

standards for retail financial products

In response to the report by Don Cruickshank, *Competition in UK Banking*, the Government promised to consult further on one of the recommendations. This paper meets that commitment. It discusses the case for basic quality standards for retail financial products.

2. The Government believes that markets work best for consumers of financial products when competition is lively and transparent. In such markets consumers can drive down prices and achieve better quality by shopping around. But that cannot always be achieved readily. For products which are not easy to understand, there is a case for defining Government standards to help consumers recognise straightforward products which may suit their needs.

3. As the Cruickshank report recommends, this paper proposes a benchmark standard for a basic bank account. It goes on to discuss a possible standard for credit cards. It also invites feedback about other markets in which benchmark standards might be beneficial.
4. The Treasury would welcome reactions to the ideas and proposals in this document. You may find it helpful to answer the questions in annex A when you reply - though this is not essential.
5. Please send replies to:

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6. Please say in your reply if you represent a group and if so, explain its size and coverage. All feedback is welcome but it is particularly helpful to hear from consumers who want to use financial services.
7. Your reply may be made public unless you ask for it to be kept confidential.
8. Please reply by 30 April 2001.

EXECUTIVE SUMMARY

9. This consultation paper :

- ? examines further the case for the wider use of benchmarking minimum standards - CAT standards - for retail financial services products recommended by Don Cruickshank in his report 'Competition In UK Banking' in March 2000.
- ? considers the detriments consumers face and options for tackling them, including the role of legislative controls, statutory regulation, and the minimum standards approach to help consumers compare products and to shop around for the best product for them among those available.
- ? proposes CAT standards for credit cards and basic bank accounts as soon as effective conditions for these can be agreed.
- ? seeks views on appropriate conditions for CAT basic bank accounts and credit cards, including whether these could include a link between interest charges and bank base rates.
- ? seeks views on which other retail consumer financial products, including some insurance and pension products, could also be benefit from the benchmarking approach.

10. Credit cards

The proposed CAT standard for credit cards would cover **C**omparability, **A**ccess and **T**erms, and could include the following provisions :

Comparability

- ? All statements must include clear information on :
 - ? the annual percentage rate (APR)
 - ? interest chargeable on part payment of the outstanding amount
 - ? what date interest is charged from
 - ? all other charges

- ? No more than one interest rate for purchases and one for cash advances (these can be the same).
- ? The order in which payments should discharge the debt.

Access

- ? No minimum spending limit
- ? No link to other products, eg repayment protection
- ? Credit available on the provider's normal terms

Terms

- ? Information in clear, simple language
- ? A minimum deadline between statement and minimum payment date
- ? Minimum payment to be no more than 5% or £5 of the outstanding balance
- ? Maximum £20 penalty for late or incomplete payment
- ? Maximum £5 penalty for exceeding the credit limit
- ? No minimum credit limit, with notification of changes to the agreed limit

- ? A direct debit payment option
- ? Limits on customer liability for lost or stolen cards
- ? Clear information on exchange rate charges

11. **Basic bank accounts**

The proposed CAT standard for basic bank accounts would cover **Charges, Access and Terms** and could include the following provisions:

Charges

- ? No charges for everyday transactions
- ? No risk of an overdraft

Access

- ? No requirement for initial or regular deposits
- ? Customers must be able to use:
 - ? cash machines
 - ? cash and cheque deposits
 - ? automated credit transfer
 - ? direct debit, standing order or budget accounts

Terms

- ? All advertising and paperwork must be straightforward, fair and clear
- ? Account holders must receive regular statements and minimum notice if CAT standards terms are to be withdrawn
- ? Account holders must be able to withdraw all funds

Both proposed CAT standards are discussed and set out in more detail in the consultation paper and annexes.

12. Background

- a. In April 1999 Individual Savings Accounts (ISAs) were launched as a new tax-free savings vehicle to encourage the savings habit, particularly among those who were previously less likely to save. To further encourage savings among those unsure how to get the best deal from the range of ISAs on offer, a new concept was also introduced at the same time: the CAT standard.
- b. This set out minimum standards for Charges, Access and Terms for ISA products that adopted them. In March 2000 the CAT standard principle was extended to domestic residential mortgages as part of the Government drive to get a better deal for home buyers.
- c. The CAT standard approach has shown some success for consumers in these cases. There is evidence that the CAT standard has achieved significant market share and set an effective interest rate floor for ISA savings products, and that it has shown encouraging progress in increasing the proportion of mortgages with no minimum indemnity guarantee on fixed or variable rate mortgages, and with no redemption charge after fixed rate periods. The Government has also recently announced that the CAT standard approach will also be used to help buyers of long term care insurance products to get the right product for their needs on the best terms available in a particularly sensitive area of the market.
- d. Although the Government was already building on these initial CAT schemes, also in March 2000, Don Cruickshank recommended extension of the principle to a wider range of

financial products in his report 'Competition In UK Banking'. While approving the benchmarking principle to improve customers' ability to make informed choices, he recommended flexibility in their definition and suggested that the charge component would not be appropriate for all CAT products and that further use of the approach should focus on comparability between products.

- e. Publication of this consultation paper document follows from Don Cruickshank's main recommendations. It sets out detailed proposals for CAT standards to apply to credit cards and basic bank accounts, and invites views on the wider use of the CAT approach. However, the CAT standard for basic bank accounts retains the charge component, and the paper invites views on whether it should also apply to CAT standard credit cards and other suitable future CAT standards.
- f. The consultation paper also examines the background to the development and use of financial products generally, and in particular the difficulties experienced by consumers in making best use of the options available to them. It draws on a range of research and other data in developing the case for the wider use of the benchmarking approach as well as the lessons available to date from CAT ISAs and mortgages.

13. The way forward

- a. The consultation paper agrees that benchmarks with upper limits on charges - at least for new or unsophisticated users - can be useful for some financial products, but that for other products encouraging competition by focusing attention on prices for otherwise very

similar products may be more appropriate. It concludes that it will clearly be important to distinguish in which parts of the retail financial services market the two types of benchmark might best operate, and seeks further views on the question.

b. The consultation paper concludes that CAT standards can in principle add value for consumers of financial products in two ways:

? helping consumers recognise products and product characteristics that are worth considering where there is no regulation of the selling process.

? defining basic square deal products where the selling process is regulated, opening up scope for lighter regulation, eg modernizing the current polarisation rules for CAT ISAs and stakeholder pensions.

c. It suggests that circumstances where the extension of the benchmarking principle may have potential value include where:

- ? it is hard for consumers to understand what is offered.
- ? it is hard for consumers to compare apparently similar offers.
- ? competition is not about quality or value.
- ? simple, clear and fair offers will give many potential consumers sufficient for their needs.
- ? people might gain by shopping around to meet their own needs and interests.

