

Credit card comparisons

A report by the Office of Fair Trading

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1 EXECUTIVE SUMMARY

1.1 OFT found that approximately 70 per cent of consumers who have taken out a credit card in the last three years did not shop around at all. As credit cards can be expensive products we wanted to understand how consumers could be helped to choose the best value card for their needs.

1.2 We also found that consumers have problems comparing financial products in general and credit cards in particular. This is for a number of reasons. First, credit cards are necessarily complex, because of their intrinsic flexibility¹. Secondly, financial products are often described in a way that makes it difficult for consumers to understand.² Thirdly, the rules regulating the sale of credit products mean that a great deal of regulated information must be provided by card issuers to potential card holders. This can have the effect of dissuading consumers from reading product information.³

1.3 Although we recognise that we can never persuade all consumers to shop around for their credit cards, we do believe that this report makes recommendations which will make shopping around much easier and much more worthwhile for consumers than is currently the case. We recommend that:

- the FSA introduce a price comparison website for credit cards, as part of its 'moneymadeclear' site. This would have the advantage of having almost complete market coverage, be run by a trusted organisation, and allow consumers to list products by their 'cost of credit' based on their typical usage
- summary boxes present information in a consistent way and, where possible, information should be included in tabular form. Currently

¹ See paragraph 4.6

² See paragraph 4.7

³ See paragraph 4.14

information is presented in a variety of ways, which makes direct comparison between cards difficult

- terminology be standardised wherever possible. Where terminology is standardised, it should be used by all credit card issuers, and
- an on-going consumer education strategy be established, to which OFT will contribute, to discuss the benefits of shopping around for a credit card and to show how, using the right tools, consumers can obtain the credit card that best suits their needs.

1.4 By consulting widely, and involving a wide variety of stakeholders in the project, we believe that the recommendations made here, although carrying no legal force, will be taken forward by the various parties, primarily the FSA and the credit card industry. We expect the results of their efforts will be that consumers are better able to select the right credit card for their payment needs.

2 BACKGROUND

Credit card interest calculation methods super-complaint

- 2.1 On 1 April 2007 the OFT received a super-complaint⁴ from Which?, a UK consumer body and publishers of the Which? magazine. Which? outlined the problem it had found that consumers faced in comparing the differing methods that credit card issuers use to calculate interest repayments. There is no standard calculation method, and each interest calculation method used has an effect on how much interest is charged. This results in the potential for credit cards with the same Annual Percentage Rate of interest (APR)⁵ to cost consumers widely differing amounts when used in similar circumstances.
- 2.2 Which? put forward the idea that credit card issuers should all use a standard interest repayment calculation method. Consumers would benefit from standardisation as APRs would be more comparable.
- 2.3 On 26 June 2007 the OFT published its Reasoned Response⁶ to the super-complaint submitted by Which?. The OFT concluded that standardisation of the interest calculation methods used by credit card issuers to calculate interest would not address the fundamental problems faced by consumers, and could prevent card issuers from offering products which met different consumer needs, as well as reducing product innovation.
- 2.4 OFT concluded that the problem was much wider than that identified by Which?. The majority of consumers - 70 per cent according to OFT's research - did not shop around at all when choosing a credit card. Even if

⁴ A super-complaint, as defined in section 11(1) of the Enterprise Act 2002, is a complaint submitted by a designated consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'.

⁵ The Annual Percentage Rate (APR) expresses the total charge of credit as a standard measure that borrowers can use to compare the credit charges under one deal with another, whatever rate or method of charging is used.

⁶ A copy of the Reasoned Response can be found at www.offt.gov.uk/shared_offt/reports/financial_products/oft935.pdf

interest calculation methods were standardised, most consumers would not be any better off as they were not carrying out comparisons anyway. The OFT concluded that, rather than focusing on standardisation of interest repayment calculation methods, a greater impact could be achieved by helping consumers to choose the best card for their needs. The OFT therefore decided to initiate a negotiated approach to finding a way for consumers to make well informed decisions about the best card products for their needs, without restricting the commercial freedom of card issuers. The OFT intended to work with the credit card industry, with consumer groups such as Which?, and with regulators and government bodies, and would report on the agreed recommendations, conclusions, and any agreed actions within six months.

Scope of the project

- 2.5 The project set out with a clear aim: to agree with the credit card industry ways to help consumers make better-informed decisions about which credit card to choose. To achieve this, OFT has identified where improvements are necessary to existing information and is supporting the introduction of better comparative tools, such as a dedicated, independent price comparison website for credit cards.
- 2.6 The OFT has concentrated its focus solely on credit cards⁷ and has not included debit cards, charge cards, or other payment cards in either its research or recommendations. The OFT's recommendations are made within the framework of existing and proposed legislation.

⁷ A credit card is a payment card which is not directly linked to a bank account, or one store or narrow selection of stores, and offers an on-going line of credit. For an explanation of why OFT limited the scope of this project to credit cards, see paras 4.2 - 4.4.

3 SUMMARY OF RESEARCH AND ANALYSIS CARRIED OUT

3.1 The OFT adopted an evidence-based approach to this project. With that in mind, we determined to find out:

- what information consumers wanted, and would use, in choosing a credit card
- whether the issue had been successfully addressed already in other countries
- whether the issue had been successfully addressed in other markets
- the views of experts in the field of consumer protection, regulation and card issuing, and
- the practical effect of any recommendations made.

Consumer survey

3.2 OFT commissioned a market research company, ORC international (ORC), to carry out a consumer survey, with the aims of:

- discovering the scale of the problem (how many consumers pick the first card offered to them, and, for those who do choose between cards, how many cards they examine), and
- finding out from consumers which methods of comparing cards they would value and would use in practice.

3.3 The target population for the survey was:

- consumers who currently had one or more credit cards, and
- consumers who were actively considering taking out a credit card.

3.4 The average length and suitability of the questionnaire was pilot tested by 20 interviews prior to the main survey fieldwork, and 1,214 responses were collected as part of the main survey. These were

collected in such a way as to ensure that the sample was representative of the United Kingdom population as a whole in terms of the age, gender, geographical spread and ethnic and social background.

Literature review

- 3.5 The literature review involved identifying academic and other papers which dealt with theoretical and practical research into consumers making decisions when faced with complex products. The research addressed underlying problems which might affect a consumer's behaviour when faced with choosing between complex financial products such as credit cards, but was more theoretical than practical. Some papers, however, also included findings based on studies with a quantitative element. A list of studies referred to in this report is at Annexe A.

