

**dti**

**CONSUMER AND COMPETITION  
POLICY**

**Credit Card Cheques: A  
Discussion Paper**

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We champion UK business at home and abroad. We invest heavily in world-class science and technology. We protect the rights of working people and consumers. And we stand up for fair and open markets in the UK, Europe and the world.

# CREDIT CARD CHEQUES: A DISCUSSION PAPER

## WHY IS DTI CONDUCTING THIS CONSULTATION?

This consultation is seeking views on whether it is necessary to make changes to the regulation of credit card cheques. In particular, we are seeking views on how to ensure that consumers who use the product do not incur unnecessary credit charges due to a lack of understanding about the implications of using a credit card cheque.

**Issued** 24 November 2005

**Respond by** 24 February 2006

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## Executive Summary

The purpose of this paper is to seek further information and views about the issue and use of credit card cheques. **Section 1** sets out the background to the issue, with reference to previous discussion on this topic during the Treasury Select Committee hearing on credit card charges and marketing; debates during the passage of the Consumer Credit Bill; and the Task Force on tackling over-indebtedness.

**Section 2** considers the development of the credit card cheque sector and the main criticisms that have been leveled against them – in particular:

- the unsolicited nature of their issue
- a lack of transparency about the consequences of using a credit card cheque.

**Section 3** looks at how the regulation of credit card cheques has developed in recent years with particular reference to the Banking Code. It also considers what further measures may be needed to address the concerns described in section 2.

**Section 4** lists a number of specific options for consideration:

- **Option 1:** Do nothing. Keep the operation of the credit card cheque sector under review in the light of the revised Banking Code/APACS guidance.
- **Option 2:** Use existing legislative powers to specify information that accompanies credit card cheques.
- **Option 3:** Use existing legislative powers to require specified information to be printed on credit card cheques.
- **Option 4:** A combination of options 2 and 3.

## **How to respond**

When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

Responses to this consultation should be sent to [credit.review@dti.gsi.gov.uk](mailto:credit.review@dti.gsi.gov.uk). You can also write to:

Consumer Credit Team  
Department of Trade and Industry  
Consumer and Competition Policy Directorate  
Bay 428  
1 Victoria Street  
London SW1H 0ET

**The deadline for responses is 24 February 2006.**

An electronic version can be found at <http://www.dti.gov.uk/ccp/consultations.htm>.

### **Confidentiality & Data Protection**

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want other information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Where confidentiality is not requested, responses may be made available to any enquirer, including enquirers outside the UK, or published by any means, including on the Internet.

### **Help with queries**

15. Questions about the policy issues raised in the document can be addressed to:

Iain Adlington  
Consumer Credit Team  
Department of Trade and Industry  
Bay 428  
1 Victoria Street  
London SW1H 0ET

Tel: 020 7215 3806

Email: [credit.review@dti.gsi.gov.uk](mailto:credit.review@dti.gsi.gov.uk)

16. If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

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A copy of the Code of Practice on Consultation is in Annex E.

## **Consultation questions**

*Are there other examples where credit card cheques are used?*

*Why do some merchants accept credit card cheques and not credit cards?*

*Where does their assumption that the cheque will be honoured come from?*

*What does a retailer do with a credit card cheque once they have accepted one? How do they ensure that they get paid?*

*What are the essential characteristics that define a credit card cheque from an ordinary bank cheque?*

*What evidence of consumer detriment can you provide concerning the unsolicited provision of credit card cheques?*

*What evidence of consumer detriment can you provide concerning a lack of transparency about the use of credit card cheques?*

*To what extent has the situation changed since the 2002 Household Survey?*

*How effective are the new provisions in the Banking Code?*

*Are there other key information requirements (concerning the use of credit card cheques)?*

*Do you have views on the form and content and prominence requirements?*

*Where should any additional information about credit card cheques be listed – on the cheque itself or with the literature that accompanies a credit card cheque?*

*How feasible is it to place information on the reverse of the cheque?*

*What information should be placed there?*

*Could the information be placed elsewhere – e.g. on the counterfoil?*

*What impact would there be on consumers? Would they read the information?*

*Which of options set out in section 4 do you prefer? Do you have alternative options to suggest?*

## **RIA questions**

*Do you agree with assumptions used and the estimate for the potential consumer detriment arising from a consumer failing to understand the charges associated with the use of credit card cheques?*

*Have the recent changes to the Banking Code and APACs guidance reduced this? What evidence is there to demonstrate this?*

*Do you agree with benefits set out under each of the options? Are there any additional benefits, which should be included? (Where possible please supply quantifiable estimates)*

*Do you agree with costs set out under each of the options? Are there any additional costs which should be included? (Where possible please include quantifiable estimates)*

*Are there any other ways that we can ensure that the final option we choose is designed and implemented in a way which minimises costs to business?*

## **SECTION 1: INTRODUCTION**

1.1 Tackling over-indebtedness and achieving more responsible lending and borrowing is a key priority for the Government. It is in this context that this paper has been published, although any discussion of this issue must acknowledge that the issues surrounding the availability and use of credit card cheques are only one piece of a much larger picture.

1.2 This paper follows earlier discussion about credit card cheques, in particular by the Treasury Select Committee on Credit Card Charges and Marketing<sup>1</sup>, and the Task Force on Tackling Overindebtedness<sup>2</sup>. The Task Force's second report made a number of recommendations concerning the precautions lenders should make about a customer's financial status before sending out credit card cheques and the information that should be provided concerning the charging arrangements, conditions of use and the difference in protection compared with the use of a credit card. Meanwhile, the Treasury Select Committee has made similar recommendations and also expressed concern about how the unsolicited issuing of credit card cheques had the potential to disproportionately affect households at risk of overindebtedness.