14. We would be grateful for views on all the issues set out in the consultation paper by 30 April.

context

15. In the modern world people will increasingly need to look after their own financial interests for themselves. No Government could realistically hope to meet everyone's expectations of welfare services at a tolerable level of taxation. Moreover, people expect and hope for more as they become better off.
16. People increasingly need to use financial services in their everyday lives. They need money transmission services to deal efficiently with managing their money. Some 90% of households¹ already have bank accounts. The Government wants to see that proportion rise. When benefit payments are made by automated credit transfer (ACT) in 2003, nearly everyone will have ready access to money transmission services. In the meantime, with Government encouragement, the high street banks are starting to offer basic bank accounts to meet the needs of people who are reluctant to use bank accounts now.
17. To make the best of the opportunities available, people must be able to rely on financial products and the firms which provide them. For too long many ordinary people have found using financial products baffling or off-putting. That is unnecessary and wasteful.
18. The Financial Services Authority (FSA) is the Government's chosen single

¹ There are various measures of the take-up of current and deposit accounts for households and for individuals. For more information see *In or Out*, FSA, July 2000.

regulator for a wide range of financial services, including those directed at retail consumers. FSA aims to tackle imperfections in the way that markets work so that competition can operate in the interests of those using financial services. For consumers the main imperfection is information asymmetry: essentially, the concern that providers of, and advisers on, retail financial products know a great deal more about them than those who buy them - or perhaps more commonly, those to whom they are sold.

19. It is important that any form of regulation strikes a proper balance between protecting consumers and encouraging competition among providers of goods and services. This document is about one method of providing reassurance to consumers in a way which can complement the protections provided by the FSA.

consumers' attitudes to financial services

20. Research recently published by the Consumer Panel² which advises FSA brings this out clearly. Some 6% of people have no financial products at all. About a third of people say they do not trust the retail financial services institutions - banks and insurance companies - with which they have long term relationships. And there is a declining trend of confidence in how secure people feel their savings are. It is hardly surprising therefore that the same report shows that take up of many financial

² Annual survey of Consumers and Annual Report, 1999.

services is low, with - for instance - only 58% of people having savings and 17% of people with non-mortgage consumer loans (other than credit cards).

21. Some of this reluctance to use financial services is understandable. It is easy to overreact to reports of problems and scandals. It is ironic that the news of such problems often breaks partly because of action to remedy them: for instance, the major scandal of personal pensions misselling. On coming to power in 1997, the Government took swift and decisive action to support the regulators' efforts to get the firms responsible to sort out this shameful episode. So far some £5bn in compensation has been offered to some 650,000 investors and FSA estimates total compensation will eventually reach £11½bn.

22. Sadly this is a symptom of an underlying problem. Too many financial services firms have been cynical about their customers' interests - more interested in devising creative ways of hiding profit centres than in building real value for their customers.

23. Box A sets out some cogent examples³ of how this can arise.

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The latter two examples are from the *1999 Disclosure Report*, published by the Personal Investment Authority (PIA), which is to be replaced by FSA in 2001; the third from the Cruickshank report. Both March 2000.

4 Set by PIA at 6% for most investment projections.

5 *Sixth Survey of the Persistency of Life and Pensions Policies*, PIA, November 2000.

6 Measured in terms of reduction in yield, ie the amount per year by which charges reduce investment growth.

**Box A: examples of poor value
for consumers of financial services**

- ? Most credit card issuers do not make it clear that where the balance outstanding is not repaid in full within a given period (often 25 days), interest is charged on the full amount of debt outstanding from the day that purchases are made (not the due date for the minimum payment) - with the result that people can easily pay more interest than they expect or intend.
- ? Using the standard projection rate for investment returns⁴, only four 25 year endowment plans (out of the 116 listed) offer surrender values after five years which at least return the premiums saved. Of these four, none is competitive with typical savings rates in deposit accounts offered by banks and building societies. Even though endowment plans taken out in connection with a mortgage are portable when another mortgage is taken out, eg when moving house, a quarter of plans sold through company representatives are no longer in force after 4 years of being taken out because they have been surrendered⁵.
- ? Depending on the level of contributions, the charges⁶ payable on personal pensions where contributions stop after five years average 6-10% a year - even though this is a product intended to be suitable for people whose working patterns are erratic. In fact the average (median) period of employment in a single job is about five years⁷ and this is borne out by the lapse rates for regular contribution personal pensions, which reach some 35% after four years⁶ - so many people saving in this way must get poor value.

24. Practices such as those box A have enabled firms to mislead their customers by offering complex products with confusing detail hidden in the small print. Their advertising may be accurate, but too often it is designed to deceive.

25. While the regulatory system for selling retail investments is intended to deliver reliable *advice* on products, it does not bear directly on their *design*. Indeed it has been possible to over-engineer products to appeal

⁷ *The flexible labour market - implications for pension provision*, Pamela Meadows for NAPF, 1999.

to advisers more than to customers. This typically introduces such complexity that it can be almost impossible for people to select financial products without advice. At best, customers struggle to grasp the choices available to them. At worst, it is easy for people to be enticed into purchases of more intrinsic value to the salesman than to the customer.

26. In addition, there are some financial products whose sales do not entail regulated financial advice. This category includes most retail banking products - such as current bank accounts, credit cards and consumer savings accounts. These tend to be more straightforward to understand but, like packaged retail investments, can also suffer from the tendency of the retail finance industry to develop unnecessary complexity too often associated with hidden and unexpected charges.
27. Fortunately not every financial services firm has a strategy of selling products so complex that customers are readily misled. Some appreciate that looking after their customers' interests is a sound way to develop service relationships - often long term - to benefit both the public and their own businesses. And, as in other areas of retailing, new entrants have begun to challenge established firms to change their ways. This competition puts downward pressure on prices, with upward pressure on intrinsic product quality, and encourages customers to shop around for real value and quality.
28. For example, new entrants in the mortgage market place have introduced daily interests rate calculations, rather than the traditional norm of calculating interest at annual rests, of allowing overpayments to reduce interest of the debt, or the term of the loan and far more flexibility in terms of locking in the borrower. The competition in the market place, together with the Government's introduction of CAT standards for mortgages has contributed to developments in the mortgage market which are far more consumer friendly than even as recently as three or four years ago.
29. The Government has sought to encourage more firms to provide people

with services and products worth buying. Some firms are rising to these challenges. This paper is about how to take this trend forward. The following sections set out the rationale behind the Government's proposals with the details of the CAT standards in the annexes.

the retail market for financial products

30. For customers, choosing financial services is unlike many other kinds of shopping. Box B sets out some reasons why customers can find financial services forbidding.

Box B: reasons why consumers may hesitate to shop for financial services

- ? Customers often lack confidence about their own ability to cope with financial transactions.
- ? Financial products cannot be seen or touched to help assess their quality.
- ? With a few exceptions, repeat purchases are rare so it is not often possible to profit from sampling or experience.
- ? Advice from informal sources, such as friends or family, may not help much as any particular financial product cannot be suitable for everyone's circumstances.
- ? Disengaging from financial commitments after they have been made is often difficult to achieve or results in actual financial loss.
- ? The concepts and ideas involved are unfamiliar to many people - often including those confident or skilled in other demanding disciplines.
- ? It is often not clear to consumers how to put things right when something goes wrong - even if it is possible to do so.

31. So people often end up with financial deals which can be a long way from what would best suit their interests if they were able to choose well. The very fact that the financial services industry has been able to make profit out of practices such as those described in box A is evidence of this. Other examples of financially damaging practices which do persist are set out in box C.