Stakeholders

- 3.6 OFT consulted widely. Key external stakeholders (industry bodies, different types of card issuers, consumer groups and regulators) were invited to form an Advisory Group (membership is at Annexe B). The Advisory Group provided OFT with advice on proposed recommendations.

International comparisons

- 3.7 OFT contacted regulators from the EU and ICPEN⁸ that have developed or developing credit card markets. They were asked for their experience on how consumers choose between complex products such as credit cards within their territories, and if they had developed any tools or techniques to help consumers in their decision making.
- 3.8 We discovered some countries (including Canada) have developed government sponsored websites which allow consumers to compare complex financial products. The USA has developed a method of helping

⁸ International Consumer Protection and Enforcement Network

consumers to understand and compare interest calculation methods. We tested a similar approach as part of this report.

Testing our recommendations

3.9 OFT also carried out some in-depth testing of the recommendations described in Chapter 5.⁹ Thirty-six consumers were asked to act as if they were interested in taking out a new credit card. They were then shown a website, different summary box options, and some illustrative scenario options. After using these comparison tools, the group discussed how user-friendly each tool was. Because of the small sample size used, OFT hopes the bodies tasked with taking forward OFT's recommendations will carry out larger scale in-depth research, with a view to making comparison tools as practical as possible.

⁹ The Better Regulation Executive and National Consumer Council consider that 'Pre-implementation testing (of informational solutions) should be conducted in a format and context as near as possible to the real life context in which information will be provided.' Better Regulation Executive and National Consumer Council (2007) - *'Warning! Regulated information: a guide for policy makers'*
www.ncc.org.uk/nccpdf/poldocs/NCC168pd_warning_too_much_information.pdf

4 SCALE OF THE PROBLEM

4.1 Although evidence cited in the super-complaint Reasoned Response showed that 70 per cent of consumers did not shop around for credit cards,¹⁰ it was important that OFT gained a much more detailed understanding of the exact nature of why the majority of consumers did not compare credit cards. This would allow OFT to focus on the most important concerns, and to target recommendations so as to have the most effect.

Market definition

4.2 A credit card is a payment card which is not directly linked to a bank account, or one store or narrow selection of stores, and offers an on-going line of credit. This report **only** refers to credit cards, and does not cover other types of payment cards such as charge cards (which don't involve an on-going line of credit), debit cards (which are linked to a bank account), store cards (which are linked to a store or group of stores), and pre-paid cards (which must have value loaded on to them before they are used). This report also only deals with credit cards available to consumers, not commercial credit cards.

4.3 By defining the market in this way, the recommendations that we have made will apply to cards that can be compared directly. The recommendations made in this report will not help consumers to choose which type of payment card is most suitable for them.

How credit cards are used

4.4 Consumers make payments using their credit card and are billed by the issuer at the end of each billing cycle. The consumer usually has the option of making a minimum payment against the outstanding balance, any sum between the minimum and the full amount, or to pay all of the outstanding balance. Any balances not repaid within the interest free

¹⁰ See www.offt.gov.uk/shared_offt/reports/financial_products/oft935.pdf

period offered by the credit card issuer will be subject to interest charged by the issuer.

Market size

4.5 In 2006, the value of credit card transactions (purchases and cash acquisitions) amounted to £105.2 billion,¹¹ an increase on the equivalent 2002 figure of £17.9 billion. The value of balances outstanding on credit cards at the end of 2006 was approximately £66 billion. Credit card issuance slowed in 2005, and actually declined in 2006. Datamonitor considers, however, that the United Kingdom credit card market will continue to grow, albeit slowly, over the next five years.

Features of a credit card

4.6 Credit cards are flexible tools, and it is that flexibility which can make them difficult for consumers to compare. Credit cards are commonly used:

- as a payment tool for purchases, both in retailers' premises, and over the telephone or the internet
- as a credit tool, both for purchases, and for transfers of balances from other cards, or for cash advances
- abroad, where they are more widely accepted, and
- because they offer a higher degree of protection for consumers when making a purchase, through Section 75 of the Consumer Credit Act 1974. Essentially this means that credit card issuers are individually and jointly liable with suppliers if a cardholder has a valid claim against the supplier for misrepresentation or breach of contract. The

¹¹ Datamonitor - *'UK Plastic Cards 2007'*

House of Lords ruling of 31 October 2007 confirmed that this also applies to transactions made abroad.¹²

Problems in comparing cards

4.7 The consumer survey carried out by ORC showed that 68 per cent¹³ of consumers did not compare the card they most recently acquired with any others. This clearly shows that most consumers are not choosing effectively between credit card products. This finding is backed up by several other factors:

- 13 per cent of those questioned in the survey compared the card they took out with only one, two or three other cards
- according to the survey, the most common reason for consumers choosing a particular card was that it had been recommended by their bank (32 per cent of all respondents), and
- the complex nature of credit cards and financial products in general adds to the difficulties which consumers face when attempting to choose a credit card which best suits their needs.

4.8 The last point was confirmed by several pieces of published research. The FSA's baseline survey of financial capability¹⁴ indicated that most people are poor at choosing financial products and often do not seek independent advice.

4.9 The nature of financial products, notably the number of different providers and the complexity of the information, tends to make searching for them more difficult and/or more costly than for other goods. Financial products are generally not purchased or obtained

¹² OFT's News Release on the ruling: www.of.gov.uk/news/press/2007/149-07

¹³ The figure of 68 per cent comes from the survey that ORC carried out for OFT as part of this project, and is distinct (but noticeably similar) to the 70 per cent figure found as part of the survey cited in the OFT's super-complaint Reasoned Response.