1.3 More recently, the Minister for Consumer Affairs, Gerry Sutcliffe, along with his front-bench counterparts, Charles Hendry and Norman Lamb has been in discussion with the Association for Payment Clearing Services (APACS) about a number of issues that have been raised during the passage of the Consumer Credit Bill. Credit card cheques were among the topics discussed.<sup>3</sup>

1.4 The Government is now seeking views on how to ensure consumers who use credit card cheques understand the nature of the product and do not incur unnecessary credit charges due to a lack of knowledge about the implications of using a credit card cheque. The Government is not proposing to prohibit the issuing of credit card cheques, but it is keen to ensure that consumers are fully informed about the consequences of using a credit card cheque. These issues are discussed in more detail in sections 2 and 3 with some options for improving the transparency requirements concerning credit card cheques set out in section 4.

## **SECTION 2: BACKGROUND AND ISSUES**

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<sup>1</sup> House of Commons Treasury Committee. Credit card charges and marketing. Second Report of Session 2004-05.

<http://www.parliament.the-stationery-office.co.uk/pa/cm200405/cmselect/cmtreasy/274/27402.htm>

<sup>2</sup> Household Survey on the Cause, Extent and Effects of Overindebtedness. November 2002.

<sup>3</sup> <http://ovscob01/pocmintv5.nsf/07075833e4a7f5e980256a79004176aa/b5c3120653bf89908025704600377ce2?OpenDocument>

## **Purpose Of Credit Card Cheques**

2.1 Credit card cheques have been an additional facility on credit card accounts for about 10 years, and are issued by 11 of the 15 major financial institutions. They are usually provided as an additional instrument to a credit card and to some extent are similar to normal bank account cheques (and can be used in the same situations). According to data collected by APACS, the UK payments association, around 3.4m cheques were written during 2004 which is very small percentage (0.2%) of the number of overall credit card purchases in the UK (a total of 1.727 billion in 2004). The cheques can be used to make payments to other individuals or be paid into a cardholder's own account. Once deposited, the amount then appears on the next credit card statement. Most credit card cheques are not guaranteed and will be returned unpaid if the credit limit has been exceeded.

2.2 Credit card cheques do not grant new lines of credit or increase credit limits but they do provide an alternative means of accessing the existing credit line. Most credit agreements start from a low credit base and the limits are increased over time depending on the management of the account by the cardholder.

2.3 Credit card cheques are typically issued in small quantities (e.g. in fours or tens) rather than a standard chequebook. One major issuer reports that around 60-70% of credit card cheques written by their cardholders are at promotional interest rates.

2.4 Credit card cheques are mainly used for high value transactions. The average value of a credit card cheque transaction is about £850 as against £58 for a UK credit card purchase and £120 for a personal cheque payment, suggesting credit card cheques are being used for specific types of high-value transactions. Typically, credit card cheques are used for one-off purchases. Such transactions might include payments to traders who don't accept card payments and other types of regular or non-retail payments. Balance transfers are another reason why such cheques are sometimes used, while some consumers have used credit card cheques to pay utility bills (see paragraph 2.12).

*Are there other examples where credit card cheques are used?*

*Why do some merchants accept credit card cheques and not credit cards?*

*Where does their assumption that the cheque will be honoured come from?*

*What does a retailer do with a credit card cheque once they have accepted one? How do they ensure that they get paid?*

*What are the essential characteristics that define a credit card cheque from an ordinary bank cheque?*

## CRITICISMS OF CREDIT CARD CHEQUES

2.5 Criticisms of credit card cheques operate at a number of levels.<sup>4</sup> At the more general level it is argued that they can appear as a new credit line to consumers (even though they are not) and therefore encourage increased spending. Some lenders have also been accused of adopting aggressive marketing ploys, for example by targeting the cheques at vulnerable consumers, especially at particular times of year such as Christmas, or that they have been sent along with flyers for holidays. In the past some credit card cheques have been sent with pre-printed amounts already filled in.

2.6 Beyond these general criticisms, there are two inter-related aspects about credit card cheques that have caused particular concern. Firstly, that the consumer does not have to actually ask for the cheques because they are sent out at the discretion of the credit provider. Secondly, the consumer may not be aware that different terms and conditions apply to transactions carried out via a credit card cheque as compared with a credit card.

### *Unsolicited issue of credit card cheques*

2.7 Most of the companies who issue credit card cheques choose to do so at their discretion rather than at the customer's request. This practice was criticised by the Treasury Select Committee who recommended that the practice should cease. The Household Survey of 2002 also made similar criticisms. Since then revisions to the Banking Code and associated APACS guidance (see section 3 and Annex B) have been made so that the customer is now given the option of saying they do not want to receive credit card cheques. Lenders are also instructed not to issue credit card cheques to:

- Customers who are in arrears or over-limit
- Customers with limited scope to borrow more or who are at their limit
- Customers who have opted out of receiving cheques
- Accounts where there are fraudulent activities or lost / stolen procedures pending

2.8 A separate but related concern regarding the unsolicited issue of credit card cheques is one of fraud. Because most credit card cheques are sent unsolicited, they are seen as being particularly vulnerable to fraudulent use because the consumer is unaware that they have been dispatched. For some issuers such fraud peaked towards the end of 2004

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<sup>4</sup> For examples, see Consumer Credit Bill Hansard report of House of Commons Standing Committee E, 27 January 2005, columns 132-143.

but was successfully addressed through the implementation of specific counter-measures which forced fraudsters elsewhere. In the event that credit card cheque fraud is perpetrated, the lender would be liable for any financial loss rather than the consumer. Therefore it is in the credit industry's interest to put in place robust anti-fraud measures. For example, some lenders have put in place precautionary measures such as checking with the account holder if credit card cheques are presented when they have only been infrequently presented in the past. Other measures include using courier services to deliver the cheques and checking to see if the address of the customer concerned has changed before dispatching the cheques.

