COMPETITION COMMISSION

PAYDAY LENDING MARKET INVESTIGATION

Annotated issues statement

31 January 2014[1]

Introduction

1. This document provides an update on the progress of our market investigation into payday lending and, in particular, the next steps before we publish our provisional findings later this year.[2] We are publishing alongside this document some working papers summarizing our analysis to date and we will be publishing further papers in the next few weeks.[3] In publishing these documents, we are inviting comment from interested parties and flagging up those competition issues on which we are concentrating our analysis. They will also inform our hearings with payday lenders and others which we will be holding in March.

2. We highlight those issues which we consider are likely to represent the focus of the next stage of our investigation as we draw up our provisional findings and those issues about which we currently have fewer concerns.[4] We also aim to place our investigation in the context of the changes to the regulatory framework, some of which have been announced since we started our investigation.

3. This document and the working papers are informed by our work over the last seven months during which we have gathered an extensive amount of evidence from a wide range of parties through qualitative and quantitative consumer research; submissions; responses to questionnaires; discussions with parties; site visits; and our own desktop research. We have gathered evidence from customers; payday lenders and their representative bodies; lead generators and search engine providers; credit reference agencies; other credit providers, such as banks and home credit providers; price comparison websites; and debt advice charities and consumer groups.

4. At this stage in our inquiry we have not reached any provisional conclusions. Any views set out in this document may change in light of the comments and further evidence we receive; and any further analysis we carry out.

5. All parties are invited to respond to this statement and the related working papers in writing. In particular, where parties consider there are inaccuracies or gaps in our understanding or evidence base, they are invited to provide us with any further necessary evidence. We would expect such written submissions to be the principal means by which parties respond. However, as noted above, we will shortly be holding formal hearings with some of the lenders which have been the subject of our investigation.

6. We invite parties to respond in writing to this statement and the working papers published alongside it by **5pm on Friday 28 February 2014**. Further working papers

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[1] This document was updated on 7 February 2014 with corrected figures in paragraph 34 footnote 25 and paragraph 92 footnote 46.
[2] We are aiming to publish our provisional findings in May/June 2014.
[3] The full list of the papers to be published alongside this document, and planned publication dates for others, are set out in the annex.
[4] This document builds on our issues statement, published in August 2013.

will be published in the next few weeks. We are aiming to publish all the working papers listed in the annex to this document, and referenced throughout, by the end of the week commencing 17 February 2014. Specific closing dates for consultation on each working paper will be notified when they are published. We expect that final comments on the last working papers to be published will be requested by **5pm on Friday 14 March 2014** in order that we can take them into account in our provisional findings.

The context for the Competition Commission's investigation

7. As we noted in our August 2013 issues statement, payday lending has been, and continues to be, an issue which attracts a large amount of political and media attention. Our investigation is taking place against this background and changes to regulation of the sector.[5] The Financial Conduct Authority (FCA) assumes responsibility for consumer credit from 1 April 2014. In October 2013, it published its detailed proposals for the FCA regime for consumer credit, including payday lending. Also, Parliament has recently passed legislation which places a duty on the FCA to impose a price cap on the cost of payday loans by 2 January 2015.

8. We describe in this section our role and specific statutory remit; and how we propose to take into account recent changes in legislation and the regulation of payday lending. We also briefly describe the scale and scope of the analysis we are undertaking to fulfil our statutory role, the progress with this analysis, and, where appropriate, how this might inform the work of others, particularly the FCA.

The role and remit of the Competition Commission and market investigations

9. The Competition Commission (CC) is an independent public body which helps to ensure effective competition between companies in the UK for the ultimate benefit of consumers and the economy. Investigating markets referred to us by the Office of Fair Trading (OFT) or sector regulators is one mechanism through which we do this.[6]

10. In the case of payday lending, the OFT made the reference to the CC on 27 June 2013 under the Enterprise Act 2002 (the Act). The reference followed an OFT examination of the market which concluded that there may be competition problems which needed in-depth investigation. We are now required by the Act to decide whether any feature or combination of features in this market prevents, restricts or distorts competition, thus constituting an adverse effect on competition (AEC).[7] If we find that features of the market are harming competition, we must consider appropriate remedies to address the AEC and/or the resulting detriment: such remedies may include action taken by the CC or recommending action by others.

11. Competition benefits consumers. It encourages suppliers to lower their prices and to innovate and improve the service they provide to consumers. Our investigation seeks to assess how competition for payday lending is working and, if we find a problem, to intervene in the market to make it work better for consumers.

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[5] We summarize the legislative framework governing payday loans and how this is changing in our working paper on the regulation of payday lending.
[6] From April 2014, the functions of the Competition Commission (CC), including those in relation to pre-existing market investigations under the Enterprise Act 2002 such as the payday lending investigation, will be taken over by the Competition and Markets Authority (CMA).
[7] Our guidelines state: 'A market investigation may examine any competition problem and identify the feature causing the problem. It aims only to see if competition within the particular market under review is working well or can be improved and is not seeking to establish general rules and obligations for firms.' (CC3 Guidelines to market investigations (CC3), paragraphs 18–21.)

