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Gift cards: the gift that should keep on giving

Fairer Finance

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Executive summary

More and more consumers are using gift cards - with the market doubling in size over the past five years to now be worth over £6bn annually. To coincide with this, the number of major retailers facing insolvency has also grown - with many household names such as House of Fraser, Maplin, and Toys 'R' Us falling into financial difficulty this year alone.

Despite their growing use, and the growing risk of purchasing them, there still remains a worrying lack of consumer protection in the gift card market. Since 1982, there have been six major reports into the issues surrounding consumer rights in this area, with only the 2002 Enterprise Act making a difference to practice in the market.

Fairer Finance has identified three key failings in the gift card market. This report shows exactly why these issues need addressing, as well as offering long overdue solutions to redress consumer detriment.

1. Gift cards are allowed to be sold with expiry dates chosen by the company. Companies already benefit from gift cards, as the money loaded onto them depreciates in value, the longer it is held and remains unspent. The effects of inflation mean that if someone was to try and use their gift card after five or 10 years, they would be able to buy fewer goods with the money on the card.

Fairer Finance believes there is no reason why the scales need to be tipped further in the company's favour by forcing gift cards to become worthless after an arbitrary period of time.

The UK is behind the curve on this issue, as the sale of gift cards with expiry dates is already banned in Canada, as well as several US states, such as California, Florida, and Connecticut.

Expiry dates in the UK can be as short as eight weeks.

2. There is no onus on companies to honour gift cards during administration. If a retailer puts themselves into administration, they are allowed to cancel all existing gift cards. This means consumers who have been given gift cards find their presents are worthless.

An average of 38 companies have failed in the UK each year for the past ten years, affecting 2,716 stores. In 2018 alone, household names such as Toys 'R' Us, House of Fraser, Poundworld, and Maplin have all entered administration. These events are outside the customer's control, and so the customer should not bear the penalty of them. Despite this, consumers lose on average £83 each due to gift cards not being honoured during administration.

3. The funds held in gift cards aren't protected if a company enters liquidation. If a company is liquidated, gift card holders are likely to receive almost no money back. On average, they receive less than 1p per £1 on their gift card in this situation. Again, through no fault of their own, consumers are being told the funds that were invested in the card are now worthless due to events outside of their control.

Fairer Finance believes three new measures are needed to provide adequate protection for consumers who buy and are given gift cards:

- **Expiry dates on gift cards should be banned.**
- **All gift cards must be honoured during administration.**
- **Gift cardholders should be protected when a company goes into liquidation.**

To protect consumers in this last sceanrio, we'd like to see retailers have to ring-fence any unused money on gift cards bought in the last five years. Consumers with unused gift cards would then be entitled to a full refund for up to one year after the liquidation was announced. At the end of that time, any unclaimed funds could be added to the pot for unsecured creditors.

These extra protections for gift cardholders will ensure that gift cards are honoured in the spirit that they were given. Many other countries have already taken steps to protect those who give and receive gift cards, and it's time the UK followed suit.

1. Background

Gift cards are becoming increasingly popular, with over half (57%) of consumers saying they intend to give gift cards as a present at some point in the future. Gift cards allow the purchaser to load the card with a set amount of money, which the recipient can then spend at participating stores. They provide an easy means of gifting a cash sum, while being more personal than a simple cash gift.

Because of the convenience gift cards provide for increasingly time-strapped consumers, the gift card market has doubled in the past five years - and is now worth more than £6bn annually.

However, as their use has increased, so has the resulting consumer detriment. The UK Gift Card and Voucher Association estimates consumer losses totalling £300m a year from gift cards being lost, expiring, or no longer being honoured by the company that sold them.

Some of this loss is down to the consumer – losing the card or forgetting to use it – which can't be protected against. But there remains significant loss resulting from gift cards expiring or becoming worthless when a company runs into financial difficulties.

Currently, gift cards tend to be issued with expiry dates. From research conducted by Fairer Finance of 72 major gift cards, this date is often between 12 and 24 months from when the card is issued, after which it's no longer usable. While this time period is most common, there exists no regulatory framework to determine what this period should be. This leaves some cards being valid for a period of only 8 weeks, compared to others that are valid indefinitely.