2.9 In its consideration of this issue, the Treasury Select Committee recommended that the industry should adopt new measures to combat the fraudulent use of credit card cheques and that the ending of unsolicited issuing would be a helpful measure in this regard.

### *Transparency issues*

2.10 The issue of transparency is a key priority for the Government in promoting consumer understanding in the credit industry. New regulations on credit advertising, the form and content of credit agreements, and early settlement provisions are already in place and have improved the information available to consumers before and when they enter into credit agreements. The Consumer Credit Bill also contains a number of important provisions to improve the quality and quantity of information available to consumers after they have entered into credit agreements. As with all other credit agreements, the Government believes that credit card cheques should also be accompanied by clear information.

2.11 The issue of transparency was also considered by the Treasury Select Committee in an earlier report<sup>5</sup>. It said that when credit card cheques are issued they should be accompanied by clear information regarding the APR and fees. In particular it was felt that it should be made clear that interest will be calculated from the date of the transaction with no interest free period, and that consumers do not have the same degree of protection as they do when using a credit card. Section 75 of the Consumer Credit Act, where the finance provider is made jointly and severally liable for a breach of contract by the supplier in respect of items worth between £100 and £30,000, does not apply to credit card cheque transactions (assuming that the relevant agreements are not debtor creditor supplier agreements falling within section 12(b) or (c) of the Act). This is because the relationship between the supplier and credit card issuer does not exist in the case of credit card cheques.

### *Evidence of consumer detriment*

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<sup>5</sup> First Report of Session 2003-04, Transparency of Credit Card Charges, HC 125.  
<http://www.parliament.the-stationery-office.co.uk/pa/cm200304/cmselect/cmtreasy/125/12502.htm>

2.12 To date the direct link between the issuing of credit card cheques and a detriment to the consumer remains inconclusive. According to the 2002 Household Survey, one in six (16 per cent) of households with credit cards had been sent cheques by their card supplier during the previous 12 months. (This is equivalent to 8 per cent of all households in Britain.) In almost all cases these were sent unsolicited. Only a minority (13 per cent) of cheque recipients had actually used any of them. A third of those users had used the cheques either to pay bills or to pay off debts. Only a third of cheque users knew that they paid interest on the money straight away. The Survey also found that credit card cheques had been sent to above average proportions of cardholders who were either in financial difficulty or spending a high proportion of their income on repaying the money they had borrowed.

- *What evidence of consumer detriment can you provide concerning the unsolicited provision of credit card cheques?*
- *What evidence of consumer detriment can you provide concerning a lack of transparency about the use of credit card cheques?*
- *To what extent has the situation changed since 2002?*

## **SECTION 3: DEVELOPMENTS CONCERNING THE REGULATION OF CREDIT CARD CHEQUES**

### The Banking Code and APACS Best Practice Guidelines

3.1 The Banking Code is a voluntary code which sets standards of good practice, seeking to give rights to customers over and above what the law provides and seeking to ensure that customers understand what they can expect in their day-to-day dealings with financial institutions.

3.2 The first Code was published in 1991 and has been regularly updated to cater for the changing financial services environment. The Code is independently monitored and enforced by The Banking Code Standards Board.

3.3 The Banking Code has recently been amended (March 2005) and for the first time addresses the issue of credit card cheques. In response to recommendations by the Treasury Select Committee and as a result of the APACS best practice guidelines (see paragraph 3.4), the Code and its Guidance for Subscribers, has introduced some significant new practices around the issuing of credit card cheques. The Banking Code prescribes that customers have the right to say that they do not want to receive credit card cheques, should be informed about any fees if they use the cheques and that customers should be aware that they do not have the same level of protection with a credit card cheque, compared to a credit card. In addition, the Guidance to Subscribers (which is intended to clarify to Banks/building societies what the Banking Code means and how it should be interpreted) states that credit card cheques are now only to be sent to qualifying cardholders. They should not be sent out to customers who are in arrears or over limit; customers with a limited scope to borrow more; and accounts where there are problems of fraud or procedures pending to deal with lost or stolen cards. Another key provision, contained in the Guidance to Subscribers, is that credit card cheques should no longer be issued with a pre-completed amount filled in.

3.4 Under the associated APACS Best Practice Guidelines, credit card cheque customers should now be provided with very clear information about the cheques and the consequences of using them. For example, the details of when interest would start to accrue, indicative rates of interest and the level of protection on purchases made with a credit card cheque.

3.5 The Banking Code contains a section specifically on complaints procedures and all subscribers will have a formal procedure for complaints handling. In addition, the Banking Code Standards Board has a helpline which can also be referred to. Further details are available on the BCSB website: <http://www.bankingcode.org.uk/>).

3.6 Annex B sets out the relevant parts of the Banking Code, the Guidance for Subscribers and related APACS Best Practice Guidelines.

## *How effective are the new provisions in the Banking Code?*

### Unsolicited issue of credit card cheques

3.7 As discussed in section 2, the Treasury Select Committee recommended an end to the unsolicited issuing of credit card cheques so that they would not be issued unless the customer specifically requested the cheques.

3.8 From the industry perspective, the disadvantage of requiring the customer to make the request (to “opt-in”) is concerned with the nature of the product. If the customer had to ask to be provided with credit card cheques, it would undermine the accessibility of the product. Although credit card cheques are often not used by the consumer, they have been found to be convenient in unusual, unpredictable situations, such as paying an emergency plumber. The ability to use credit card cheques in such situations could be lost if there was an opt-in.

3.9 The argument in favour of the opt-in approach is that given that the vast majority of credit card cheques are unused, such an approach would be a more cost-efficient method of distributing credit card cheques. This is particularly so given that the product, albeit niche, is now well established among consumers who therefore should be able to determine in advance whether or not they may have a future need for a credit card cheque.