12. Other public bodies have responsibilities in relation to payday lending. It is the role of the OFT, and the FCA from April 2014, to check and enforce compliance with the regulatory regime. HM Treasury has responsibility for the legislative framework for consumer credit regulation and Government policy on consumer credit. The CC's remit is to investigate, and where appropriate, to intervene to address any perceived failings in a market associated with competition. In fulfilling our competition remit and carrying out an in-depth market investigation, which sheds significant light on the way a market is working, we would expect to highlight issues or provide information which is of relevance to other areas of public policy in relation to that market.

Relationship between our investigation and the regulation of payday lending

13. In carrying out our work, we are mindful of the implications of forthcoming changes to the way payday lending is regulated. As set out in paragraph 7, on 1 April 2014 the FCA will take over the regulation of the consumer credit industry. The FCA aims to ensure firms are 'regulated effectively and that those posing a higher risk to consumers are subject to enhanced supervision'.[8] In preparation for its new responsibilities, the FCA has published proposals for changes to the regulation of high-cost, short-term credit, including payday lending, such as limits to the number of times a loan can be rolled over; and limits to the use of continuous payment authority.[9] Also, the FCA has a new legislative duty to impose a cap on the cost of payday loans by 2 January 2015 and aims to consult on proposals later this year.

14. The relationship between our investigation and these developments is relevant in two ways: first, our work and analysis may inform the FCA's development of its rules; and, secondly, changes to regulation, such as the introduction of a price cap, are likely, as in any market, to affect the nature of competition. We consider each issue in turn.

15. The duty on the FCA to impose a cap was introduced with the objective of protecting consumers against 'excessive charges'.[10] We recognize that our analysis and evidence may be relevant to the FCA's development of its proposals for the form and level of the cap, and its obligations to undertake an analysis of the competition implications of it. We have therefore shared information and data with the FCA, in response to its requests, taking into account our own statutory responsibilities in relation to the information we collect.

16. It is generally accepted that the proposed regulatory interventions such as the introduction of a price cap and other rules governing payday lending will affect competition in this market. For example, the Government recognized that introducing a price cap is likely to affect the way competition works in this market.[11] Similarly, in preparing its detailed proposals for the regime for consumer credit, the FCA considered the effect of its proposals on competition.

17. Depending on its level and the way in which it is implemented, a price cap in particular may significantly affect the incentives of companies to enter the market or the incentives of those within the market to remain in or supply certain groups of customers. It might also affect the way in which firms compete, and in particular the way that lenders compete on prices in order to win and retain customers. Proposals

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[8] Detailed proposals for the FCA regime for consumer credit, CP13/10, October 2013, paragraph 1.4.
[9] The FCA will publish its final detailed proposals in February 2014.
[10] Section 131 of the Financial Services (Banking Reform) Act 2013 states that the FCA rules should be 'with a view to securing an appropriate degree of protection for borrowers against excessive charges'.
[11] See House of Lords Debate on the Third Reading of the Financial Services (Banking Reform) Bill, 9 December 2013 cc 684–688.

for how the cap will be set will not be published by the FCA before our provisional findings.

18. Our assessment of competition is, by necessity, based on how competition is working now and how it has been working over the period covered by our evidence base. In considering whether any features[12] of the market lead to an AEC, we will take into account the impact on those features of any proposed regulatory changes or other changes in the market and in particular whether those changes are likely to strengthen or weaken the features that we find. If we were, in our provisional findings, to identify any feature or combination of features in this market which we provisionally found prevented, restricted or distorted competition, we would consider any potential remedies in the context of the proposed price cap and other regulatory changes. These considerations would inform our final report.

19. We describe below the scope and scale of our analysis and some initial observations based on that analysis. The final section of this document considers the potential implications of our initial observations for our assessment of competition.

Understanding payday lending

20. Market investigations enable the CC to undertake a broad, in-depth assessment of the operation of a market where it is desirable to focus on the functioning of a market as a whole. We have powers, which we have exercised in this investigation, to obtain detailed evidence from companies operating in the payday lending sector either directly by offering loans, or indirectly, by providing brokerage services for Internet-based lenders; and from those providing other credit products or related services.

21. In summarizing our work to date, we describe progress with our evidence gathering and analysis and, where appropriate, any emerging results which we are taking into account in our ongoing assessment of competition.

Defining a payday loan

22. The 'traditional' payday loan involves a relatively small sum unsecured loan repayable on the borrower's payday. There are a range of loan products currently available offering borrowers relatively small sum loans, with different amounts of flexibility regarding when repayments are made. For example, some new products allow repayment in a number of instalments.