32. Unsatisfactory experiences of using financial services are discouraging in themselves. They are also opportunities missed. When people have the confidence to choose products and services for themselves, they often achieve much better outcomes. For instance, people who were sold regular premium endowment policies by company advisers in 1995

were at least a third more likely to have surrendered them four years later than people who bought similar products by choosing for themselves through direct offer advertisements⁵. What makes this really damaging for investors is that in almost every case people who surrender endowment policies so early in their term will get poor value for their savings. As an illustration of this, the average surrender value after five years of a 25 year endowment policy sold by a company representative was only 68% of premiums paid in 1999⁸.

Box C: how people can get poor deals with financial services

- ? The standard interest rates on several popular credit cards are very much higher than the rates charged by some competitors, even neglecting special offers.
- ? Over 20% of people do not stay with their endowment savings plans beyond four years, even though this will usually mean that they get back appreciably less than they have paid in⁵.
- ? There is a very wide range of prices for similar services, eg simple life protection insurance - a strong indication that people are not shopping around to drive prices down.
- ? People on lower incomes often save in inefficient ways, eg letting benefits or commissions mount up before drawing them out, or contributing to regular premium insurance based saving plans only to cash them in as soon as contributions can be returned in full, sometimes simultaneously starting another identical plan.

33. Because of the barriers described in box B, many consumers will not want to face the chore of choosing financial services for themselves. But more people could gain confidence to make their own decisions if the conditions

⁸ 1999 *Disclosure Report*, PIA, March 2000.

in the market helped them to do so. The Government wants to foster market conditions in which people are readily able to get reliable information about the products and services on offer. With such clarity, consumers who want to will be able to exercise informed choice.

34. To achieve this, it is important that financial services and products are as clear and understandable as is feasible given their nature. If a significant proportion of consumers are able to shop around in this environment - as they do for many other consumer products, from books to washing machines - the market will be more genuinely competitive, to the benefit of all consumers. There is a barrier to be overcome in moving to this kind of market for financial services as there is evidence that financial consumers tend not to shop around⁹. Indeed, it seems that some two thirds of consumers consult only a single adviser when choosing a financial product.

35. Most consumers could gain from signposts to help them recognise products offering reasonable quality and value. And those willing to shop around need ready means of comparing different products. Generally, transparency in the market should empower consumers to decide the level of service, including advice where appropriate, that best meets their circumstances and needs.

the Government's response

36. Action to deliver some basic protections for financial consumers is already in hand. The Government has set up FSA as the single regulator of (most) financial services, both retail and wholesale. Parliament has already

⁹ *Informed Decisions?*, FSA consumer research, November 2000

approved the new powers in the Financial Services and Markets Act (FSMA) which will come into force later in 2001.

37. This step will bring together a number of real benefits for ordinary people buying financial services and products:

- ? most firms providing retail financial products, or advising on them, must be authorised by FSA, which uses common standards for their honesty, solvency and competence;
- ? FSA also sets standards for how these firms should operate, including, in some cases, how products can be sold, and what information must be made available at the point of sale;
- ? when things go wrong, customers can expect firms to deal with their complaints. If this does not resolve the problem, they can turn to the complaints authority (the Financial Ombudsman Service, FOS); or, in the case of defaulting firms, to the single compensation scheme (the Financial Services Compensation Scheme, FSCS) to provide redress where it is justified;
- ? complementing these measures, FSA also has responsibility for educating consumers to help make them better informed and more able to look after their own interests.

38. This approach is very far from regulation for its own sake. The Government seeks to achieve a light touch where that is enough, with real protection for the vulnerable where that is needed. Moreover, the FSMA explicitly recognises consumers' own responsibilities for looking out for their own interests¹⁰.

39. In reaching regulatory decisions about how to protect consumers, FSA is

¹⁰ The FSMA sets out the FSA's statutory objectives. Sec 5(2)(d) states that the FSMA: "the general principle that consumers should take responsibility for their decisions".

charged with statutory responsibility for balancing a number of factors. These include efficiency, proportionality, and the value of innovation and competition. FSA cannot realistically aim to provide consumers with absolute protection; in particular against the risks of a product not delivering hoped-for returns. But it does seek to strike a reasonable balance by looking to help consumers achieve a fair deal without imposing unwarranted costs on firms providing products and advice, and their customers.

40. In seeking to protect consumers, FSA can use a range of measures to deliver the best outcome. This approach is sometimes described as using the right regulatory tool for the job¹¹. An important part of securing an orderly retail market which consumers can use with confidence is preventative work: encouraging firms to manage their risks so that FSA need rely less on troubleshooting when things go wrong. To move this forward FSA is developing an explicit risk-based approach to regulation.¹². It is far more satisfactory for the consumer to achieve the right result first time than to have to secure redress after disappointment. Fortunately this is a win-win solution since satisfied customers are usually more commercially satisfactory for providers and intermediaries to deal with - not least because they often provide free unsolicited advertising.

41. An important feature of the regulatory tools available to FSA is its new legal responsibility for consumer education. Over time, FSA plans to help many consumers of financial services to gain confidence about using financial services and where appropriate, become willing to choose for themselves. This will support the Government's determination to make financial products and markets more transparent and thus more

¹¹ *A new regulator for the new millennium*, FSA, January 2000

¹² *Building the New Regulator*, FSA, December 2000

competitive.

42. This is a demanding strategy.

43. DTI research¹³ shows that even for the most straightforward financial products, people do not readily shop around for financial services, and are reluctant to switch providers, especially to new entrant firms, which are not readily trusted. Similarly, as the FSA Consumer Panel has found², consumers' grasp of financial products is low. For example, 50-65% of consumers found it hard to understand the charges on financial products, depending on the product. And some 35% of the sample believed that past investment performance is a *guarantee* of future performance - even though research¹⁴ for FSA shows clearly that it is a poor predictor.

44. However, even modest improvements are capable of delivering significant improvements in outcomes for consumers. To begin with, education and information can give consumers the confidence to ask exploratory questions about financial products and offers. With more confidence they can go on to challenge product providers' and advisers' assumptions about their requirements. Press articles and other media coverage can also awake their awareness of the issues. In such a climate it will be much harder for poor quality products to flourish.

45. FSA is developing its strategy for carrying out this important new responsibility. It is building up a range of generic leaflets for consumers¹⁵. Later this year it will also make available an ambitious set

¹³ *switching suppliers*, DTI, November 2000

¹⁴ *Past Imperfect? The performance of UK equity managed funds*, FSA, August 2000.

¹⁵ Ring 0845 606 1234 or look at www.enquiries@fsa.gov.uk

of comparative tables, starting with a limited range - including pooled investment funds and mortgages - with plans to widen the range of products covered in time. These tables will be available from FSA's internet website¹⁶, which will be continuously updated; or personalised comparisons can be ordered over the telephone. This new authoritative source of information will give ordinary people a ready and reliable way of comparing the different products on offer, to help them understand the choices and trade-offs they can juggle.

46. As FSA's consumer education efforts begin to bear fruit and improve consumer understanding and confidence, there could be scope for simpler regulation of transactions at the point of sale, at least for some kinds of products. Where FSA's regulations provide for clear disclosure of product content, there may be less need to prescribe how the sales process should work if the market for financial products has become sufficiently transparent and competitive.