3.10 The Government's present view is that to ban the unsolicited issue of credit card cheques would be a disproportionate measure at this stage given the industry's commitment to carry out appropriate checks concerning the prospective consumer's credit worthiness before sending out any credit card cheques. As discussed in paragraph 3.3, credit card cheques are now only to be sent to qualifying cardholders, while consumers can also opt-out of receiving credit card cheques if they wish.

3.11 It is also recognised that there are situations where credit card cheques may be advantageous to the consumer (for example, when making a large purchase from a merchant who does not have credit card facilities). However, while the Government considers that the receipt of a credit card cheque does not of itself have adverse implications for the consumer, it is important that the consumer should have sufficient information to be able to make an informed decision about whether using a credit card cheque is appropriate for the transaction concerned.

3.12 The prime focus of this consultation, therefore, is to ensure that consumers' should have clear information about credit card cheques and the implications of using them.

## Enhanced Information Requirements

3.13 Credit card cheques are a relatively modern development and are not specifically provided for in the 1974 Act. However, there are provisions in the Act regarding the form and content of documents relating to credit agreements that would seem to be relevant in this context.

3.14 As discussed above, the Banking Code and APACS guidelines have already been amended to set out new requirements that credit card cheque providers should follow when issuing such cheques in order to make customers' more aware of the consequences of using the cheques.

3.15 However, there is no set format for the provision of information among credit card cheque issuers. For example, some providers include the necessary information in a summary box attached to the letter accompanying the credit card cheque. Other providers include similar information but as a footnote to the letter. Some letters emphasise the use credit card cheques can be put to, but are less clear on what the disadvantages of using the cheques may be. In many examples, it would seem the customer would have to look in different places in the accompanying literature in order to get the full information.

3.16 With this in mind, it may be appropriate to consider enhancements to the information requirements concerning the provision of credit card cheques. For example, whether there should be a requirement for information to be presented together as a whole, (i.e. in one place without interspersing) and with specific requirements on the prominence or relative prominence of the information. Also, whether there should be a requirement to give equal prominence to descriptions of the advantages and disadvantages of using credit card cheques. To address concerns that consumers' are often sent credit card cheques without actually requesting them, it may also be appropriate to require a specific statement in the credit agreement along the lines "you may be sent credit card cheques" so that the consumer can take a view on whether they want to receive the cheques or not as is provided for in the Banking Code.

3.17 As far as the information itself is concerned, among the key pieces of information a consumer needs to know about the cheques is the following:

- What interest rate is applicable – does it differ from the rate applicable to ordinary credit card transactions
- When do interest charges start and is there an interest-free period
- Are there transaction charges
- What happens if you go over your credit limit

*Are there other key information requirements?*

*Do you have views on the form and content and prominence requirements?*

3.18 An alternative/additional proposal is that key information could be placed on the cheques themselves. There is a limited amount of space on the reverse of the cheque where some basic information could be placed. Annex A contains some suggestions as to how this provision might be made to work in practice.

*Where should the information be listed – on the cheque itself or with the literature that accompanies a credit card cheque?*

*How feasible is it to place information on the reverse of the cheque?*

*What information should be placed there?*

*Could the information be placed elsewhere – e.g. on the counterfoil?*

*What impact would there be on consumers? Would they read the information?*

## **SECTION 4: OPTIONS FOR CONSIDERATION**

In view of the preceding discussion the following are to be considered:

**Option 1:** Do nothing. Keep the operation of the credit card cheque sector under review in the light of the revised Banking Code.

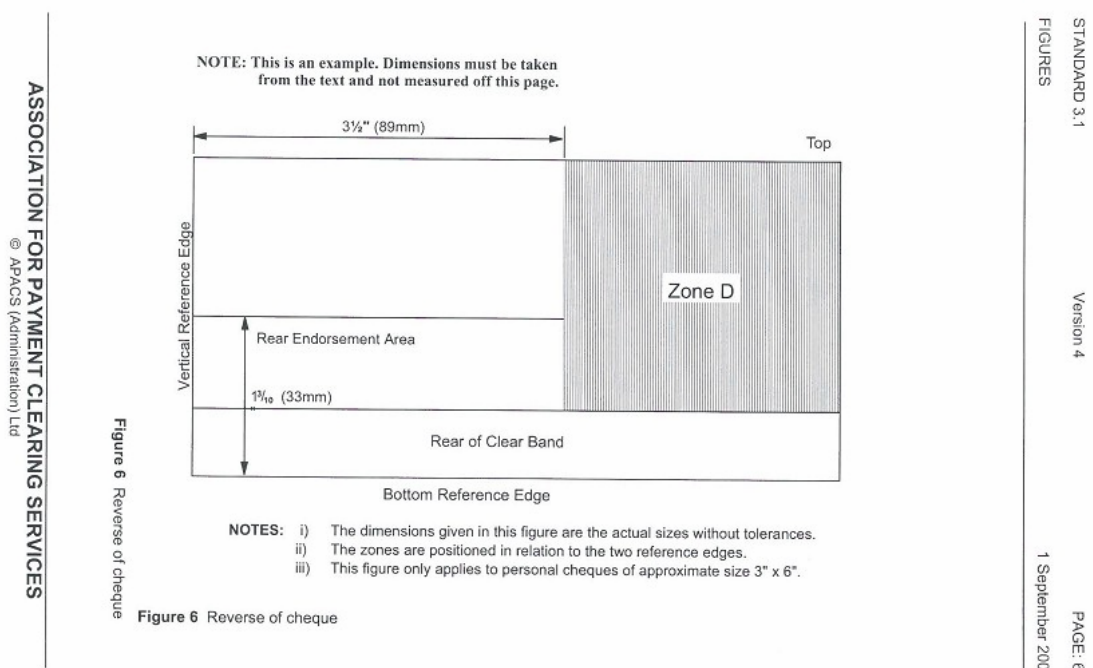
**Option 2:** Use existing legislative powers to specify information that accompanies credit card cheques.