Further issues exist concerning the increasingly common event of company insolvency. Once a company is seen to be failing, it enters a period of administration. During this time, it is up to the administrators to decide whether to honour gift cards or not. Considering this is becoming more common, with five large retailers falling into administration this year alone, the potential consumer detriment here is an ever-growing concern.

If a company fails to recover after administration, it then enters liquidation. During this period, gift card users are the lowest on the list of priorities for reimbursement.

Since 1982, there have been six major reports into the protection of consumers during companies' insolvency. The most high profile was the Office of Fair Trading's response to the collapse of Farepak in 2006. The collapse resulted in around 150,000 customers being unable to receive the goods they'd already paid for, with no official protection existing to reimburse them.

The most recent major report into the treatment of consumers during company insolvency came from the Law Commission in 2016, which put forward suggestions to the Secretary of State for Business, Energy, and Industrial Strategy. Citizen's Advice then followed up with a similar report in 2017, which largely echoed the Law Commission's suggestions.

The main suggestion was granting preferential status to consumers who made a prepayment during the three months leading up to insolvency, and only to those who have a claim of £100 or more. Citizen's Advice agreed, though believed this doesn't go far enough.

They saw no reason why those that made a prepayment more than three months before insolvency should be denied preferential treatment. Equally, they saw that the median prepayment on gift cards they analysed was £30 - and there was no compelling reason why honouring gift cards should be capped at £100 claims or more.

2. Improving consumer protection

The initial suggestions from the Law Commission have been 'welcomed', but not acted on, by the Secretary for Business, Energy, and Industrial Strategy. Fairer Finance believes this issue should be tackled immediately, as the importance of introducing these proposed consumer protections will only increase as company insolvencies become more common.

Here we outline exactly what protections must be introduced, and why, to ensure against further consumer detriment. We've identified three key areas which will require change to create what Fairer Finance believes is a fair gift card market.

1. Ban expiry dates

Gift cards almost always come with expiry dates. This means that after a certain period of inactivity, the value of the card drops to zero. Fairer Finance sees no reason why this should be the case, as gift cards already work in the providers favour in various ways, and would continue to even if expiry dates were banned.

The UK is behind the curve on this issue. Although this practice is normalised, it isn't the norm internationally. The US passed the Credit Card Accountability Responsibility and Disclosure Act in 2009, which banned the sale of gift cards with an expiry period of less than five years. Certain US states have taken this further – Florida, California, and Connecticut, for example, have all banned the issuing of expiry dates on gift cards.

Similarly, Canada has banned the sale of gift cards with expiry dates since 2008, with the exception of those sold in shopping malls. But even these must have a minimum 15 month expiry period.

There is currently no minimum expiry dates for gift cards issued in the UK, with some becoming worthless after only eight weeks. Having analysed 72 gift cards from major UK retailors, 57 expire after 24 months or less after last use. This means that without making a transaction or top-up with the gift card, the money put into the card becomes worthless.

We don’t see any reason why this should be the case. We take the stance here, and throughout this report, that consumers who have purchased gift cards have made a form of prepayment for goods and services. Currently, the gift card is treated by providers as the product itself, rather than a means to a product.

The provider already holds the advantage when selling gift cards, even if the market worked in a way that we’d deem to be fairer. The money loaded onto the card is constantly depreciating in value, and so the provider is benefiting from the outset by virtue of inflation.

There is also the more obvious benefit to the provider – that the money must be spent only in their stores. As well as this, being able to only spend the money in their stores come with additional advantages. According to the UK Gift Card and Voucher Association, due to having to spend the money at a certain store, 60% of gift card users were introduced to a new brand through them, while 18% became regular customers. On top of this, 72% of gift card users spent more than the value of the card.

Considering these innate benefits to the provider, there seems no reason to further tip the scales out of the consumer’s favour by applying expiry dates. At least £5.40 per £100 spent on gift cards is lost by consumers through lack of use – either by loss of the card or failing to use it before expiry.

It's therefore appropriate to redress some of this consumer detriment by ensuring gift cards don't expire, and that consumers don't miss out by not using them on time.