47. This should be a win-win outcome. Responsible product providers can gain greater freedom and consumers can benefit from the lower costs to be expected in a competitive market. FSA's plans for some changes in regulation of marketing and sales of investments should also make more real choice available for many consumers (see para 97). This should empower more consumers to choose financial services for themselves, perhaps building on research using FSA's comparative data (para 45).

¹⁶ www.fsa.gov.uk

product regulation

48. Product regulation is not a prominent feature of the UK system for financial regulation.

49. The main exception is regulation of collective investment schemes (cis), that is authorised unit trusts and open ended investment companies (oeics). These are authorised in the sense that FSA authorises the schemes themselves for promotion to the general public, as well as the firms and people who sell them. By contrast, there is no such system for investment linked insurance policies, which often operate in practice as savings schemes and which can provide much the same economic exposures for their customers.

50. FSA's product regulations for cis specify a range of important characteristics of the schemes, notably:

- ? that the pool of investors' funds in a scheme must be managed by an FSA authorised firm and held safe by an independent authorised custodian;
- ? the quality of the investments held by the scheme;
- ? how widely investments must be diversified;
- ? how the price of units in the scheme are to be set to ensure fairness;
- ? how providers must arrange for frequent dealing opportunities for investors.

51. Intrusive as they are, these regulations do not set limits on what collective

investment schemes may charge their customers. By contrast, the previous rules (effective before the Financial Services Act came into force in 1988) did. Since the price limits were lifted in 1988, the charges paid by investors in authorised cis have risen by about two thirds¹⁷. (At the same time, the variety of funds available in which to invest has increased considerably.)

52. There are no other significant areas of product regulation in financial services - in the sense of determining product design and limiting provider firms' ability to vary the basic product design. Indeed, such restrictions are forbidden for insurance products¹⁸. Only for collective investment schemes is it mandatory¹⁹.

53. And there is good reason to hesitate about introducing any kind of product regulation:

- ? the more that product and service providers are guided toward certain features and away from others - whether by prohibition or encouragement - the smaller is the area available for innovation and competition among providers;
- ? in particular, any upper price limit may appear to be an agreed acceptable level and so could encourage product prices to escalate to the limit, leaving consumers paying more than they might

¹⁷ Until 1988, cis charges could not exceed 13.5% over 20 years (they were typically either 5% initial + ? % annual or 3% initial + ½% annual) while current average cis charges are 3.47% initial charge and 1.16% annual charge (*Fifth Disclosure Report*, PIA, November 1999). So for a 10 year investment holding, with investment growth at 6% a year, current investors pay on average some £242 for each lump sum of £1000 invested, while pre-1988 investors paid no more than £148.

¹⁸ By virtue of Article 29 of the Third Life Directive, 1992

¹⁹ By virtue of the UCITS Directive, 1986.

otherwise;

- ? intervention could tend to make products less flexible than necessary unless the specifics of the product regulations are kept up to date to cope with technological development;
- ? especially if the standards set are high, they can form an effective barrier to entry for new provider firms, leading over time to less choice, lower quality and higher prices for consumers;
- ? perhaps most dangerous of all, product intervention can cause consumers to jump to the conclusion that they need not look out for their own interests, contrary to the presumption built into the FSMA (para 38).

54. For all these reasons the Government has no enthusiasm for extending product regulation to a wide range of retail financial products.

55. The Government does however want consumers of financial services to get a reasonable range of choice and decent value. So there may be a case for less direct intervention to *influence* product design. Even intervention of weaker kinds may carry some of the dangers described in para 54. So it should not be undertaken lightly.

product intervention

56. In regulating financial services, FSA uses two main techniques:

- ? **prudential:** to ensure that each authorised firm is solvent and adequately managed to cope with the risks the business is likely to face, eg by holding sufficient capital and operating robust systems of business control;

? **conduct of business:** to cause each authorised firm to treat its customers to adequate standards, including by subordinating its own financial interests to those of its customers, disclosing information at the point of sale, treating its clients' funds with proper care and - perhaps most important of all - recommending financial products which are suitable for its customers' needs

57. To some degree, FSA applies prudential regulation to *all* its authorised firms. Using powers in the FSMA, it may apply conduct of business regulation to only *certain* kinds of business, notably investment business.

58. As noted earlier, these regulatory techniques do not bear directly on the *quality* of the financial products on offer. Even where product regulation applies, it does not determine charges paid by consumers as such. But given the imperative for people to use financial services to provide for themselves (para 15), the Government has an interest in delivering good *value* for customers, provided that this can be achieved within a competitive market which helps deliver real choice to consumers.

59. As a recent FSA occasional paper²⁰ has argued, regulation to deliver reliable advice may not be enough to deliver acceptable outcomes for a majority of financial consumers:

A pure advice based regime.....does suffer from the fact that it is very hard to get advisers to act fully in the interests of consumers. This works against some very powerful incentives. Introducing disclosure requires consumers to understand and act on the data disclosed. Many simply do not have that capability.

²⁰ *CAT standards and stakeholders - their role in financial regulation*, Paul Johnson, September 2000. FSA Occasional papers express the views of the author and not necessarily those of the FSA.

60. However, intervention to encourage providers to improve product quality need not, be statutory. It may be helpful to consider the range of techniques which can be used in a variety of markets where consumers have an interest in securing good outcomes for quality and value in goods and services. Box D sets out the main ways, starting with the most intrusive forms and scaling down to the least interventionist.

Box D: methods of product intervention

Product specification: only accepted products might be made available for sale through a prior approval procedure, as is used for over the counter pharmaceuticals. The Medicines Control Agency operates a statutory system of licensing of medicines suitable for public sale and prescription. This is linked with monitoring, including active checking of standards of pharmaceutical manufacture and wholesaling, with enforcement of licencing conditions where necessary.

Prohibitions: while allowing some diversity of products, there could be specific legal bans on certain product features, as happens in aspects of food retailing. There the Food Standards Agency is able to do this through its statutory role of protecting public health from risks which may arise in connection with the consumption of food.

Minimum standards: there could be legal limits on the vital features of the products that can be sold, with freedom on the part of the providers to do better than the minimum. This is the approach adopted for stakeholder pensions, the Government's new flagship pension for people of modest means. So far, ahead of the introduction of the standard in April 2001, conclusions must be cautiously drawn. It seems that this approach is causing providers of all retail pension products to cut their charges to fit the stakeholder standard, though there are signs that only a limited number of provider firms is willing to compete on these terms.

Invitations to tender: where direct competition among suppliers is difficult or impossible, it can sometimes be simulated by setting up an open contest in which potential monopoly suppliers compete to offer the best terms, leading to just one being chosen as supplier. This approach has long been used for designing prominent public buildings and more recently for instance in awarding contracts for commercial radio and television licences. If these can be for set periods, there is scope for repeat competitions at intervals. This device is usually a proxy for competition rather than a way of delivering standards in a market which would otherwise be open to competition. It could however be used in a market where there is advantage in a limited number of providers, eg to select a small number of

competing licensed providers for certain important products.

Product certification marks: an inspecting authority verifies the quality of products, eg by examining processes or by testing batches, and then awards a recognised mark of approval. The best known such organisation is the British Standards Institution (BSI), which tests products and services against its own (and in some cases international) standards, so that qualifying goods and services may then display a recognised logo, in this case the BSI kitemark.