**Option 3:** Use existing legislative powers to require specified information to be printed on credit card cheques.

**Option 4:** A combination of options 2 and 3.

*Which option do you prefer? Do you have alternative options to suggest?*

- Annex A



## WHAT INFORMATION SHOULD BE PROVIDED

The following are suggestions for information that could be placed within zone D on the reverse of the cheque:

- Refer to monthly statement for details of charges and interest
- Handling fee - refer to statement
- Interest will apply from date of debit
- Cheques do not offer the same level of protection as a card transaction
- Cannot be used for balance transfers or outside the UK
- This cheque cannot be guaranteed

## ANNEX B

### **EXCERPTS FROM THE BANKING CODE; BANKING CODE GUIDANCE FOR SUBSCRIBERS; AND APACS BEST PRACTICE GUIDELINES ON CREDIT CARD CHEQUES**

#### Banking Code

“10.15 You have the opportunity to say you do not want to receive credit card cheques and we will let you know about any fees if you use these cheques. You may not have the same level of protection when you use a credit card cheque as you do with a credit card. “

#### Banking Code Guidance for Subscribers

**In addition to the APACS best practice guidelines for credit card cheques set out below, the following customers should not be issued credit card cheques:**

- Customers who are in arrears or over-limit\*
- Customers with limited scope to borrow more or who are at their limit
- Customers who have opted out of receiving cheques
- Accounts where there are fraudulent activities or lost / stolen procedures pending,

**\* this is taken to mean that subscribers will not send cheques to customers who are in arrears with their payments or over-limit at the time of selection for receipt of credit card cheques.**

**Issuers should not issue unsolicited credit card cheques with a pre-completed amount.**

**Issuers will follow the APACS Best Practice Guidelines for credit card cheques. These include the following:**

- Before credit card cheques are sent out to a customer the issuer will always assess the customer's ability to repay.
- Issuers will provide new customers with a first time opt-out of receiving credit card cheque mailings.
- Existing customers will be able to opt-out of receiving credit card cheques by contacting their issuer.
- Issuers should undertake appropriate checks to assess a customer's suitability before sending credit card cheques.
- Issuers should notify customers that regular checks may be made (the method and timing of advice will be at the issuer's discretion).

- Information should explain the purpose and key features of credit card cheques, including how they might be used and any associated charges.
- Information should explain how, for the purposes of the account, credit card cheque transactions will be treated e.g. if they are treated as cash advances and the relevant terms and conditions that will apply.
- Customers should be advised if there are any restrictions on the use of cheques e.g. if they cannot be used to make balance transfers.
- Customers should be told what steps to take if they do not wish to use their credit card cheques.
- Issuers should notify customers of the interest rate the cheques will attract (recognising that the rate can only be correct at the time of cheque mailing and is therefore indicative) and from when interest will accrue.
- The duration of any promotional rates should be made clear.
- Issuers should give the customer information on all charges (i.e. other than interest) and the circumstances under which these charges will be applied to the account. This should include any charges relating to unpaid cheques.
- Issuers will not offer customers specific inducements, such as prize draws, to use credit card cheques. This does not apply to promotional interest rates, such as lower APRs.
- Issuers should advise customers of the level of protection on purchases made with credit card cheques and highlight how this differs to purchases made with their credit card. For instance, if credit card cheques are treated as a 'cash' transaction, they will not benefit from protection provided on credit card purchases under Section 75 of Consumer Credit Act.
- Where issuers provide customers with a cheque guarantee function on their credit card, they should inform the customer whether credit card cheques can be guaranteed<sup>4</sup> (given that the guarantee facility may be attached to a different account). Customers should be advised that where a cheque has been guaranteed, it cannot be countermanded.
- Issuers should provide the customer with a clear explanation of any exclusions, exemptions or limitations that apply to credit card cheques e.g. if they are unable to be used to pay off another account with that organisation; any geographical limitations; or any limitations on the ability to countermand etc.

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<sup>4</sup> Within the provisions of the UK Domestic Cheque Guarantee Scheme

## **ANNEX C**

### **PARTIAL REGULATORY IMPACT ASSESSMENT**

#### **1. Title of proposal**

##### **Issue and marketing of credit card cheques**

#### **2. Purpose and intended effect of measure**

##### **The objective**

Credit card cheques provide an additional means of accessing a credit account. However, at present some consumers who use credit card cheques are not fully aware of the nature of the product and hence incur charges that they may have otherwise chosen to avoid.

This RIA therefore considers several options examining how best to ensure that consumers do not incur these charges because of a lack of understanding of the product.

##### **The background**

Credit card cheques have been an additional facility on credit card accounts for about 10 years, and are issued by 11 of the 15 major financial institutions. They are usually provided as an additional instrument to a credit card and to some extent are similar to normal bank account cheques (and can be used in the same situations). Credit card cheques do not grant new lines of credit or increase credit limits but they do provide an alternative means of accessing the existing credit line.

This option of using a credit card cheque can be useful to consumers when, for instance, the retailer does not have the means to process a transaction with a credit card. However, transactions carried out by credit card cheque can be subject to different terms and conditions than those transactions carried out via a credit card. This difference can result in consumers paying more in interest and penalty charges than they may have anticipated.

According to data collected by APACS, the UK payments association, around 3.5m credit card cheques were written during

2004. At an average value of £850<sup>7</sup> per cheque, this means that just under £3bn was written on credit card cheques in 2004 representing 2.2% of the total amount lent on credit cards<sup>8</sup>.

This consultation and RIA follows earlier discussion about credit card cheques, in particular by the Treasury Select Committee on Credit Card Charges and Marketing, and the Task Force on Tackling Overindebtedness in 2003/4 and 2004/05. Both expressed concern about how the unsolicited issuing of the cheques and a lack of information about the consequences of using the cheques might have an adverse impact on consumers.