¹⁴ FSA (2006)– *'Financial capability in the UK: Establishing a Baseline'*
www.fsa.gov.uk/pubs/other/fincap_baseline.pdf

frequently (although credit cards are a possible exception for some consumers) so there is less opportunity for consumers to learn about how these markets operate. The complexity of financial products can also mean that it is difficult for consumers to understand the available information.¹⁵

- 4.10 Other research suggested that for all the flexibility of credit cards, consumers often chose cards on the basis of only a few criteria. One piece of research suggested that a typical consumer selects a credit card product based on the brand, annual fee, interest free period, affinity or rewards benefits, and the stated interest rate if the consumer expects to pay interest in the immediate future.¹⁶ Because those terms are often contained in the advertising materials (such as leaflets and mailshots), consumers may be unlikely to read the contract. A typical consumer may therefore not consider the terms defining or explaining the consequences of late payment or excessive borrowing.¹⁷
- 4.11 The FSA has reported that providers of financial products may gain from the lack of price transparency about their products. It may, therefore, be in the provider's interest to increase the complexity of the product charges so as to increase the cost to consumers of making price comparisons and consequently decrease price transparency.¹⁸ As a result, consumers do not shop around when the perceived costs (for example perceived difficulties due to lack of transparency and time costs) of doing so are greater than the perceived benefits.
- 4.12 The FSA also reports that the opaque pricing of many financial products and many consumers' inability to assess financial information make it relatively expensive to shop around. Providers can add to the problem knowing that consumers cannot process complex information; they can

¹⁵ FSA (2002) – 'Losing Interest: How much can consumers save by shopping around for financial products' www.fsa.gov.uk/pubs/occpapers/OP19.pdf

¹⁶ Jinkook Lee & Jeanne M Hogarth (2000) – 'Relationships Among Information Search Activities When Shopping for a Credit Card' *Journal of Consumer Affairs* 34 (2), 330–360.

¹⁷ *ibid*

¹⁸ FSA (2007) – 'Modelling changes to consumer welfare cause by reduce price transparency' www.fsa.gov.uk/pubs/occpapers/op26.pdf

create 'noise' by increasing the quantity and complexity of information which makes it more difficult for consumers to see the real price.¹⁹

- 4.13 With heterogeneous products such as credit cards it may be more difficult for consumers to compare products - what is best for one consumer is not necessarily best for another consumer and therefore information provided through word of mouth or advertising is less valuable.²⁰
- 4.14 Recent research has shown that much of the regulated information (that which must be provided by law) provided on credit contracts did not reach its target audience, often because there was too much of it or the way that it is provided tends to dissuade consumers from reading it. This is likely to make comparing credit cards less attractive to consumers. The authors of the report have called for regulators to try and find improved ways of providing regulated information which better protect consumers and help them make decisions.²¹
- 4.15 These problems affect certain types of consumers more than others. FSA's research has shown that the propensity to shop around for financial products varies by age, income and other socio-economic characteristics. Consumers who are least likely to shop around include those in:
- socio-economic groups D and E
 - low income groups, and
 - the very youngest consumers (18 - 24 year olds) and older consumers (aged 55 and over).²²

¹⁹ *ibid*

²⁰ *ibid*

²¹ Better Regulation Executive and National Consumer Council (November 2007) – 'Warning! Too much information can harm' www.bre.berr.gov.uk/regulation/reform/next_steps/too_much/

²² FSA(October 2002)– 'Losing Interest: How much can consumers save by shopping around for financial products' www.fsa.gov.uk/pubs/occpapers/OP19.pdf

4.16 OFT's research carried out for this project also found that consumers who were least likely to have compared their card with other cards before acquiring it were those:

- aged 65 and over
- who do not access the internet for personal/leisure use
- who did not consider themselves well-informed about financial services or products
- in socio-economic groups D and E
- who had only one credit card
- who lived in a household income of less than £20,000, and
- who had a disability.

4.17 In summary, it appears that only 32 per cent of people taking out a credit card actually shop around at all. For those that do shop around, making a useful comparison is made difficult for a number of reasons:

- the nature of financial products makes comparison difficult
- because credit cards are flexible tools with many uses, comparison between cards is even more difficult
- it may be in the interests of providers to make product information more difficult to compare, and
- consumers may not read the regulated information on credit contracts because of its impenetrability.

Costs to consumers

4.18 Some previous FSA research indicates that if consumers did shop around for a credit card, they could make substantial savings. A report²³ calculated that the average loss in pounds per annum if a card holder chose the average priced credit card rather than the cheapest was £137 per year.

Conclusion

4.19 We believe that the scale of the problem justifies the need to take the action proposed in the next chapter.

²³ *ibid*

5 DISCUSSION OF OPTIONS

5.1 A number of options for improving the ability of consumers to compare credit cards were considered as part of this project. Some were suggested by stakeholders, while others arose from OFT's research. The main options are set out below, with arguments in favour and against.

Price comparison website

5.2 Which? made the point in its super-complaint that the majority of consumers were unable to choose accurately the cheapest credit card for them - even if they used the APR - because the different interest calculation methods used by card issuers meant that two cards with the same APR could actually cost differing amounts. Which? suggested that interest calculation methods should be standardised, so that the APR was more comparable for consumers.

5.3 OFT agreed that consumers could not easily assess which was the cheapest credit card for them, but did not consider that standardisation was the answer. Standardisation of interest calculation methods:

- was not supported by the industry or by government
- would lead to reduced consumer choice (research showed that some consumers did choose between interest calculation methods)
- would lead to reduced innovation: card issuers would be unable to move from the 'standard' method, even to methods which would be more beneficial to consumers
- would not address the wider problem that most consumers were not comparing cards using the APR anyway, and
- would not mean that consumers could get a good idea of the actual cost of a card based on usage, as the APR provides only a percentage figure.

5.4 OFT considered whether a price comparison website would address these and other problems that consumers encountered with comparing credit cards. In order for such a website to benefit consumers by helping them to choose the best card, it would have to:

- provide an accurate idea of the cost of the card. That would mean more than comparing cards simply on the interest rate or the APR. It would have to give an accurate picture of the cost of credit for each card, including the effect of the interest calculation method, based on the individual consumer's likely usage
- have complete, or virtually complete, market coverage. A site which did not have complete market coverage could miss out on the best cards
- be completely independent. For consumers to trust a site, it should not have financial links to card issuers, and
- be usable for consumers. If the site was too complex or time consuming, most consumers would not use it.