Benchmarks: providers of products could measure them against voluntary standards set by the Government, a trade body, or any other trusted source. The Government's CAT standards for individual savings accounts (ISAs) and mortgages are examples of this approach. These are examined in greater depth in paras 65-70 below.

Disclosure: regulation or voluntary standards could give consumers salient features of products in a standard format in order to make comparisons particularly useful. The DETR for example encourages compliance with a Green Claims Code, which many consumer product oriented firms voluntarily adopt. A logo helps consumers recognise the environmental qualities of the packaging and/ or contents of many everyday consumer products like soft drinks, washing powder and foodstuffs, and by implication the environmental consciousness of the manufacturer.

61. All these methods of product intervention can reassure consumers in different ways and to different extents. None of them can be identified as best everywhere. A balance needs to be struck appropriate to the circumstances of products and their markets.
62. It is hardly surprising that the stronger forms of intervention are used in markets - such as pharmaceuticals and food - where consumers' personal safety is an overriding priority. In other markets the case for

no, or less, intervention is more attractive. Where it is possible, the aim must be to find an approach which:

- ? gives product providers incentives to market good quality financial products;
- ? encourages consumers to shop around where they feel confident to do so;
- ? in a market where competition works openly and transparently.

CAT standards so far

63. In retail financial services, the Government has recently set voluntary benchmarks for two kinds of retail financial product, and plans benchmarks for a third.
64. The first set of CAT standards, introduced when individual savings accounts (**ISAs**) were launched in April 1999, were designed to complement the policy of encouraging saving, especially for people able only to save small sums. The Government's policy aim was that everyone saving through ISAs should be able to get good value for their money on their savings. With low stable inflation it seemed possible that smaller savers might be offered products with relatively low returns, as indeed had sometimes happened with one of the predecessor products, the TESSA (tax exempt special savings account). It also

seemed possible that new or inexperienced savers might find it difficult to distinguish good value products from less satisfactory ones - reflecting both the poor numeracy of many potential new savers and the power of the concept of tax relief as an inducement.

Box E: CAT standards in action in the ISA market

McKinseys have collected information about the ISA market for the first full year of ISAs (1999-2000), drawing on a sample of just over half the total ISA market. The key conclusions include:

- ? about half of ISA savings were in CAT standard products;
- ? nearly all cash ISAs were either CAT standard or offered *better* interest rates; whereas non-ISA savings accounts were typically at lower interest rates (the Cruickshank report shows that only two of 12 popular high street savings accounts met the CAT interest standard);
- ? charges on CAT standard equity ISAs in pooled funds were about half those on comparable non-CAT standard ISAs, whose charges were similar to those on PEPs the previous year; while over a quarter of CAT standard equity funds were *cheaper* than the upper limit for CATs;
- ? just over a third of CAT standard equity ISAs were actively managed, with the remainder trackers;
- ? about two thirds of CAT standard equity ISAs were bought by people direct, in contrast to about an eighth of non-CAT standard ISAs bought this way.

So, at least for the first year of ISAs, CAT standards have:

- ? set an effective floor for the interest rate paid on cash ISAs - making sure that this form of saving offers savers reasonable value;
- ? delivered a relatively good value method of investing in equities;
- ? encouraged relatively confident savers to choose straightforward equity based savings products for themselves.

These outcomes are a good match for the Government's policy objectives for CAT standards for ISAs (see para 65).

65. The standards were designed to deal with these concerns. The products they define are straightforward, clear, easy to understand and fair in the sense of offering decent value. While no savings product can be universally suitable, CAT standard ISAs do provide a safe harbour: even where they may not be the most appropriate, savers should still find they deliver reasonable returns. So it should often be possible for people to choose to buy CAT standard ISAs for themselves, with little or no advice.
66. There is a CAT standard for each of the three kinds of ISA (cash, insurance and equity based savings). Annex B summarises the standards. The objective was not to deliver the best possible value but rather to ensure that savers could readily identify ways of saving which they would not later regret because of unforeseen product features. Research for the Treasury by McKinsey's shows that CAT standards have indeed delivered these objectives. Box E summarises the key findings.
67. The CAT standards for ISAs were intended to encourage manufacturers of retail savings products to market square deal accounts. The standards have also encouraged product providers to use straightforward user-friendly features in non-CAT products.
68. CAT standards for **mortgages**, introduced in April 2000, used the same basic approach of defining straightforward safe harbour products offering a square deal which customers were unlikely to regret (the

details of the standards are summarised in annex C). But their role was expected to be different. They were intended not so much to define fair value products in themselves as to set benchmark terms against which other mortgages could be compared. They were set at a time of significant public concern about a range of product features in some mortgages which were perceived as both detrimental and difficult for many borrowers to understand.

69. The evidence so far is that the existence of the standards has encouraged manufacturers to avoid or curtail some of the less satisfactory product features which CAT standards deliberately avoid. Box F, which draws on work for the Treasury by The Research Department Limited, the financial research centre, describes these trends in more detail.

70. In a parallel paper on long term care investment products²¹, the Government also proposes to set CAT standards for **long term care insurance**. Once settled, these standards are likely to operate in a different way again to those for ISAs and mortgages. In these standards there is no upper charge limit but rather advisory guidelines on the standards of cover. They should help potential customers - often at a vulnerable moment in their lives - recognise worthwhile products in a market which can be complex and confusing.

²¹ *Long Term Care Insurance*, H M Treasury, December 2000

Box F: CAT standards visible in the mortgage market

The mortgage market is very well populated, with some 1800 different loan offers available. The Treasury introduced CAT standards for mortgages in March 2000 to help borrowers recognise product features which might help them secure reliable products. The market has reacted by moving some mortgage products toward the features in the CAT standards, though others have not adjusted. (There are relatively few mortgage products on the market which meet all the features of the CAT standard.)

Areas where the market has moved toward the CAT standards are, in terms of numbers of products and proportions of relevant products available:

	Oct 1999	Jan 2001
<i>no mortgage indemnity guarantee (MIG) on variable rate mortgages</i>	31 (15.2%)	52 (26.5%)
<i>no MIG on fixed rate mortgages</i>	85 (27.2%)	238 (57.3%)
<i>no redemption charge after fixed rate period</i>	240 (76.7%)	348 (83.9%)

and in terms of number of mortgage lenders:

<i>interest payable daily</i>	14 (13.3%)	28 (21.1%)
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However, areas where lenders have not moved toward the CAT standards are:

- ? *booking fees*
- ? *redemption charges on variable rate mortgages*
- ? *choice of payment date in the month.*

71. The CAT standards for the three different kinds of product are pitched at the *light* end of the range of styles of product intervention described in box D. In their various forms they are all benchmarks, with no barrier to marketing products which do not meet the standards.

Provider firms self certify by measuring their products against the standards, in the knowledge that inaccurate claims to meet them will expose them at best to ridicule by their competitors and in the extreme to discipline from FSA as their regulator for making false claims. And the part of the market unaffected by the CAT standards can continue. This approach is consistent with the concern that regulation and other intervention in the retail financial services market should be proportionate - no more intrusive than necessary. The essential concept is to make sure that people can readily identify safe harbour products offering decent value and reliable standards.