However, since these discussions the industry has made a number of changes. The Banking Code was updated in March 2005 to ensure that consumers have the opportunity to say that they do not want to receive credit card cheques. Associated APACS guidance was amended in April 2004 and contains specific advice concerning the issuing of credit card cheques and the kind of information that should be provided to users of such cheques. Further information is available in Annex B.

All of the 11 APACS members who supply credit card cheques subscribe to the guidelines.

The Government is now considering whether further steps are needed to improve consumer awareness of the implications of using a credit card cheque.

The DTI has also considered whether, in the light of concerns expressed by the House of Commons Treasury Select Committee on credit card charges and marketing, measures should be introduced to curb the unsolicited issuing of credit card cheques. Option 5 below considers this in more detail but, as discussed in paragraph 3.10 of the consultation paper, the Government is not presently persuaded that such a course should be adopted.

### **Rationale for Government Intervention**

Because credit card cheques give consumers access to the same line of credit that is available on their credit cards, consumers may be unaware of the differences in the costs associated with paying for a transaction by credit card cheque as opposed to credit card. Credit card cheques are used relatively infrequently compared to credit card transactions, so it is unlikely that

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<sup>7</sup> This figure is fairly high since credit card cheques are often used in circumstances where consumers are making an emergency purchase where other methods of payment are not accepted and/or they need to use credit to pay for this.

<sup>8</sup> VZQH - Total lent on credit cards £133bn figure taken from Table A5.6 Monetary & Financial Statistics August 2005, Bank of England.

consumers are as familiar with the terms and conditions of using credit card cheques as opposed to their card. There is a risk that some lenders are taking advantage of this lack of familiarity and are encouraging consumers to unwittingly use a more expensive form of credit.

The DTI 2002 Household Survey on Over-indebtedness<sup>9</sup> showed that only a third of cheque users knew that they paid interest on the money straight away. If this percentage were the same in 2004 and assuming that the average interest on money spent using credit card cheques was 17% for 20 days<sup>10</sup>, consumers would be paying over £18m in unexpected interest payments.<sup>11</sup>

In addition, consumers may also be unaware of the set fees associated with using the cheques. Assuming a similar percentage of awareness and an average set charge of £2, detriment resulting from fees may be £4.6 m bringing the total to around £23m.

This estimate is a maximum for the annual consumer detriment resulting from unanticipated interest charges since:

- Changes in the Banking Code and APACS guidance in March 2005 and April 2004 respectively, mean that information on the charges associated with use of the credit card cheques should now be clearly displayed. This should help reduce the number of consumers who are unaware that they will incur interest from the point at which the cheque is used. However, in so far as the guidance formalised existing practice, this change may have had relatively minor effects in practice.
- Many consumers are likely to continue to use a credit card cheque even if they are aware of the costs that this involves, since in some cases it may be the most convenient or suitable means of transaction.

Nevertheless, there is a real risk that despite the changes that industry have made, consumers continue to experience detriment running into several millions through a lack of awareness of the costs of using the cheques.

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<sup>9</sup> Household Survey on the Cause, Extent and Effects of Overindebtedness. November 2002.

<sup>10</sup> The 17% is an estimate for the average interest rate that consumers incur on credit card cheques. This aims to take account that a high proportion of consumers use credit card cheques when the interest is on a promotional rate. 20 days is used here as the basis for the calculation to represent the average time that elapses between consumers using the credit card cheques and clearing the balance on their card.

<sup>11</sup> Based on 3.5m credit card cheques being issued with an average value of £850 and two thirds of consumers being unaware that they incur interest straight away.

***Question: Do you agree with assumptions used and the estimate for the potential consumer detriment arising from consumer failing to understand the charges associated with the use of credit card cheques?***

***Have the recent changes to the Banking Code and APACs guidance reduced this? What evidence is there to demonstrate this?***

### **3. Options**

**Option 1: Do nothing.** This option would allow time for changes in the industry resulting from the revised Banking Code to bed down. The sector could be reviewed again at a later point once evidence on the impact of these changes is available

**Option 2: Use existing legislative powers to specify information that accompanies credit card cheques.**

This option would to some extent codify what is already in the Banking Code/APACS guidance in respect of the information that should be provided when credit card cheques are issued to consumers. Under the terms of the Code (and its guidance for subscribers), agreements should now have very clear information provided about credit card cheques and the consequences of using them. In particular this includes the details of when interest would start to accrue, indicative rates of interest and the level of protection on purchases made with a credit card cheque. This option would make the provision of such information a legal requirement.

Option 2 also invites consideration of whether it would be appropriate to include a specific requirement upon credit card cheque providers to give information to consumers at the outset of the agreement that they may be sent credit card cheques at some point in the future.

**Option 3: Use existing legislative powers to require specified information to be printed on credit card cheques.**

This option considers the possibility of inserting a form of wording on the cheque itself. In terms of prominence, this goes further than the Banking Code and as such could heighten consumer awareness of the consequences of using a credit card cheque at the time of the transaction.

**Option 4: A combination of options 2 and 3.**

**Option 5: A prohibition on the issue of unsolicited credit card cheques.**

This option means that credit card cheques would only be issued at the consumer's request. This would in effect mean that consumer's would opt-in to receipt of credit card cheques. This option could be combined with option 2 and/or option 3.

#### 4. **Costs and Benefits**

##### **Sectors and Groups affected**

The 11 major financial institutions that issue credit card cheques (see Annex D).

Small business that use credit card cheques for payment.

##### **Benefits**

###### **Option 1: Do nothing**

Industry already has to comply with the Banking Code and cheque issuers also follow APACS guidance so there would be no additional benefits involved with this option. However, this would give time to see how the industry reacts to the recent changes to the Banking Code and to gauge its impact on credit card cheque use.

###### **Option 2: Use existing legislative powers to specify information that accompanies credit card cheques.**

At present all 11 credit card issuers comply with the Banking Code and APACS guidance on credit card cheques so making these legal requirements is unlikely to have any practical effect on consumer detriment.