5.5 Although there will be certain legal issues which would need to be resolved, a practical way of achieving this would be for the FSA to introduce a price comparison website for credit cards which met these needs, as part of its 'moneymadeclear' website.²⁴ The FSA has considerable experience in running price comparison sites, as it already does so for pension annuities, mortgages, savings accounts, stakeholder and personal pensions, unit trust and Open Ended Investment Company²⁵ ISAs, investment bonds and savings endowments. By allowing consumers to order products by the cost of credit, we believe that consumer awareness of the cost of cards will be increased, and that in

²⁴ www.moneymadeclear.fsa.gov.uk

²⁵ A United Kingdom registered company that acts as an umbrella fund investing in other companies and constantly adjusts its investment criteria and fund size.

turn will lead to more informed behaviour from consumers in choosing financial products.

- 5.6 The consumer research carried out for this project demonstrated that there is strong support for the introduction of a price comparison website. A price comparison website along the lines recommended here would be used by 75 per cent of consumers who recently took out a credit card. Of all the comparison tools suggested to consumers, the price comparison website was the preferred method of more than half (55 per cent).
- 5.7 This is supported by other research. The Resolution Foundation²⁶ found that comparison websites can substantially reduce the risk of people buying inappropriate, poor quality or over-priced, financial products - a phenomenon that the FSA has identified as a common problem in the United Kingdom. This view is supported by other research which demonstrates the benefits of comparison websites which can help consumers make informed choices especially in markets where it may be difficult to understand the final price of a financial product. An independent price comparison website may be a helpful method to assist confused consumers through increasing transparency.
- 5.8 The Resolution Foundation said in its recent report that existing price comparison sites could improve their performance in a number of ways, including:
- being more transparent about how their commercial relationships affect the content of their sites (BizReport refers to research which found that one in three British consumers had already stopped using price comparison websites and nearly half said that they would

²⁶ Resolution Foundation (October 2007) - *'Compare and Contrast: How the UK comparison website market is serving financial consumers'*.
http://www.resolutionfoundation.org/pdfs/research_report_webcomparison.pdf

cease to use them if they were found to be biased or selective),²⁷
and

- by providing personalisation of credit card information, as opposed to presenting generalised lists of 'types' of products.

5.9 The proposed FSA price comparison site for credit cards, as currently envisaged, would allow consumers to find the cheapest card based on his or her individual payment behaviour - something not currently available. Consumer research showed that FSA's impartiality would be strongly valued by credit card holders. The FSA price comparison site would also have complete or virtually complete market coverage. As FSA has significant experience in providing price comparison sites for financial products already, we consider that it would be the ideal home for a price comparison website for credit cards.

5.10 The stakeholders that we consulted were generally in favour of the independent price comparison website. Card issuers themselves were especially supportive, particularly about the proposals that the site should be run by the FSA, should allow consumers to list products in order of the cost of credit, and should cover the full credit card market (even the large financial institutions that do not support commercial price comparison sites were in favour).

5.11 We also identified that a price comparison website was not a complete solution, however, as approximately 39 per cent of UK households do not have access to the internet.²⁸ Additionally, there is a danger that consumers might not use the website if it is not sufficiently well advertised or sign posted.

²⁷ www.bizreport.com

²⁸ National Statistics (2007) - 'Omnibus Survey; Northern Ireland Omnibus Survey; Survey of Internet Service Provider' www.statistics.gov.uk/cci/nugget.asp?id=8

Repayment calculators

- 5.12 A credit card repayment calculator is a web-based tool which allows consumers to enter their proposed credit card usage, and to have their repayments calculated. A number of card issuers have experimented with credit card repayment calculators. OFT considered recommending that each credit card issuer install a calculator of standard design on each of their websites. The calculator would allow consumers to input their proposed payment details, and in turn they would receive an estimate of the cost of using that card, both in cash terms (over a set period) and as an effective annual rate. Consumers would then be able to compare that with repayment calculators on other issuers' websites.
- 5.13 This solution would have the advantage of allowing consumers to work out the cost of credit, taking into account interest calculation methods and order of payment allocation, based on their individual circumstances. Consumers would, however, have to visit many sites to compare information.
- 5.14 The consumer survey found that 70 per cent of consumers questioned thought that calculators on each provider's website would be a useful tool for comparing different credit card products, but only 12 per cent said that they would be their preferred method of comparison. Repayment calculators received a mixed reception from stakeholders. Some stakeholders were fully supportive of repayment calculators as a comparison tool, but only if the calculators were of good quality and included on all card issuers' websites. There were some advantages over a single website operated by the FSA, as it would be easier to ensure that product offerings were up to date (as each credit card issuer would update their own website). Other stakeholders, such as the Consumer Credit Counselling Service, pointed out that repayment calculators on every card issuers' website would be beneficial as a tool to help reduce over-indebtedness, by making consumers more aware of the costs of using credit cards for borrowing.
- 5.15 Other stakeholders did not support the use of repayment calculators as a comparison tool on the basis that consumers' search costs would be

very high and each card issuer would have to pay maintenance and installation costs (as opposed to just the FSA with the comparison site).

Defining interest calculation methods

- 5.16 Which? identified as part of its super-complaint that most credit card holders did not understand how the interest calculation methods used by their card issuer affected the cost of the card. The OFT also found that few card holders took interest calculation methods into account when choosing a credit card. One way to assist consumers to compare cards would be to simplify the way that information about interest calculation methods was presented. OFT investigated a method based on Regulation Z, which forms part of the *Truth in Lending Regulations* in the United States of America. The method considered by the OFT would require a number of interest calculation methods to be defined and to be given an identifier ('method A', 'method B', etc). Independent organisations such as newspapers, regulators etc would then rank which methods were the cheapest for consumers to use. Other interest calculation methods would be permissible, but instead of being given an identifier, they would have to be explained fully to consumers on product literature.
- 5.17 We did not ask consumers about this approach as part of our quantitative market research survey as we found the concept was too difficult to explain as part of such a survey. We did, however, receive strong views from internal and external stakeholders. A small number of card issuers strongly supported this approach as a way of ensuring that consumers were able to decide which interest calculation method was the cheapest.
- 5.18 Most stakeholders, however, opposed the idea. They considered that it would serve to confuse consumers more than inform them. Some told us that a Regulation Z-type approach might act as a disincentive to the introduction of new, innovative ways of making interest charges, as card issuers would be reluctant to part from one of the defined interest calculation methods. Other stakeholders said consumers might be misled as to which card was the cheapest, as the card with the cheapest

interest calculation method might actually have a very high interest rate, or high charges.