2. Ensure gift cards are honoured during administration

In the current economic environment, more and more large retailers are facing administration. Five household names have entered into administration talks this year alone. While the closure of stores such as Blockbuster in 2013 or Phones4U in 2014 were headline news, in 2018 the administration of large companies such as Toys 'R' Us, House of Fraser, Poundworld, and Maplin have become a regular occurrence.

In fact, an average of 38 companies have failed in the UK each year for the past ten years, affecting 2,716 stores. And analysis from Moore Stephens focused on the financial health of 35,000 businesses, and found that 19% of clothing retailers are showing warning signs this year. This trend is only continuing, in terms of both frequency and size.

But despite the increased regularity of administration, the protections for gift card users have remained unchanged. During administration, the company is still able to trade goods and services, and new customers are welcomed. But there is no onus on companies to honour gift cards during this period – and often companies don't.

This is due to the definition of gift cardholders' rights, as detailed by the Sales of Goods Act 1979. The act makes the distinction between 'specific' goods, and 'unascertained' and 'future' goods.

'Specific' goods are those designated by a company to be provided for a consumer's prepayment. For example, pre-ordering a new book before release would be defined as a 'specific' good – the payment is received and a specific book in the warehouse is chosen to immediately fulfil the provider's obligations. This then becomes the property of the consumer, even before the book is provided.

'Unascertained' and 'future' goods are those that are not yet designated as 'specific' goods. Gift cards are an example of this. There has been a transaction in the purchasing of the gift card that signals goods will be provided in the future – but what these goods are hasn't yet been decided. As a result, the goods don't become the property of the consumer, and instead remain in possession of the provider.

During a period of administration, a company is obliged only to provide 'specific' goods. Purchasers of gift cards don't have this protection, and so there is no requirement for gift cards to be honoured. This a further issue resulting from the definition of gift cards as being a product in of themselves, rather than a means to a product.

This leads to no clear ruling around how gift cards should be treated. Some companies honour them in administration, some don't. HMV, for example, stated that gift cards would not be honoured, before deciding to honour them at a later date. When homeware chain TJ Hughes went into administration in 2011, its administrator Ernst and Young decided to honour gift cards – on the condition that cardholders with cards worth less than £100 would spend double their value.

Citizen's Advice has found that the mean loss to a consumer resulting from their gift card not being honoured during administration is £83. The aggregate consumer loss here is large – for example, HMV alone held £6.5m worth of gift cards during administration.

This is not only a financial issue, but also a moral one. If during administration a consumer can go into a store and buy goods, then why can't a consumer that's effectively already paid for the goods do the same?

There is no dependable means for consumers to claim back, or even use, their gift card during administration. Consumers have to rely on the goodwill of companies, the unreliable chargeback scheme (which is predicated on the judgement of the debit or credit card provider), or Section 75 of the Consumer Credit Act 1974.

This section allows the purchaser of the gift card to claim back the amount, but only if they spent £100 or more on a credit card. Not only does this rely on a credit card being used, but it reimburses the purchaser not the recipient of the gift card. This is impractical for most gift cardholders as they were not the purchasers of the card. And crucially, most gift cards have a value of less than £100 so wouldn't qualify for this protection anyway.

There is the argument that if companies were forced to honour gift cards, then this would increase the risk of companies falling out of administration and into liquidation. But the capital wrapped up in gift card sales is often very small in comparison to the overall figures dealt with during administration.

For example, during the administration of HMV in 2013, the company held £6.5million worth of gift card deposits. But the company collected over £923million in sales that same year. Gift cards therefore accounted for less than 1% of sales revenue – far less when considering the £6.5million figure includes all active cards, not just those sold in that year.

Another point to consider is that even when gift card deposits are protected and honoured during administration, research from the Law Commission shows that in practice the vast majority of this goes unclaimed. One example drawn up was the administration of Land of Leather, before which the company put gift card deposits in trust. Only 15% of this money was ever claimed.

We therefore see no reason why gift cards shouldn't be honoured during administration, and urge regulation to be drawn up to ensure that they are.

3. Ring-fence funds from all gift cards bought in last five years, to ensure refunds are available for a year once liquidation proceedings have begun.