However, there are concerns that consumers do not realise they will be sent credit card cheques and this option would provide for a specific statement in the credit agreement along the lines "you may be sent credit card cheques". This would mean that consumers would be given a better opportunity to take an early view on whether they wanted to receive credit card cheques with the result that some consumers might decide to exercise their rights in the Banking Code to opt-out before being sent any cheques.

This could also deliver benefits to industry, as they would no longer incur the costs associated with sending credit card cheques to those consumers who have no intention of using them. Evidence from the 2002 survey on Household over-indebtedness indicates that only about 13% of cheque recipients had used any of them. This means

that over 20 million credit card cheques are sent out and not used each year<sup>12</sup> Assuming cheques are sent out in batches of 4, this means over 5 million letters containing unused cheques are sent out to consumers. If some more of these consumers opted out, say 10%, this would save industry around £125,000 a year.<sup>13</sup>

**Option 3: Use existing legislative powers to require specified information to be printed on credit card cheques.**

This option considers the possibility of inserting a form of wording on the cheque itself. In terms of prominence, this goes further than the Banking Code and as such could heighten consumer awareness of the consequences of using a credit card cheque at the time of the transaction. This option has the potential to recover some of the consumer detriment currently caused by the fact that some consumers are unaware of the costs of using a credit card cheque and hence use it in situations where, with full understanding, they would have chosen a different payment mechanism.

However, evidence from the 2004 MORI report for DTI<sup>14</sup> indicated that the majority of consumers fail to read credit card agreements. To the extent that this is also true for additional information provided as part of options 2 or 3, it is possible that a significant number of consumers may continue to be unaware of the charges incurred and associated consumer detriment will persist.

**Option 4: A combination of options 2 and 3**

See above discussion of options 2 and 3.

**Option 5: A prohibition on the issue of unsolicited credit card cheques.**

This could deliver benefits to industry in terms of savings on printing and dispatch costs of credit card cheques, as those cheques that are printed and dispatched would only be sent to those consumers that intended to make use of the cheques. This could reduce the number of credit card cheque transactions and help ensure that they are only used by consumers who are confident that such a transaction is appropriate to their circumstances.

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<sup>12</sup> Using the fact the 13% of people use credit card cheques from the Household survey information and assuming that those who do use an average of 4 per year, in addition to the fact that 3.5m credit card cheque transactions were made in 2004.

<sup>13</sup> Assuming each unused batch of credit card cheques would have cost 25p to print and dispatch.

<sup>14</sup> Qualitative research into consumer understanding of the form and content of credit product documents.

This would also benefit consumers who do not want to receive these cheques.

**Question: Do you agree with benefits set out under each of the options? Are there any additional benefits, which should be included? (Where possible please supply quantifiable estimates)**

## **Costs**

### **Option 1: Do nothing**

None.

### **Option 2: Use existing legislative powers to specify information that accompanies credit card cheques**

This option would largely provide for in legislation the information-related requirements that are already provided for in the Banking Code/APACs guidance and should therefore have no major additional cost implications given that all 11 credit card cheque providers subscribe to the Banking Code and the APACS guidance.

Requiring credit card cheque providers to give information to consumers at the outset of the agreement that they may be sent credit card cheques at some point in the future may involve the provision of additional information (depending on the current practice of the credit provider in question). However, it is envisaged that such information would be provided along with other information about the credit agreement and so should not involve any significant on-going costs.

Simply requiring by law that credit card cheques should be accompanied by clear information about the implications of using them should not, therefore, add any significant costs to business because this is already required by the Banking Code/APACS guidance. There would be some further small one-off costs incurred by business in the form of administration and familiarisation with the legislation but such costs would be negligible.

### **Option 3: Use existing legislative powers to require specified information to be printed on credit card cheques.**

Requiring some additional information to be printed on the credit card cheques themselves would have additional cost implications. If the cost of printing the additional information on the cheque is calculated at 2p per

cheque, the additional cost across the industry is estimated at over £500,000 per annum.<sup>15</sup>

There would be some further small one-off costs incurred by business in the form of administration and familiarisation with the legislation but such costs would be negligible.

#### **Option 4: A combination of options 2 and 3**

Neither options 2 or 3 involve any significant ongoing costs. The main transitional cost concerns the printing of the additional information on the credit card cheque as described above.

#### **Option 5: A prohibition on the issue of unsolicited credit card cheques.**

This option is likely to lead to a significant reduction in credit card cheques given that the onus would be on the consumer to proactively ask to receive the cheques.

For those consumers who do choose to receive credit card cheques this option would mean that they would incur some cost in doing so which they do not at present. The magnitude of the costs depends how the 'opt in' worked in practice. A free-phone number may be cheapest from a consumer point of view but will still incur some small costs associated with the individual's time. Business would also incur some small additional costs processing and recording information on those who choose to receive these cheques, although such mechanisms should already be in place to deal with those consumers who want to exercise their existing "opt-out" right.

Whilst credit card cheques are not widely used by most consumers, they have come to be viewed by some consumers as a useful addition to their credit facilities. Often credit card transactions are undertaken in unusual, unpredictable situations – i.e. they can be convenient in one-off situations but often go unused. The ability to use credit card cheques in such situations would be lost if there was an opt-in as consumers may frequently be unaware that they may find credit card cheques useful in the future and so may not choose to receive them. This would result in a loss to these consumers if they later realise that having access to credit card cheques, for example to cover an emergency payment where other payment mechanisms are not accepted, would have been valuable to them.