72. But the very existence of product standards could deter product providers from competing to improve on the standards, either as to quality or price. The limited evidence available on CATs for ISAs is encouraging on this point since there are competing products appreciably cheaper than the CAT standard. And it is clear that non-ISA cash savings products generally offered appreciably worse value.
73. The existence of credible quality standards could also make it easier for firms to enter markets new to them - as indeed there is some evidence that firms used the CAT standards for ISAs to gain a greater market share in pooled equity savings than they had previously achieved.
74. However, different parts of the retail financial services market might react differently to the introduction of quality standards. Customers' knowledge of and confidence with different products varies. And over time, after rising to the challenge of meeting a defined standard, providers might get complacent and stop striving to improve on it.

the Cruickshank report on CATs

75. The Cruickshank report recommends a different role for CAT standards from those they have taken so far. Noting the danger of setting an apparently acceptable upper limit on prices, it recommends that:

the Government should introduce benchmarks for a wide range of personal consumer products to facilitate price comparisons. Unlike the current CAT standards, these benchmarks should not specify price caps.

76. So in this style of CAT standard, there would be:

- ? Comparable products
- ? defined easy Access
- ? decent Terms designed to avoid customer regrets.

77. In support of its recommendation, the Cruickshank report cites the need to improve competition in the markets for several popular retail banking products. For example, it explains that information to encourage people to switch accounts is neither easy to get nor easy to compare, leading consumers to be insensitive to prices. Other

consumer research²² confirms that modest users of financial services tend to believe that all product providers offer similar products.

78. The Cruickshank report therefore sees value in encouraging providers to offer commoditised products whose prices can readily be compared, leaving quality aside. It should then be easier for people to see how they might gain by shopping around - just as happens for other products and services where comparisons and switching are easier, eg groceries and certain white goods.
79. It would indeed be welcome if consumers were able to gain confidence of this kind. It should make more people willing to change suppliers and thus put pressure on provider firms to continue to offer quality and value to their *existing* customers - not just to new customers as is often the case. This approach seems admirably suited for relatively straightforward products which many people understand fairly well. It should work particularly well when harnessed with FSA's new tables of comparative data for a range of retail financial products (para 45). And it fits well with the Government's recognition of the need for consumers to take some responsibility for their own financial interests (para 38).
80. However, evidence from some other areas of the market suggests that this approach may not be universally suitable. In the ISA market the CAT standards appear successfully to have challenged suppliers to offer products at more competitive prices than would otherwise have been generally available (box E). In the mortgage market the evidence

²² *Understanding small savers II*, Claire Whyley and Elaine Kempson for AMP, September 2000

so far is more mixed (box F).

the way forward

81. It therefore seems possible that for *some* financial products it can be useful to set benchmarks with upper limits on charges - at least for new or unsophisticated users - while in *others* it is better to encourage competition by focussing attention on prices for otherwise very similar products. If this proposition is correct, it will clearly be important to distinguish in which parts of the retail financial services market the two types of benchmark might best operate. It is important to remember that too much intervention could damage competition.

82. CAT standards can in principle add value for consumers of financial products in two ways:
 - ? helping people recognise products, and product characteristics, worth considering where there is no regulation of the selling process, as with mortgages at the moment;

 - ? defining basic square deal products where the selling process is regulated, opening up scope for lighter regulation, as FSA now proposes in relation to the distribution of both ISAs and stakeholder pensions.

83. As noted earlier, there is not a strong case for setting CAT standards in every aspect of the retail marketplace. But it may be helpful to recognise characteristics of parts of the marketplace where the

benchmarking of reliable product standards may have some potential value. Some possible criteria are set out in box G.

**Box G: criteria for retail financial products and services
where CATs may add value for consumers**

- ? Where it is hard for consumers to understand what is offered.
- ? Where it is hard for consumers to compare apparently similar offers.
- ? Where competition is not about quality or value.
- ? Where simple, clear and fair offers will give many potential consumers sufficient for their needs.
- ? Where people might gain by shopping around to meet their own needs and interests.

Just some of these criteria would make CATs worth considering.

84. In order to understand the market for retail financial products better, the Treasury plans to commission qualitative research on consumer attitudes and preferences. This research will seek to establish:

- ? which products consumers most distrust;
- ? which products consumers most want help with choosing;
- ? to what extent CAT standards might help them choose;

- ? in each case, whether it is useful for a CAT standard to set an upper limit on price.
85. Readers are invited to suggest which products or services might be suitable for any future CAT standards which might be proposed. One innovative possibility might be a CAT standard for healthcheck financial advice, ie a service in which an adviser identifies generic products suitable for a customer's needs.
86. This kind of service, which is not yet common, is proposed in the report of the FSA's Consumer Panel. This report recognises a need for financial advice which is not linked to specific financial products and which does not therefore carry any connection to any specific product or product range. On the strength of this kind of generic advice, the customer can decide how to implement the prescription, if at all, and with which provider firm or firms. One advantage of this service, if it were to become popular, is that a single fact-finding interview with an authorised financial adviser would enable a consumer to access a range of products for himself or herself through direct (execution only) transactions.
87. A pure advice service of this kind need not cover a consumer's full financial needs. It might be particularly useful to cover just advice on pensions, especially as stakeholder pensions are introduced. FSA has developed decision trees to help consumers assess whether stakeholder pensions are likely to be the right choice for them. Use of these trees will encourage a good number of prospective savers to seek advice. It may be that people would be more confident about doing so if they knew that the advice would come with no actual or implicit

commitment to follow through with purchase of products through the adviser. Armed with advice on the type of pension saving which might make most sense, people could then shop around - as in other retail markets - for the offer which best matched their requirements.

88. Where consumers do feel able to shop around this could be a powerful means of encouraging competition and delivering good value. Indeed if such an initiative were popular it could break the recognised barrier which seems to prevent many customers considering the products of more than one firm for any single purchase at one time.
89. It would be helpful to appreciate whether consumers and financial advisers see any value in this style of service. The concept appears to work well for medical and optical prescriptions - both markets, like financial services, where customers are rarely expert. And FSA's plans to liberalise the polarisation rules²³ may make it easier for consumers to make use of this kind of service in future.
90. The Treasury would welcome any evidence in this area which readers feel able to share - confidentially if need be. For example, product provider firms may have researched consumers' reasons for resisting competitive offers of new products.

²³ These current rules limit the range of ways in which retail financial advisers may operate. Subject to the outcome of consultations, in future there could be greater variety of retail financial outlets, **with** more real choice for consumers.

the basic bank account CAT

91. The Government study into financial exclusion (PAT14, published November 1999) has already set a benchmark for a basic bank account (BBA) suitable for people new to using banks. It is reproduced at annex D in CAT standard format to match the other standards. In effect it is a CAT standard with a zero charge, defining a product suitable for people who want basic money transmission services without the risk of going into debt.