A further issue arises after the administration process. At this point one of two things can happen: either the company recovers, and continues trading as normal, or it falls into liquidation.

During liquidation all assets are pooled, and creditors are reimbursed the money put into the company, with certain creditors holding priority. Bottom of this list are 'unsecured' creditors – a category into which gift cardholders fall.

Until 2002 there was no onus on companies to reimbursed unsecured creditors at all, as prescribed by the 1986 Insolvency Act. But with the introduction of the 2002 Enterprise Act, a proportion of assets are required to be put aside for them. This is known as 'the prescribed part'.

However, this is capped at £600,000, which is a very small proportion of the deposits held by gift card users. On top of this, a certain proportion of this amount goes towards the administration costs of handling the resulting claims.

In practice, this means that during liquidity gift card users get back less than one pence per pound put in, according to analysis of 31 failed retailers by the Law Commission. To take two examples from 2012, the collapse of Peacock saw less than 0.7p per £1 refunded, while the collapse of JJB Sports saw only half of this refunded – merely 0.34p per £1.

Liquidation is an increasing occurrence, with 2017 seeing a four year high as one in 213 companies collapsed. It's therefore imperative to grant gift card users suitable protection against this.

Consumers buy gift cards in good faith – and pass them on as presents to friends, relatives and colleagues. Yet, without breaching any terms, and due to events outside of their control, the recipient can be left with nothing. The collapse of MFI in 2008 saw £8.5million lost by consumers, despite the consumers having done nothing wrong.

We believe that all money on gift cards bought in the last five years should be ring-fenced during liquidation, and that gift cardholders be considered preferential, not unsecured, creditors. This protection should apply to gift cards purchased in the last five years, to provide a cut-off to ease the calculation of costs during this period. Considering that 98.5% of users spend the money on gift cards within the first year, this should be ample protection while also easing the task of accounting projections.

Furthermore, these funds should be ring-fenced for a year from the point liquidation is announced. A year is the average amount of time a company spends in a period of liquidation, according to RPG Business Recovery, and this cut-off again eases the difficult accountancy work needed during liquidation. Any reclaimed card assets can then be reallocated to unsecured creditors at the end of the period.

To coincide with this, a few minor disclosure remedies must be brought in. Firstly, the purchase date of the gift card should be clear on the card itself. This ensures that consumers know whether or not their card is still valid during insolvency.

Secondly, a statement should be released by the company at point of administration to tell consumers exactly what their rights are during this time. If the company then falls into liquidation, an additional statement should be released to provide additional clarification. The media can then be relied on to provide further disclosure in the following months.

3. Conclusions

There are three distinct failings in the gift card market. We believe these should be rectified immediately, to ensure against further consumer detriment in the market.

Gift cards are free to be issued with expiry dates, despite there being no clear reason why this should be the case. Gift cards are already stacked in favour of the provider, as the money loaded on the card is always losing value and can only be spent in participating stores.

There is currently no requirement on companies to honour gift cards during administration. Despite consumers having effectively made a prepayment for goods, this prepayment can be deemed invalid by the company. Consumers have bought the gift card in good faith, and not breached any terms. Yet due to events outside of their control, the company is free to declare that the payment they made is now worthless.

During liquidation, gift card users are of the lowest priority to be reimbursed. If they receive anything back, it's typically less than 1% of the money on the card.

To rectify this, we want the government to amend legislation to do three things.

1. Expiry dates on gift cards should be banned. In addition, electronic records of gift cards should be kept so that consumers who lose gift cards can have the old card cancelled and a new one issued – without losing the whole value of the card.

2. All gift cards must be honoured during administration. Firms should not be able to treat gift cardholders as creditors whom they have protection from in administration.

3. Gift cardholders should be protected when a company falls into liquidation. All money loaded onto gift cards in the previous five years should be ring-fenced. For a year from when liquidation is announced, gift cardholders should have the right to claim the value of their card back.

To coincide with these changes, the purchase date should be stated on the gift card itself. The suggested administration procedure should be disclosed by the company during administration, and similar during liquidity gift card users should again be told their rights by the company.

These three distinct and specific changes should be made to ensure the gift card market works appropriately in the interest of both consumers and businesses.

Endnotes

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