5.19 We concluded that a UK version of Regulation Z is not worth pursuing:

- by introducing an identifier for a number of interest calculation methods, consumers will be asked to compare at least two features, the values of which, in practice, they would have problems comprehending. For example, would a consumer be better off with a card that has a 9.9 per cent APR and uses Method A, or a card with an 11.9 per cent APR which uses Method B?
- it would be very difficult to rank the identifiers objectively. Some observers may consider that Method A is cheaper than Method B, while others may disagree - this will generally depend upon how consumers use the card. For some consumers with unusual payment patterns, an interest calculation method which is generally labelled the most expensive may actually be the cheapest
- any method not given an identifier would probably be distrusted by consumers, even if it was more generous to them. This limits the incentive for card issuers to introduce new, cheaper methods of calculating interest (and, admittedly, more expensive methods too)
- search costs are raised. To access a ranking the consumer might need to look at an independent website/newspaper etc, as well as the product literature of every card he or she wishes to consider. If the rankings were included as part of the product documentation, search costs would not be raised, but the already crowded product documentation would be even more so
- interest calculation methods are just one feature of what makes up the cost of credit on a card. Even if such an approach were successful, consumers would also need to take into account fees, charges, interest rates etc to be able to determine the cost of credit, and

- there is little support from most of the industry for this solution, and gaining a consensus on which methods should be assigned an identifier would take a long time, and intensive resource.
- 5.20 The Board of Governors of the US Federal Reserve System is currently consulting on proposed amendments to Regulation Z intended to improve the effectiveness of the disclosures consumers receive in connection with credit card accounts and other revolving credit plans. The Federal Reserve is unlikely to report until Spring 2008.
- 5.21 OFT suggested in its evidence to the Treasury Committee²⁹ that it might be worth exploring a similar approach whereby one interest calculation method becomes the 'benchmark', with others permissible as long as they are accompanied by a full explanation. Unlike the 'Regulation Z-type' approach, there would only be one benchmark. The other problems with defining interest calculation methods remain, however: consumers would have to choose between the benchmark and other methods (some of which may be cheaper); consumers would still have to compare the method with other issues such as interest rate and charges; methods that differ from the benchmark may be distrusted even if they are cheaper; search costs could still be raised; and it is likely that securing agreement on one interest calculation method would be even more onerous.
- 5.22 We conclude that a Regulation Z type approach would not be suitable for the UK. It would add an extra layer of complexity to consumers' decision making process, and could potentially be very misleading.

Illustrative scenarios

- 5.23 Illustrative scenarios take a 'typical' example of payment behaviour, and provide an illustration of the cost of credit and the length of time it would take to pay the outstanding balance assuming either minimum or

²⁹ House of Commons Treasury Committee (December 2003) - '*Transparency of Credit Card Charges (2003-4)*'
www.publications.parliament.uk/pa/cm200304/cmselect/cmtreasy/125/125.pdf

partial repayments. They can also be used at the outset of an agreement, on the basis of an assumed pattern of spending and repayments. Illustrative scenarios have the benefit of providing a 'pounds and pence' illustration of the cost of credit and, as such, can act as a guide to the cost of using a particular credit card. They are also designed to impress upon consumers that making the minimum payment is a costly and slow way to pay off the outstanding balance on their cards.

- 5.24 We evaluated how useful illustrative scenarios were as a comparison tool. Thirty-five per cent of those we surveyed said that they would find illustrative scenarios very useful to help them compare cards. Five per cent of those asked said that this would be their preferred method for comparing credit cards.
- 5.25 Opinion among stakeholders was, however, more sharply divided about the effectiveness of illustrative scenarios as comparison tools. Which? strongly supported illustrative scenarios as they put the cost of the card in a 'pounds and pence' format. Some credit card issuers considered that illustrative scenarios allowed consumers to compare the cost of cards in an easily understandable and comparable way. APACS has provided a standard format for illustrative scenarios for the issuers that choose to use them, with the majority already doing so. However, maximum value for consumers would be derived if all issuers used them.
- 5.26 On the other hand, a number of card issuers saw little value in illustrative scenarios, primarily because it would not be practical to provide scenarios on the numerous ways that a consumer could use a particular credit card. Consumers could be misled as to which card was the cheapest, or the eventual cost of that card, as very few consumers will use a card in the same way as that described in the illustrative scenarios. While it is possible to provide more scenarios so as to give a wider range of possible forms of use, there is a danger that consumers would feel overwhelmed with information, and would not look at any of it. This could undermine the impact of other, more important, information.

- 5.27 The Treasury Committee said in its first report 'Transparency on Credit Card Charges (2003)'³⁰ that there was potential for improved transparency by the inclusion of examples giving the cost of different borrowing scenarios. A clear indication of the cost of repeatedly making the minimum repayment and the length of time it would take to clear an outstanding balance was one illustrative scenario recommended by the Treasury Committee.
- 5.28 Dr Neil Stewart of the University of Warwick has however provided evidence from a pilot study which indicates that including minimum payment information on product literature actually reduced the hypothetical payments made by those who did not repay the bill in full.³¹ This finding is taken to be a practical example of 'anchoring'. Dr Stewart describes participants as anchoring their repayment on the suggested minimum payment and then failing to adjust it sufficiently upwards.
- 5.29 As part of the testing of recommendations carried out by the OFT, a number of mocked-up illustrative scenarios were created, consistent with the standard APACS guidance, but provided in different styles. There was a relatively cheap credit card, an expensive credit card, and one between the two. The respondents were asked to determine which was the cheapest. Of the 33³² respondents who answered the question, all except three answered correctly based on the information provided.
- 5.30 When consumers were asked for comments on the illustrative scenarios, some said that the format was quite complicated and that they did not fully understand the information provided. Others, however, commented that the scenarios would help them to plan finances better. On balance, the illustrative scenarios tested were of use to the respondents.
- 5.31 The evidence as to whether illustrative scenarios help consumers and should therefore be on the product literature of each card issuer is finely balanced. As a comparison tool they clearly have value, as demonstrated

³⁰ *ibid*

³¹ Neil Stewart (University of Warwick) '*Adding Minimum Payment to Credit Card Statements Actually Reduces Repayments*' (draft)

³² Three of the 36 respondents did not answer the question

in the limited testing programme, although they are not the only basis on which consumers can choose cards. But there is no consensus within the industry on their value, and many issuers argue strongly that they could confuse consumers and lead to inappropriate decisions. It appears, therefore, that there is no overwhelming argument for recommending that all credit card product literature should include illustrative scenarios. The OFT considers that it should be a matter for individual card issuers to decide whether or not to use them. We also recommend that more work is carried out by the credit card industry into the implications of the research on 'anchoring' by the University of Warwick.