92. Treasury Ministers challenged the banks to offer BBAs by October 2000. All the main High Street banks now do so. BBAs do not let their customers run the risk of building up unauthorised overdrafts. So these accounts are particularly helpful for people without a strong credit history. Some BBAs are already available through post offices (as well as bank outlets) and in future more will be.

a credit card CAT

93. The Government response to the Cruickshank report also promised a CAT standard for a credit card. A proposed definition is at annex E. As with other CAT standards for retail financial products, this definition outlines a straightforward easy to understand card which should not give its users unforeseen regrets after a period of use - as the Cruickshank report shows that some current cards do. The document invites readers to consider alternative forms of CAT standard for credit

cards. One version, like the CAT standard for ISAs, would have an upper limit on the interest rate the card could charge. The alternative would set no limit as such but would encourage transparent competition on interest rates within a clear product definition designed to avoid catching customers out.

94. In the light of reactions to this definition, the Treasury is seeking comments on a draft CAT standard for credit cards (see Annex E).

using CATs

95. FSA commissioned some qualitative research from BMRB in the first year of ISAs, 1999-2000. Initially it showed that public awareness of the CAT standards for ISAs was low. Over the year awareness built, especially for cash ISAs. Consumer understanding of the CAT standards remained low but once the CAT standards were explained they were generally well received. Smaller and less sophisticated savers were more enthusiastic than more seasoned savers. This latter group was inclined to believe that the CAT standards would have an adverse effect on performance²⁴. Others felt confident to select their own ways of saving, either for themselves or using an authorised adviser firm, without the help of benchmark standards.

²⁴ There is powerful evidence to the contrary in *Past Imperfect? - the performance of UK equity managed funds*, FSA occasional paper 9 by Mark Rhodes, August 2000

96. So far FSA's rules about marketing of ISAs have:
- ? required ISAs claiming to be CAT standard to measure their characteristics against the standard;
 - ? required other ISAs simply to note that they are not CAT standard.
97. FSA now proposes some significant changes in regulation of sales of retail investments. It is consulting²⁵ on whether the polarisation rules on sale of some quality assured products such as CAT standard ISAs can be made less restrictive - and in particular whether it might be possible for sales agents tied to one product provider firm to sell another's CAT standard ISAs. The basic idea is that CAT standard ISAs are readily understood and will rarely offer poor value for savers. (Later FSA will also consult on more substantial liberalisation of the market for retail sales. This will include reconsidering the arrangements for disclosure of product and other details at the point of sale.)
98. Some firms selling CAT standard products have argued that the Government should itself promote the concept of CAT standards. It is understandable that firms should want official endorsement of their products. But this might undermine the very idea of the CAT standards. They are not intended to reassure potential consumers that no further enquiries need be made. Rather, they are meant to be a starting point from which consumers may find it helpful to assess competing products against their own needs and aspirations. There is

²⁵ *Reforming Polarisation: First Steps*, FSA, January 2001

no implied guarantee that a CAT standard product will suit everyone. Nor are all CAT standard products risk free. It is important that FSA's rules on disclosure should so far as possible prevent any misconceptions of this kind.

regulatory impact

99. Introducing CAT standards for retail financial products does not require statutory regulation. The standards are voluntary and impose no direct compliance costs on provider or adviser firms.
100. Nevertheless it is important to consider whether the use of CAT standards might impede small firms or other new entrants to the retail financial services market. There is no direct effect in that firms are free to offer products which do not meet the standards. Some new firms may even find that the consumer recognition of CAT standards helps launch new products. So there may be some gain for smaller firms even though the challenge of meeting charge limits may place upper bounds on profit.

what next?

101. Through this consultation exercise, the Treasury hopes to assess:

- ? how far it would make sense to set more CAT standards for retail financial products;
- ? what CAT standards, if any, it would be sensible to set.

102. To make progress, the Treasury would welcome feedback on the discussion in this paper. It may be helpful for readers to structure their replies around the questions in annex A. These questions are not intended to limit debate. Other ideas are welcome.

home financial services

H M Treasury

January 2001

ANNEX A: questions for feedback

1. Do readers agree there is a case for identifying retail financial services or products inexperienced users suitable for inexperienced users?
2. If so, is it right to conclude that products for inexperienced users should be simple, clear and fair to help people understand what they are buying?
3. Should the existing regulatory techniques be adapted to provide this service?
4. Is there value in defining standards for basic financial products? Should the Government do this? If not who should?
5. Is it right to conclude, as in the Cruickshank report, that for some transparent products it is better to define product standards without a price limit?
6. Are the suggested criteria for using product standards (box G) right? Could they be improved?
7. Which retail products, if any, should the Government consider for quality standards? Should any of these possible new standards define a price limit?
8. Is there a role for generic advice standards? - and for pension advice in particular?
9. Is the proposed credit card CAT standard (annex E) sensible? Could it be improved? How?

These questions are suggestions for feedback. Other reactions to this paper are welcome.

ANNEX B

summary of CAT standards for ISAs

For full details, see the Treasury website, www.hm-treasury.gov.uk

CAT standard for cash ISA	
Charges	No one-off or regular charges of any kind, eg no charge for withdrawals or for any regular service (such as use of ATMs), except that charges for replacements (eg duplicate statements, lost cards) are permitted.
Access	Minimum transaction size no greater than £10. Withdrawals within 7 working days or less.
Terms	Interest rate no lower than 2 percentage points below base rate. Upward interest rate changes to reflect base rate movements within a calendar month. Downward changes may be slower. No other conditions, eg no limits on frequency of withdrawals.

CAT standard for insurance ISA	
Charges	Annual charge no more than 3% of the value of the fund. No other charges (eg no separate charge for the guarantee on surrender values).
Access	Minimum premium no greater than £250 lump sum a year, or £25 a month.
Terms	Surrender values should reflect, over time, the value of the underlying assets of the fund. No specific surrender penalties. After 3 years, and thereafter, surrender values should at least return the premium.

CAT standard for stocks and shares (equity) ISA	
Charges	Total charge no more than 1% of net asset value per year. No other charges to be paid by the saver.
Access	Minimum saving no more than £500 lump sum a year or £50 a month.
Terms	Authorised unit trust, oeic or investment trust as defined below. Fund at least 50% invested in shares and securities (satisfying the requirements in the tax regulations) which are listed on EU stock exchanges. Units and shares to be single priced as in FSA regulations for authorised funds. Investment risk highlighted in literature.

ANNEX C

Summary CAT standards for mortgages

For full details, see the Treasury website, www.hm-treasury.gov.uk

	variable rate	fixed or capped rate
charges	<ul style="list-style-type: none"> • Interest calculated daily. • Full credit for all payments when made. • No separate charge for mortgage indemnity guarantee (MIG). • Any other fees disclosed in cash up front. • Borrowers pay no fees to brokers. 	
	<ul style="list-style-type: none"> • No arrangement fee. • Interest rate no more than 2% above Bank of England base rate. • When the base rate falls, interest rates must adjust within a calendar month. • No redemption charges at any time. 	<ul style="list-style-type: none"> • Maximum booking fee is £150. • The maximum redemption charge is 1% of the amount you owe for each remaining year of fixed period, reducing monthly. • No redemption charge after the fixed or capped rate period. • No redemption charge if you stay with the same mortgage lender when you move home.
access	<ul style="list-style-type: none"> • If there is a minimum amount you must borrow to get a CAT standard mortgage, it has to be £10,000 or less. • Any customer may apply. • The lender's normal lending criteria apply. • Provided your lender is happy to lend on the new property, you can continue with your CAT standard mortgage when you move home. • If you make regular payments, you can choose which day of the month to pay. • You can make early repayments at any time. 	
terms	<ul style="list-style-type: none"> • All advertising and paperwork must be straightforward, fair and clear. • You do not have to buy any other product to get a CAT standard mortgage. • Your lender must give at least 6 months notice if they can no longer offer your mortgage on CAT standard terms. • If you are in arrears, you should pay interest only on the outstanding debt at the normal rate. 	

