurance should it be considered appropriate to do so.

The Competition Commission has evidence that most store card contracts between the provider and the retailer include the provision of insurance products within the same contract, and that store card providers see the provision of such insurance as an integral part of the store card offer and include the income streams from insurance sales when estimating the costs, revenues and profitability of their store card services.

There are several forms of insurance sold with store cards. They are payment protection insurance, which is often sold together with price protection and purchase protection insurance, and card protection insurance, covering lost and stolen cards. Payment protection insurance covers repayments on the card if the customer is unable

to work due to accident, sickness or unemployment. Price protection insurance applies to any price reductions which may occur within a given period following purchase. Purchase protection insurance covers the customer against loss, theft or damage of goods purchased using the card.

Consumers do not usually get the choice of payment protection insurance without purchase protection or price protection insurance and usually one premium is charged for the insurance package. This single premium is based on the store card balance outstanding at the accounting date and is payable regardless of whether the cardholder pays off the balance within the interest free period. If the balance is not paid within the interest free period then a further premium will be charged at the next accounting date based on the outstanding balance, that is, the insurance premium payable is related to the credit provided.

Some consumers may continue to pay for parts of the insurance package that they no longer either require or are entitled to receive. This is because price and purchase protection only last for a set period, e.g. 90 days, but a consumer who makes no further purchases but continues to revolve existing credit may continue to pay for these elements after they have elapsed. Such a consumer receives no additional benefit resulting from these continuing payments, even if the cover has not lapsed.

While the relationship between premia and the outstanding balance is in itself a cause for concern, it also helps make it more difficult for consumers to assess the costs and benefits of using store cards to finance purchases. Such difficulties are features which may prevent, restrict, or distort competition between store cards and possible substitutes.

There also appear to be barriers to entry in the provision of payment, price and purchase protection insurance in relation to store cards, as only the credit provider and possibly the retailer have information on the card's balance each month. Thus other providers have much less opportunity to sell these insurance services. The store card provider therefore has a significant advantage which restricts competition to supply insurance services associated with store cards.

Furthermore, since revenues from insurance sales are taken into account by providers when assessing the overall profitability of store card operations, the OFT suspects that these revenues will be a factor taken into account when setting the level of interest rates on store card borrowing.

Consultation

During the consultation, the OFT received objections from card providers to the proposed amendment concerning insurance. In particular there seems to be a concern that the OFT proposes to extend the enquiry by opening an entirely new field of investigation. It has not sought to do so.

The Competition Commission believe that the existing terms of reference and the provisions of the Enterprise Act allow them to consider certain aspects of store card insurance but that their ability to consider all the areas of insurance provision they consider relevant may be restricted.

The OFT does not seek to broaden the enquiry to deal with the range of insurance which may cover the risks connected with the use of store cards and related credit. But it does wish to enable the Commission to address the relationship between the provision of the store card and of credit through the use of the store card, and the insurance taken up with the store card. To that end the wording of the variation concerning insurance has been slightly altered from that on which the OFT consulted, in order to clarify the position.

The objection was also raised that making a reference limited to insurance offered in connection with store cards would be inappropriate given that there are competing products. However, the original reference was for the supply of store card credit services and the Commission's requested variation was limited to insurance taken out with store cards. If the Commission decided that insurance products offered in association with the provision and use of store cards was part of a wider market, the OFT would expect the Commission to exercise caution in framing any remedies, so as to prevent or limit any distortion of competition in the wider market.