Improvements to summary boxes

- 5.32 The purpose of a summary box is to provide the consumer with all the key information about the cost of a credit card in one easily accessible place. Although card issuers provide summary boxes they are free to present information in different ways.
- 5.33 Our consumer research survey found that of those who compared their card with other cards said of information in the summary box:
- 29 per cent had used a summary box to make comparisons
 - 28 per cent of those that had used a summary box found it 'very useful'
 - three per cent did not find it useful
 - 33 per cent of all those questioned thought that they would find a summary box useful to make comparisons, and
 - seven per cent said this would be their preferred method for comparing cards.

- 5.34 In its conclusions, the Treasury Committee³³ stated that 'further progress is needed to protect consumers from opaque and potentially misleading information' and one of the key areas identified to help achieve this aim was 'better summary boxes'. The Committee welcomed industry improvement to the content and presentation of information in summary boxes as this had made it 'easier for consumers to compare [credit card] products'. On the negative side, however, the Committee noted that some issuers had summary boxes which were difficult to read and contain small and dense print.
- 5.35 In the opinion of most stakeholders summary boxes would be improved if the information they contained were to be presented in a more standardised form. The Advisory Group voiced concerns about the amount of information in summary boxes, and that information would be better provided in tabular or bullet form (or a mixture of both).
- 5.36 To test out this hypothesis, consumers were asked to look at some information provided in summary boxes, but presented in three different ways. Some summary box information was presented in text form; some tabular form, while some was provided in bullet points. The information on each was the same - only the form in which it was presented was different. All three methods were tested on the 36 respondents as part of the limited testing programme of potential recommendations. Respondents reported a strong bias against text, with an almost equal preference for bullets and tables. Respondents commented that tables made the comparison between cards easier, and also that it was easier to understand and retain the information when not in text form.
- 5.37 We believe that it would be possible to standardise the way that information is presented in summary boxes, consistent with current and

³³ House of Commons Treasury Committee (February 2005)- '*Credit Card Charges and Marketing*'
www.publications.parliament.uk/pa/cm200405/cmselect/cmtreasy/274/274.pdf

proposed legislation,³⁴ and that this could have a material impact in improving consumer understanding and hence choice.

Standardisation of terminology

5.38 OFT believes that comparisons between credit cards would be made easier if all card issuers referred to the same feature by using the same terminology. In some cases (see Annexe C for examples) card issuers give different names to the same feature in their product literature. Which? was particularly in favour of standardising terminology for features that are the same. Some card issuers were concerned that the product literature must be consistent with the terminology used in terms and conditions, which in turn would need changing. Standardising the terminology used, however, would not only aid comparisons between credit cards, but would also lead to a greater consumer understanding of these terms.

Education

5.39 As discussed in Chapter 4, we have found that consumers have real difficulty in shopping around for credit cards. The FSA has pointed out that consumers do not shop around when the perceived costs of doing so are greater than the perceived benefits. This may be overcome, however, by simply promoting public awareness of the potential benefits of shopping around, consequently altering the balance between the perceived costs and benefits.³⁵

5.40 Stakeholders both on the Advisory Group and those spoken to separately by the OFT expressed great enthusiasm for a programme which would alter this balance, and lead to consumers understanding the benefits of shopping around before choosing a credit card. Support was particularly strong from Which?, and from many card issuers. Many agreed that a

³⁴ Including the proposed Consumer Credit Directive

³⁵ FSA (October 2002): 'Losing Interest: How much can consumers save by shopping around for financial products?' www.fsa.gov.uk/pubs/occpapers/OP19.pdf

successful campaign would be the most important outcome of this project.

5.41 OFT has significant experience in educating consumers on the benefits of shopping around, and will work with the credit card industry, Which?, and other interested parties in putting a programme together which will coincide with the introduction of the FSA price comparison website discussed above. OFT believes that the programme should have three aims:

- the programme should inform consumers of the benefits of shopping around before they take out a card
- the programme should, very briefly, explain the tools consumers can use to choose between cards, some of which we introduce, or enhance, with this report, and
- the programme should have a simple, concise message, which as far as possible is consistent with the lessons learned by the Better Regulation Executive and National Consumer Council in their report into how consumers deal with regulated information.³⁶ (It should be noted that we are not proposing that this information should be regulated, but we believe that there is substantial read-across.)

5.42 There was almost universal approval from stakeholders on the form that our consumer education should take. Stakeholders agreed with the OFT that the focus should be on providing a short, simple message, as concisely as possible. Providing on-going information, not a short campaign, was identified as key.

5.43 We consider that the centre-piece of such an education campaign should be a one-page of A4 information sheet which:

- explains the benefits of shopping around

³⁶ Better Regulation Executive and National Consumer Council (November 2007) - *'Warning! Too much information can harm'* www.bre.berr.gov.uk/regulation/reform/next_steps/too_much/

- explains briefly how to use comparison tools such as summary boxes, the APR and the FSA price comparison website, and
 - signposts to more detailed information elsewhere, including on the Consumer Direct website.
- 5.44 The interim report published by the Better Regulation Executive and the National Consumer Council³⁷ stated that, regardless of their background and skills, consumers want - and are more likely to read - a document that is succinct, simple and written in plain English. In terms of impact, 'complex information was often considered to be irrelevant or boring by more educated consumers whilst lower literacy consumers found the fact that they could not grasp the information humiliating'.
- 5.45 With that in mind, we consider that the one-page information sheet that OFT will design with the credit card industry, FSA and other interested parties, must be specifically designed to meet the requirements of lower literacy consumers.
- 5.46 The report also noted that the internet has become the predominant source of information in society. It also notes, however, that there are still some groups which have difficulty accessing the opportunities offered by these new technologies. For example, it quotes figures from Ofcom's consumer research, which demonstrates that 39 per cent of the population currently do not connect to the internet, with particularly weak access in the over-65s and socio- economic groups D and E.
- 5.47 It is therefore clear that the education campaign cannot be limited just to the internet, and must instead be delivered through a number of different channels, including by post (along with credit card documentation and monthly statements) and copies in bank and building society branches and in other places such as public libraries and Citizens Advice Bureaux.