This option could also have some impact on payees of credit card cheques, for example, small firms (especially mobile businesses such as plumbers,

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<sup>15</sup> Using the fact the 13% of people use credit card cheques from the Household survey information and assuming that those who do use an average of 4 per year, in addition to the fact that 3.5m credit card cheque transactions were made in 2004.

electricians, locksmiths etc.) who may not be set up to accept electronic transactions, i.e. debit card or credit card, but do accept cheques including credit card cheques. Small businesses may also use credit card cheques to make payments. If the outcome of option 5 was to lead to a reduction in credit card cheque transactions then this could have some, small adverse effect on small businesses.

***Question : Do you agree with costs set out under each of the options? Are there any additional costs which should be included? (Where possible please include quantifiable estimates)***

#### **5. Small Firms Impact Test**

Options 1-4 are not expected to have any impact upon small firms because the 11 issuers of credit card cheques do not fall within the definition of a small or medium enterprise. The 11 issuers in question are listed at Annex D.

Option 5 in theory could have some impact in that small firms may also be payees of credit card cheques. In some instances these firms (especially mobile businesses such as plumbers, electricians, locksmiths etc.) may not be set up to accept electronic transactions, i.e. debit card or credit card, but do accept cheques including credit card cheques. Small businesses may also use credit card cheques to make payments. If the outcome of option 5 was to lead to a reduction in credit card cheque transactions then this could have some, small adverse effect on small businesses.

#### **6. Competition Assessment**

A competition filter was carried out on the impact of the proposals on the consumer credit market. The proposals did not raise concerns about competition. Any increased costs would be proportional to each provider's market share, so no lenders would not be disproportionately discriminated against and it is unlikely there would be an effect on market structure. An increased availability of information on rates for credit cards cheques would, in theory, increase competition, however such an effect is likely to be small as credit card cheques only account for 2.2% of the credit card market.

#### **7. Enforcement , Sanctions and Monitoring**

Option 1 concerns self-regulation via the Banking Code and APACS guidance. Options 2-4 involve using existing regulatory powers under the Consumer Credit Act 1974.

Enforcement of Regulations made under the Consumer Credit Act is largely a matter for local authority Trading Standard Departments. The Office of Fair Trading also has an enforcement role and a duty to monitor the working of the Act. There would be a non-recurring introductory cost as the OFT, local authorities and Citizens Advice Bureaux train their staff in any new requirements. However, the changes would not be fundamental and concern what is essentially a niche end of the consumer credit market. Recurring costs should be capable of being absorbed within existing budgets given over to providing general advisory services.

## 8. **Compensatory Simplification Measures**

In analysing the relevant options for this RIA we have considered the implications of the wider proposals on consumer credit regulation, including the Consumer Credit Bill, and the requirements these place on industry. In reaching a final decision on the detail of the chosen policy option we will ensure that this is consistent with wider regulation in the area and has the minimal impact on industry necessary to achieve the objectives.

The main area where this will be important is on any information provision requirements in the chosen policy. These will be designed, where applicable, to ensure that they are consistent with existing requirements in order to minimise implementation and legal costs to business. For example, any requirements to show interest rates will be based on the same APR calculations and have the same definition for 'typical' APRs as contained in the Consumer Credit (Advertisements Regulations) 2004.

In addition it will be necessary to allow a sufficient transition period before the new policy recommendations come into effect and to ensure that concise guidance is available to firms about compliance.

**Question: Are there any other ways that we can ensure that the final option we choose is designed and implemented in a way which minimises costs to business?**

## 9. **SUMMARY OF COSTS AND BENEFITS**

<b>OPTION</b>	<b>COSTS</b>	<b>BENEFITS</b>
<b>1</b>	<b>Nil</b>	<b>This would allow time for an assessment of the impact that the recent changes to the Banking Code have had on credit card cheque use.</b>
<b>2</b>	<b>No significant on-going costs</b>	<b>Possible savings to industry if</b>

	<b>but some small one-off costs re administration and familiarisation with new requirements</b>	<b>the results of the changes led to fewer credit card cheques being printed and dispatched. There could also be a small gain for consumers through reduced consumer detriment if the changes led to a more informed use of the product.</b>
<b>3</b>	<b>Additional printing costs of £500K+ per annum.</b>	<b>Possible gains for consumers through reduced consumer detriment if the changes led to a more informed use of the product.</b>
<b>4</b>	<b>See 2 and 3 above</b>	<b>See 2 and 3 above.</b>
<b>5</b>	<b>Loss of consumer convenience, although this is hard to quantify. Some potential impact on small firms who accept and use credit card cheques.</b>	<b>Savings to industry in the form of reduced printing and dispatch costs.  Further potential consumer savings but hard to quantify due to unknown opt-in rate.</b>

The main consultation paper has only set out options 1-4 for consideration. Option 5 is not included. The Government's view is that a prohibition on the unsolicited issue of credit card cheques would be a disproportionate measure due to the reasons highlighted in the relevant sections of this RIA.

### **RIA questions**

*Do you agree with assumptions used and the estimate for the potential consumer detriment arising from a consumer failing to understand the charges associated with the use of credit card cheques?*

*Have the recent changes to the Banking Code and APACs guidance reduced this? What evidence is there to demonstrate this?*

*Do you agree with benefits set out under each of the options? Are there any additional benefits, which should be included? (Where possible please supply quantifiable estimates)*

*Do you agree with costs set out under each of the options? Are there any additional costs which should be included? (Where possible please include quantifiable estimates)*

*Are there any other ways that we can ensure that the final option we choose is designed and implemented in a way which minimises costs to business?*

**Annex D<sup>16</sup>**

**LIST OF CREDIT CARD CHEQUE ISSUERS**

Barclays

Capital One

Citigroup

Co-Operative Bank

Halifax Bank of Scotland

HBOS

HFC

Lloyds TSB

MBNA

Morgan Stanley

Royal Bank of Scotland

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<sup>16</sup> As known to APACS

## ANNEX E

### The Consultation Code of Practice Criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's web site, address <http://www.cabinetoffice.gov.uk/regulation/consultation/index.asp>

#### Comments or complaints

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

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