

## UK credit cards

# Downhill from here?

**After years of strong growth, the UK credit card market suddenly faces an uncertain future. The combined pressure of contracting volumes, rising credit losses and tougher regulation is squeezing income and adding to costs. Is this merely a cyclical adjustment, or does the market face long-term decline?**

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The year 2006 was a landmark birthday for the credit card industry. Back in 1966, Barclays had introduced the credit card to the UK with its iconic Barclaycard.

Yet the 40<sup>th</sup> birthday may represent a high point in the industry's fortunes.

### **The market goes ex-growth**

The recent change in industry fortunes is remarkable. Between 1995 and 2004, the value of credit outstanding on UK-issued MasterCard and Visa credit cards increased at an annual rate of 14% or higher.

Supported by rising house prices and historically low interest rates, the amount owed on credit cards rose six fold from £10.2 billion at the end of 1994 to £63.8 billion at the end of 2004 according to British Bankers Association statistics.

Despite a benign UK economic environment, growth fell sharply during 2005. Year-end credit outstanding on UK cards was only 5.7% higher than at end 2004, the lowest rate of growth for more than a decade. And during 2006, credit outstanding on cards (including interest-free balances) actually contracted by 2% to £66.1 billion.

With the benefit of hindsight, there were already signs before 2004 that UK consumers' great love affair with the credit card might be waning. The rate of growth in credit card turnover (new purchases and

cash advances on cards) fell below 10% in 2003. By 2005, it had fallen to 3.3%, little more than the rate of inflation. In 2006, it fell by 1.1%.

### **Credit losses grow**

In addition to a contracting market, the industry has experienced a sharp deterioration in credit quality, forcing issuers to increase substantially their loan loss provisions.

For example, credit card impairment charges of £490 million accounted for over 30% of Lloyds TSB's total Group impairment charge in 2006.

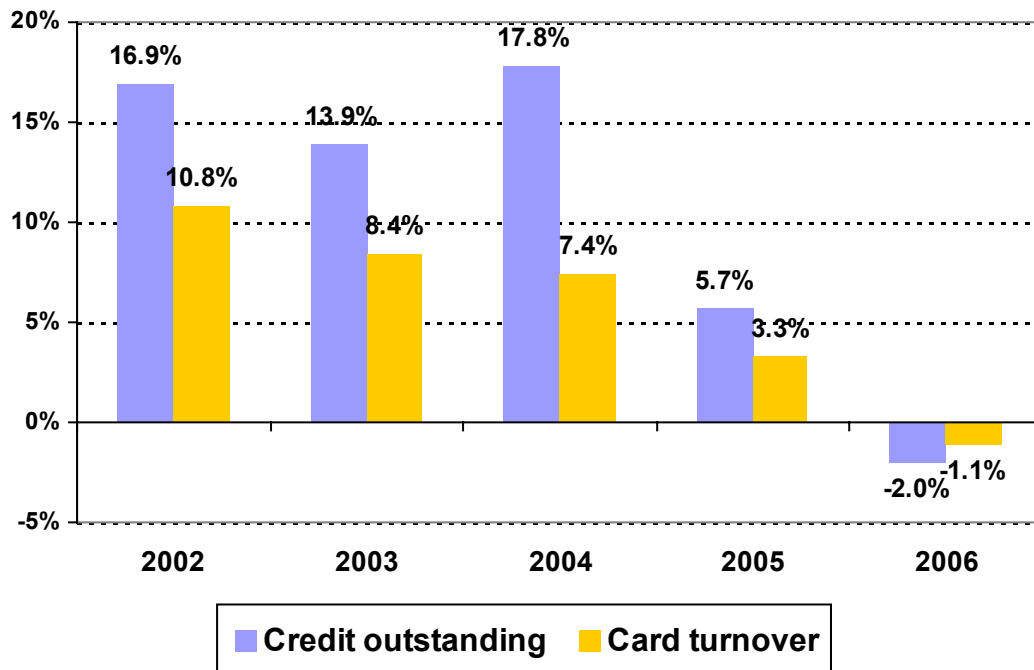
The rapid growth in consumer bankruptcies and Individual Voluntary Arrangements has been a major factor behind the escalation in write-offs.

The worry for the industry is that, unlike in the early 1990s, credit quality has deteriorated without any overall deterioration in the economy. The UK has continued to experience high employment levels, strong growth and low inflation. This leaves the industry vulnerable to further credit losses if the economy does weaken.

### **Regulatory pressures**

Regulatory investigations and rulings on key revenue streams are the third source of pressure on the credit card industry.

## Annual change in credit card turnover and outstanding balances



**Notes:**

1. Chart covers Visa and MasterCard credit and charge cards in issue only.
2. Turnover covers both purchases and cash advances.
3. Change in turnover is value in year compared with value in previous year.
4. Change in credit outstanding is value at year end compared with value at previous year end.
5. Credit outstanding includes interest-free balances.

Source: British Bankers' Association (author's presentation)

The Office of Fair Trading's April 2006 ruling on credit card default charges has forced issuers to cut lucrative late payment and overlimit fees.

HBOS for example reported that implementation of lower default and late payment fees following the OFT ruling reduced fee income by approximately £25 million in 2006, with an estimated full year impact of £60 million in 2007.

The crackdown on default charges is the first in what may be several crackdowns on non-interest revenue.

In February, the OFT referred the payment protection insurance (PPI) market to the

Competition Commission for more detailed investigation. The FSA is also investigating PPI sales practices. The sale of PPI is a lucrative source of commission income for credit card issuers. According to an OFT consumer survey, 94% of credit card PPI purchasers bought it directly from their credit card provider.

And the OFT continues to investigate interchange – the income received by the card issuer from the retailer (via the retailer's merchant acquirer) on each credit card payment.

The OFT's investigations form part of a global scrutiny of interchange. The ongoing European Commission investigation,

litigation in markets worldwide and the precedent of sharp cuts imposed in Australia raise long-term doubts about the sustainability of credit card interchange at current levels.

### **Where next?**

Some of the recent problems – notably the recent contraction in spending and borrowing volumes – may simply represent an inevitable period of adjustment after the heady growth of the preceding decade.

But the industry has to plan for longer-term structural changes as well. It faces an ageing population, with a lower propensity to borrow and many cardholders scarred by recent experience of indebtedness. And, as

shown by the recent campaign on overdraft charges, consumers are becoming more active in challenging fees they view as unfair.

Card issuers will have to offer products that respond to consumers' changing profile.

Faced with this much tougher operating environment, card issuers need to be more transparent in their pricing and to give borrowers a greater sense of control over their borrowing.

This will inevitably affect income and profits. But in the longer-term, it may prove essential to sustaining the credit card as a viable product.

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## **UK credit cards – an industry in decline?**

The report ***UK credit cards – an industry in decline?***, published in April 2007, examines the state of the UK credit card market.

The report is published by ECR Publishing Partnership, publisher of the leading payment card magazine European Card Review. It is available at a price of £750 / €1,150.

The report examines in detail trends in credit card use, competitive developments, regulatory developments and industry economics. The report is illustrated with 48 charts, tables and diagrams. An appendix analyses key sources of industry data.

The report's author is Peter Welch, a consultant specialising in the banking sector. He maintains a website and issues reports under the BankEcon brand. In 2006, Peter co-authored with Professor Steve Worthington *Banking at the Checkout*, a report published by ECR on retailers offering financial services.

For further information on the report, visit: [www.europeancardreview.com](http://www.europeancardreview.com) or [www.bankecon.com](http://www.bankecon.com)