³⁷ Interim report: Better Regulation Executive and National Consumer Council (July 2007) - *'Warning! Too much information can harm'*
http://www.ncc.org.uk/nccpdf/poldocs/NCC168pd_warning_too_much_information.pdf

5.48 Most stakeholders agreed that school leavers between the ages of 15 and 18 would benefit from this message in particular. Even though credit cards are available only for those aged 18 and over, it is important to get the message across to young people at that age for two reasons:

- by getting the message across to young people between the ages of 15 and 18, they will understand the benefits of shopping around for credit cards before they are offered a card, and
- by educating young people while they are still at school, the message can be provided to virtually all young people in an environment where they are used to learning. pfeg (Personal Finance Education Group), who are experts in this field, consider that lessons such as this about financial management learned whilst at school form an essential foundation for developing more capable financial behaviour as adults.

5.49 OFT and the Advisory Group identified a number of channels which could be utilised to explain the importance of shopping around before choosing a credit card:

- informative websites such as the FSA's *moneymadeclear* and the forthcoming young adults website (both part of the FSA website); the APACS *choosingandusing* website; and, of course, the OFT website. Links to these websites are at Annexe E. We recommend that credit card issuers provide the one-page information sheet somewhere prominently on their websites
- specific information for young people - either school age (through pfeg (Personal Finance Education Group), or education foundations such as HSBC's), or out of school (such as the FSA's Not in Education, Employment or Training (NEET) initiative)
- update existing leaflets and other written information. We recommend that the information sheet be provided in leaflet form at bank and building society branches, with mailshots to consumers when offering a credit card, and by consumer organisations such as

Which?, Citizens Advice, and the Consumer Credit Counselling Service

- amending the product literature itself. We recommend that all credit card product literature include a standard line which explains that the FSA has introduced a price comparison website for credit cards, and that consumers should check it before deciding on a card, and
- by contributing to the Thoresen Review.³⁸ The Economic Secretary to the Treasury asked Otto Thoresen to carry out a review examining the feasibility of delivering a national approach to generic financial advice. The aim is to ensure that there is greater access to high quality affordable financial advice for those most vulnerable to the consequences of poor financial decision-making. The Thoresen Review tested out the concepts of delivering generic financial advice to people in two prototype services which ran throughout Autumn 2007. Both services used FSA's *moneymadeclear* website as the source of web based advice. Generic financial advice is information and guidance on a range of financial matters, from jargon busting to planning for retirement, which aims to help people make better financial decisions and be better prepared for interacting with financial services. We believe that our aims of getting consumers to shop around, by explaining how to compare credit cards, will fit in well with this initiative.

³⁸ More detail is at www.hm-treasury.gov.uk/independent_reviews/thoresen_review/thoresenreview_index.cfm

6 CONCLUSION, RECOMMENDATIONS AND NEXT STEPS

Conclusions

- 6.1 We recognise that in the market for credit cards, the consumer is faced with a less than straightforward choice due to the number and complexity of the products, necessary because of their flexibility.
- 6.2 Of some concern, however, is the fact that our research identified that 68 per cent of consumers did not shop around at all when selecting their present credit card. Clearly these 68 per cent of consumers reduced significantly their chances of obtaining the best credit card for their payment needs. Of the remaining 32 per cent of consumers more than a third considered only two, three or four credit cards before making a final selection. One third of all credit card-holders stated that the reason why they had their present card was simply because their bank had offered them the card or had given it to them when opening an account with the bank.
- 6.3 As stated at paragraph 4.19, some previous FSA research indicates that the average loss in pounds per annum if a card holder chose the average priced credit card rather than the cheapest was £137 per year.

Recommendations

Price comparison website

- 6.4 The OFT recommends that the FSA introduce a price comparison website for credit cards, as part of its 'moneymadeclear' site. FSA fully supports this recommendation, and it is supported by a wide range of stakeholders, including members of the credit card industry, consumer groups and government.
- 6.5 A mock-up of this website was created and tested on a small number of consumers (see paragraph 3.9). While overall feedback about the usefulness and usability of the site indicated that it would be welcomed

and used effectively by consumers, many suggestions were made for improvements, all of which have been passed on the FSA.

Repayment calculators

- 6.6 The OFT considers that repayment calculators would be less useful to consumers than the FSA price comparison website. Although consumer's search costs might be reduced by gathering links to each card issuer repayment calculator in one place (for example APACS' website), it would still require consumers to enter their repayment details into each individual card issuer's website. We believe that it is likely that most consumers would not enter their details into more than a few of these websites at any one time. This would narrow comparison to these few card issuers' products.
- 6.7 As a result, we do not recommend that card issuers include on their websites repayment calculators as a comparison tool. We do, however, agree with the Consumer Credit Counselling Service that there could be some benefit in their inclusion on websites as debt-prevention tools.

Summary boxes

- 6.8 OFT recommends that providers ensure that summary boxes present information in a standard format, and that where possible, information is included in tabular form. Annexe D gives examples used as part of the testing programme, which showed that consumers preferred complex information presented in tabular or bullet form rather than text. Card issuers would still be free to put summary boxes in their corporate colours and style as they do now, as long as the information remains readable and comparable with other issuers' summary boxes. OFT will work with the industry through APACS to introduce such a summary box.

Standardisation of terminology

- 6.9 We recommend the standardisation of terminology where possible. We further recommend that where terminology is standardised, that it be used by all credit card issuers.

Education

- 6.10 We recommend, and will contribute to, the establishment of an on-going consumer education strategy which discusses the benefits of shopping around for a credit card and shows how, using the right tools, consumers can obtain a credit card that best suits their needs. The focal point of this will be a one-page information sheet explaining how to compare credit cards using the tools available.

Next Steps

- 6.11 On the price comparison website, the FSA has already agreed to include a credit card comparison site as part of its 'moneymadeclear' website, in accordance with the OFT's recommendation. OFT is committed to providing whatever advice and support it can in making the website recommendation a reality, including addressing any legal issues that need to be resolved, and has already provided FSA with the results of research undertaken as part of this project.
- 6.12 OFT is also committed to working with the industry to make the improvements to summary boxes recommended above, and to introduce the standard consumer education piece to inform consumers of the benefit of shopping around for credit cards. This work will be led by APACS.

