

our ref
your ref



Mr Rob Williamson
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By e-mail

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Dear Rob

**Wider implications:
risk-based step-changes in interest rates on credit-cards and store-cards**

As you know, under the wider-implications process that we operate with the FSA and the OFT, a wider-implications issue may be identified by the ombudsman service jointly with either the FSA or the OFT, through our regular liaison arrangements.

In the course of those arrangements, we have previously raised informally the issues associated with a series of credit-card and store-card cases we have been receiving, where:

- consumers complain of a step-change in the interest rate charged (for example, from 19% to 29%) which is then applied to pre-existing debt; and
- providers say that the interest rate has been increased in order to reflect a reassessment of the risk presented by the consumers concerned.

We currently have more than 100 cases coming towards decision (involving a wide range of mainstream card-providers). I do not prejudge what the outcome of individual cases may be, but:

- in some cases, there is an issue whether or not the rate increase was truly as a result of reassessing the risk of the customer;
- in some other cases, there is an issue whether or not the card contract included a term that allowed such a change; and
- in some other cases, there is an issue whether the term on which the card provider relied complied with the Unfair Terms in Consumer Contracts Regulations.

Whilst the number of cases that we have received so far is comparatively limited in the context of the number of cards in issue, there are indications that the practice has become widespread.

Given current market conditions, and despite the principles which the industry proposes to apply from 1 January 2009 in respect of future increases in the interest rate, there seems every prospect that the number of such cases may escalate quite quickly. Additionally, the

principles adopted in deciding these cases are likely to have significant implications for both card-providers and card-holders.

Against that background, and the additional information in the annex to this letter, I am writing to you formally (under the wider-implications process) to enquire whether the OFT:

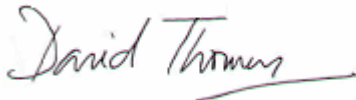
- is planning to take any regulatory action in this area (likely to resolve the cases we are considering); or
- wishes to provide any information for us to take into account in deciding individual cases.

As you know, under the wider-implications process, it is for us to decide whether or not to continue deciding individual cases whilst you consider the overall position.

In the nature of things, the consumers involved in these cases are often in straitened financial circumstances – and may be adversely affected by a delay. So, subject to any comments you wish to make, we are currently minded to proceed with the cases we have.

Many of the card providers concerned are FSA-regulated firms. Accordingly, they are subject to the FSA's rules on complaint-handling in respect of these cases. So I have copied this to our wider-implications contact at the FSA.

Yours sincerely

A handwritten signature in cursive script that reads "David Thomas". The signature is written in dark ink and has a horizontal line underneath it.

Copy to
Mr Edward Harley, Head of Department, Retail Policy and Themes Division, FSA

Annex

Wider implications: risk-based step-changes in interest rates on credit-cards and store-cards

What is common to all these cases is a step-change increase in the rate of interest charged to the customer, unrelated to a general movement in interest rates. Within that general scenario, there are four main groups of cases:

[A] Where:

- the card contract includes a term that purports to authorise a change to risk-based pricing.

[B] Where:

- the card contract did not contain any specific provision for risk-based pricing; but
- the card provider subsequently notified the consumer that it was varying the terms of the contract to add a specific provision for risk-based pricing.

[C] Where:

- the card contract does not contain any specific provision for risk-based pricing; but
- it does contain terms that allow the card provider to change the rate of interest for specified reasons such as "to reflect market changes" or "to maintain competitiveness"; and
- the card provider says that one or more of these terms is capable of interpretation in such a way as to allow a change to risk-based pricing and an associated increase in interest rate (including for existing debt).

[D] Where:

- the card contract does not contain any specific provision for risk-based pricing; but
- it does contain a very widely-drawn term that purports to allow the card provider to increase the rate of interest for any reason; and
- the card provider says that this wide term is capable of supporting a change to risk-based pricing and an associated increase in interest rate (including for existing debt) to reflect a perceived adverse change in the customer's financial position.

These cases raise (in differing combinations) a number of issues that fall to be considered in the context of, amongst other things, the Unfair Terms in Consumer Contracts Regulations (UTCCR):

- o Is a term authorising a change to risk-based pricing, as in [A], fair - especially where it purports to cover existing debt?
- o Can a card provider unilaterally introduce a new specific provision for risk-based pricing, as in [B], into a contract that had no such provision at the outset?
- o Do the sorts of interest-rate change provisions described in [C] entitle a card provider to change a consumer's existing account to risk-based pricing?
- o Does the very wide interest-rate change provision described in [D] entitle a card provider to change a consumer's existing account to risk-based pricing?
- o If the contract were found properly to provide for a change to risk-based pricing, can the card provider apply the increased interest rate to the whole of the consumer's debt, irrespective of whether it was incurred before, or after, the card provider:
 - introduced a new term allowing a change to risk-based pricing; and/or

- re-assessed the consumer's financial standing and applied the step-change in interest rate?
- o Are the answers to these questions affected by the fact that, although contractually free to close their accounts, in practice a significant proportion of consumers affected by this type of step-change may be unable to repay or re-finance their existing debt – and so have no viable option other than to remain with the card provider on the new terms?
- o If, as well as representing a higher lending risk, a consumer is also experiencing financial hardship, does a substantial interest-rate increase for risk-based pricing – even if properly provided for in the contract – represent an appropriate or proportionate response by a card provider?
- o What might represent an adequate assessment by a card provider of the customer's relative financial position? For example, could a card provider fairly conclude that a customer represented an increased risk (and so conclude that a higher risk-based rate is justified) on the basis of:
 - information solely about how the customer has managed his account(s) with the card provider; or
 - in addition, credit reference information about how the customer has managed his affairs with other creditors; and
 should a card provider alert the customer to its revised assessment of the risk he/she presents, and give him/her an opportunity to provide relevant explanatory information, before making its judgement on (or before applying) risk-based pricing?