ANNEX D

CAT standard for basic bank account

CAT standard basic bank accounts (BBAs) are straightforward, clear and easy to understand. They are free to open and run, and offer customers services that give people 24 hour access to their money without the risk of an unauthorised overdraft.

2. BBAs provide people new to using bank accounts with a convenient and secure way to manage their money. They also enable people to take advantage of any financial savings which may be offered to customers who agree to pay for certain goods and services by direct debit, standing order or budget account. For these reasons, the Government wants to see BBAs made widely available in their own right.

3. BBAs are primarily aimed at people who do not yet have a bank account, including those on low or variable incomes, or with a poor credit history. They may also be suitable for anyone who wants to separate managing their everyday money from taking out a loan.

4. When someone applies to take out a CAT standard BBA, banks do not need to check their creditworthiness, because they cannot go overdrawn. Everyday transactions are also free of charge, which should help to build the confidence of people worried about unforeseen charges.

5. This document defines standards for **C**harges, **A**ccess and **T**erms for BBAs. BBAs which meet these may be described in marketing and other promotional literature as CAT standard. (The term CAT mark should be avoided as it may mislead account holders by implying that this is an associated logo.)

6. The essential features of CAT standard BBAs are summarised for account holders in the table below. The notes which follow explain and expand upon the table so that banks and building societies can be clear about what is expected of them.

Specification & notes for banks and building societies

7. CAT standard BBAs:
 - ? do not carry a Government endorsement or guarantee;
 - ? are not guaranteed to suit every account holder;
 - ? may not be the best account available.

8. CAT standards for BBAs are voluntary. Banks and building societies should compare the contractual terms of any BBA against the standards and may advertise an account as CAT standard if it meets or betters them.

9. An important feature of all BBAs is that account holders should be able to withdraw all their money free of charge, either by free withdrawals over the counter, or through access to a buffer zone. As the minimum withdrawal from a cash machine is £10, accounts which do not provide free withdrawals over the counter should offer individuals a buffer zone, to enable them to withdraw their last penny via a cash machine.

10. BBAs which offer free withdrawals over the counter and a buffer zone free of charge would offer a superior level of service. CAT standard BBAs may offer other additional services such as: telephone, internet or digital television banking; Electron or Solo debit cards; and credit transfer - either as part of the initial account package, or by way of optional add-ons. However, the provision of additional services must not result in the risk of an overdraft, either in their own right or collectively, and availability must not be dependant on the purchase of any other products or services.

Basic Bank Accounts	
Charges	<p>No one-off or regular charges for everyday transactions. No risk of an overdraft.</p>
Access	<p>No requirement for initial or regular deposits. (Undischarged bankrupts and under sixteens may be turned down.)</p> <p>Account holders must be able to use the following:</p> <ul style="list-style-type: none"> ? cash machines; ? cash and cheque deposits; ? automated credit transfer; ? direct debit, standing order, or budget accounts.
Terms	<p>All advertising and paperwork must be straightforward, fair and clear.</p> <p>Account holders must be given regular statements, and at least six months notice if the bank can no longer offer a BBA on CAT standard terms.</p> <p>Ability to withdraw all funds (see para 9 of notes).</p>

Annex E

Draft CAT standard for credit card	
comparability	<p>All statements must give the following information clearly:</p> <ul style="list-style-type: none"> ? the annual percentage rate (APR) ? the APR expressed as base rate plus margin ? on what amount of debt interest is charged when the customer pays only part of the outstanding amount ? from what date interest is applied ? all other charges <p>No more than one interest rate for cash advances and one interest rate for purchases (the two rates may be the same)</p> <p>[The card interest rates must be within [x] percentage points of the base rate] or</p> <p>[The interest rates must track any downward movement in the base rate within [28] days of the base rate change or the cardholder must be sent a letter within [28] days of the base rate change setting out the change in the margin]</p> <p>No membership fee</p> <p>Payments must be applied to the outstanding debt in the following order:</p> <ul style="list-style-type: none"> ? interest and handling charges; ? cash advances; ? purchases on previous statements, including balance transfers; ? new purchases on the current statement; ? cash advances made, but not yet on the statement; ? purchases made but not yet on the statement.
access	<p>No minimum spending limit</p> <p>No requirement to buy linked products (eg repayment protection)</p> <p>Credit available on the provider's normal terms</p>

terms	<p>Information to be in language which is fair, clear, and not misleading</p> <p>Deadline for minimum payment to be at least [25] days from statement date, and no interest charged on new items if the balance is paid in full in this period</p> <p>The minimum payment required each month to be no more than £[5] or [5]% of the excess amount (whichever is larger)</p> <p>Penalties:</p> <ul style="list-style-type: none"> ? for late or incomplete payment to be no more than the minimum balance or £[20] (whichever is larger) ? for exceeding the credit limit to be no more than £[5] ? customers to be informed of the penalty fees at the outset <p>Customers can set their credit limits lower than the provider's choice and customers must be informed of this at the outset and whenever the provider proposes to change the credit limit</p> <p>Customer is free to pay any amount above the minimum payment of the outstanding balance each month</p> <p>Customer must be able to set up direct debit instructions:</p> <p><i>either</i> to make the minimum payment each month</p> <p><i>or</i> to clear the entire balance each month</p> <p>Customer can select their statement date at no cost at the start of the agreement, and can change the statement date at any time, at a charge of no more than £[10] for each change</p> <p>[6] months notice of change from CAT standard terms</p> <p>[30] days notice of varying of other terms, if they adversely affect the customer</p> <p>The customer may end the agreement at any time, providing all payments have been met</p> <p>If the card is lost or stolen, once the holder informs the provider, the holder will be responsible for no more than [xx] of losses which result from someone else using the card. If the card is used fraudulently without the cardholder's knowledge the holder will be responsible for no more than [xx] of losses which result from someone else using the card</p> <p>The user must be told clearly how exchange rates on purchases and advances in foreign currencies are calculated</p> <p>For cash advances, the handling charge to be no more than 1.5%</p>
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This draft CAT standard is for consultation. Feedback is welcome. In addition to the figures (some suggested, some left blank) in the table on which comments are invited, readers might like to consider the following issues.

- ? Should the interest rate be capped (as in one of the options suggested in the draft)?

- ? Should there be a limit on penalty fees (as in the draft) or would it be enough for providers to make it clear what these fees are?

- ? Are there any other charges the standard should cover, eg charges for duplicate statements?

- ? In addition to clear information about the APR, should credit card statements display the interest rate in relation to base rate (as in the draft)?

- ? Should the interest rate track the base rate (with a specified lag) so that it must fall when the base rate does?

- ? Should the standard cover information given before customers sign up?

- ? Should the standard cover credit given in foreign currencies? - eg the date when the conversion into sterling takes place?

- ? Should special rules be allowed for balance transfers?