A LITERATURE REVIEW – LIST OF PAPERS STUDIED

- A.1 Datamonitor - *'UK Plastic Cards 2007'* - Reference Code DMFS2094
- A.2 Better Regulation Executive and National Consumer Council (2007) - *'Warning! Regulated information: a guide for policy makers'* (URN 07/1573)
- A.3 FSA (March 2006) - *'Financial capability in the UK: Establishing a Baseline'* (ISBN: 1-84518-419-X)
- A.4 Malcolm Cook, Fionnuala Earley, Jody Ketteringham, Sarah Smith (October 2002): FSA - Occasional Papers in Financial Regulation (No 19) - *Losing Interest: How much can consumers save by shopping around for financial products*
- A.5 Jinkook Lee & Jeanne M Hogarth (2000) - *Relationships Among Information Search Activities When Shopping for a Credit Card* - Journal of Consumer Affairs 34 (2), 330-360.
- A.6 Elisabetta Lossa (August 2007): FSA Occasional papers in Financial Regulation (No 26) - *Modelling changes to consumer welfare cause by reduce price transparency*
- A.7 Better Regulation Executive and National Consumer Council (November 2007) - *'Warning! Too much information can harm'* (URN 07/1553)
- A.8 Resolution Foundation (October 2007) - *Compare and Contrast 'How the UK comparison website market is serving financial consumers (BUN 2092)*
- A.9 Office for National Statistic Omnibus Survey (August 2007) - *Northern Ireland Omnibus Survey; Survey of Internet provider*
- A.10 House of Commons Treasury Committee (December 2003) - *Transparency of Credit Card Charges, First Report of Session 2003-04 Volume 1 (HC 125-1)* London: The Stationary Office Limited

- A.11 Neil Stewart (University of Warwick) *'Adding Minimum Payment to Credit Card Statements Actually Reduces Repayments'* (draft)
- A.12 House of Commons Treasury Committee (February 2005) *'Credit Card Charges and Marketing' Second Report of Session 2004 -5* (HC 274)
London: The Stationary Office Limited
- A.13 Interim report: Better Regulation Executive and National Consumer Council (July 2007) - *'Warning! Too much information can harm'* (URN 07/1272)

B ADVISORY GROUP MEMBERSHIP

American Express Services Europe Limited

APACS

Barclays

British Bankers' Association

Building Societies Association

Citizens Advice

Consumer Credit Counselling Service

Finance & Leasing Association

Financial Services Authority

HBOS

HSBC

Lloyds TSB

MBNA

Nationwide

Royal Bank of Scotland Group

Which?

C EXAMPLES OF TERMINOLOGY USED THAT COULD BE STANDARDISED

Description	Terms used	Financial institution
Using a credit card to withdraw money from an ATM, advanced by the card issuer	Cash advances Cash withdrawal	Intelligent Finance American Express
Charges that are made by the card issuer for the card holder defaulting on certain aspects of the agreement	Default charges Charges Default fees	Barclaycard American Express Post Office Card
The amount of money that must be repaid by the card holder to the card issuer	Cost of Borrowing Repayments Payment example	Halifax One HSBC Egg

D WAYS OF PRESENTING INFORMATION IN SUMMARY BOXES

This annexe shows some of the different ways that information can be provided in summary boxes. The different examples were tested on 36 consumers in three groups in controlled conditions. All three groups expressed a preference for tables and bullet points over continuous text.

Example 1: Interest charging information

Table

Interest Charging Information	The periods over which interest is charged are as follows	
	From	Until
Purchases	transaction date	repaid in full
Balance transfers	transaction date	repaid in full
Cash advances	transaction date	repaid in full
Money transfers	date debited to your account	repaid in full

Text box

Interest Charging Information	We charge you interest on purchases, balance transfers and cash advances from the transaction date until you repay your balance in full. We charge you interest on money transfers from the date the transfer is debited to your account until you repay your balance in full.
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Example 2: Allocation of payments

Bullets

Allocation of payments	<p>We will apply payments we receive to your account in the following order:</p> <ul style="list-style-type: none">• interest• fees etc• promotional purchases and balance transfers• purchases made after any initial period• cash withdrawals <p>For full information please see section xx of your terms and conditions</p>
------------------------	--

Text box

Allocation of payments	<p>We will apply payments we receive to your account in the following order: interest; fees; promotional purchases and balance transfers; purchases made after any initial period; then cash withdrawals. For more information please see section xx of your terms and conditions.</p>
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Example 3: Credit limit

Table

Amount of Credit	Minimum Credit Limit	£500
	Maximum Credit Limit	Subject to status

Text Box

Amount of Credit	<p>Your minimum credit limit is £500. The maximum credit limit that you can have under this agreement is subject to status</p>
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Example 4: Charges

Table

Charges	Cash Advance Fee	3% (minimum £3)
	Foreign Exchange Commission	2.95%
	Balance Transfer Fee	3% or minimum £3
	Cheque Fee	3% or minimum £3
	Minimum Interest Charge	50p (in any month where interest charge is between 1p and 50p)
	Copy Statement Fee	£5
	Statement Date Change Fee	£5
	Processing any foreign currency payment to us	£10
	Stopped Cheque Fee (Other than lost or stolen)	£10

Text Box

Charges	Cash advances, credit card cheques and balance transfers are subject to a handling fee of 3% with a minimum of £3; the minimum interest charge is 50p (in any month where interest charge is between 1p and 50p); foreign exchange transactions subject to processing fee of £10, and foreign exchange commission is subject to a 2.95% fee; copies of statements and requests to change the date of your statement are subject to a fee of £5. Stopped cheques (other than lost or stolen) are subject to a £10 fee.
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Bullets

Charges	<ul style="list-style-type: none"> • 3% handling fee (min.£3) on: credit card cheques and balance transfers, and cash transactions • 2.95% commission on foreign currency transactions. • £10 fee on: processing foreign currency and stopped cheques (other than lost or stolen) • £5 fee on: copies of statement and changing statement date • 50p: minimum interest charge
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E LINKS TO USEFUL WEBSITES

E.1 <http://www.moneydeclared.fsa.gov.uk>

E.2 <http://www.choosingandusing.com>

E.3 <http://www.which.co.uk>

E.4 <http://www.ofc.gov.uk>