23. Although there is no statutory definition of a payday loan, or other terms often used analogously, such as, high-cost, short-term credit, payday lending is defined in our terms of reference. These describe payday lending as 'the provision of small-sum cash loans marketed on a short-term basis, not secured against collateral, including (but not limited to) loans repayable on the customer's next payday or at the end of the month, and specifically excluding home credit loan agreements, credit cards, credit unions and overdrafts'. As noted in the OFT reference, the term payday loans is not used exclusively to refer to loans linked to the borrower's payday.

24. For the purposes of our investigation we define payday loans as short-term, unsecured credit products which are generally taken out for 12 months or less, and where the amount borrowed is generally £1,000 or less. Home credit loan agreements, credit cards, overdrafts, credit union loans and retail credit are all

[12] See paragraph 31 of CC3 for a definition of features.

excluded. In gathering information we aimed to capture information and data about the range of small-sum loan products available including short-term single repayment loans and longer-term instalment products. We also gathered information from other lenders on credit products that fall outside our terms of reference, for example bank overdrafts, home credit and credit union loans. This was to inform our view on the competitive constraint presented by non-payday loan products.

25. Our working paper, **Payday loan products**, provides more detail on the range of products offered by 11 major lenders; the key characteristics of these products; and the applications and approvals process. An appendix to our working paper, **Concentration in the payday lending sector**, sets out further detail about how these 11 lenders were chosen, and our approach to collecting information from payday lenders more generally.

26. Some key characteristics of payday loans identified from our information gathering include:

- Most lenders' minimum loan amount ranges between £50 and £100; the maximum amount offered ranges between £500 and £1,000. Many lenders increase the maximum loan amount available for returning customers, though none of the lenders in our sample offered loans of more than £1,000 for a single initial repayment loan.[13]

- Most products are linked to an individual's payday; a loan will cover the period up to the day on which a borrower is next paid. For some products, if the customer's payday is within a very short period, the loan term will carry over until the next payday. The minimum loan terms that we observe among products that are repaid in a single instalment range from one to 11 days, and the minimum terms are most commonly five to seven days.[14]

- Many payday loan products offer extension facilities, commonly referred to as rollovers. For single repayment products, the most common rollover facility offered by lenders allows borrowers to pay off the interest and fees already accrued, and defer repayment of the loan principal, and further associated interest and fees, until a later date. A small number of the products offered by the major lenders do not allow for extensions of any sort; most limit the number of occasions on which a loan can be extended, generally up to a maximum of three times.[15]

- Some products allow the borrower to increase or top-up their loan before the end of the loan term. These facilities work on the principle that a customer might initially choose to borrow less than the amount they are approved for, or the lender is willing to underwrite, and so is given the opportunity to 'top up' to this higher amount during the course of the loan term.

- There are two standard methods of repayment commonly used by the largest lenders: debit-card-based and cheque-based. Online products are debit-card-based with the borrower allowing the lender the use of a continuous payment

[13] The maximum loan offered in our sample was £2,000 for an instalment product.
[14] A number of lenders offer payday products that allow an individual to borrow for longer periods and make repayments in instalments. These loans are offered for up to, or just over, a year, with repayments generally made at monthly intervals, although some lenders allow a weekly repayment schedule. As with single instalment products, repayment dates are generally tied to the customer's payday
[15] The Consumer Finance Association's code of conduct for its members introduced a limit of three rollovers per loan per customer in November 2012.

authority (CPA). The majority of high street lenders[16] offer both debit-card-based and more traditional cheque-based loans. The latter are where the borrower writes out a cheque, which may be post-dated, for the total amount repayable which the lender agrees not to cash until the end of the loan period.

- If no manual review[17] of the lending decision is required, the approvals process, excluding the time taken for the customer's bank to process transfers, can take under a minute and rarely more than five minutes from the submission of the application form. This includes the time it takes for the lender to approve the application and submit the fund transfer request. If some manual review is required, or the lender requests additional documentation from the customer, approval times can take anywhere from two hours to one week.

- There is variation in the way lenders approve loan applications and there are some differences in approach between online and high-street lenders. High-street lenders review and verify income and expenditure using some form of documentation, such as a bank statement. Online lenders tend to rely on other forms of identity verification such as mobile telephone ownership. Almost all of the lenders considered use some form of credit reference agency data; in addition, many lenders use their own internal data and risk models.

Understanding the demand for payday lending: customer characteristics and use of payday loans

27. In considering the demand for payday lending, we noted that although there has been previous analysis of the scale of payday lending, these studies have generally been subject to limitations in terms of the source of information used, its robustness and its representativeness of the industry as a whole. Previous estimates of, for example, the volume, frequency and size of loans have generally relied on extrapolation from information published by individual companies or surveys. Our analysis of customer and transaction data (**Customers and their loans**) aims to provide a comprehensive picture of the characteristics of payday loan customers and their borrowing behaviour. This involved an analysis of 15 million loans taken out between 1 January 2012 and 31 August 2013, with a total value of £3.9 billion.

28. Similarly, while previous research on consumer behaviour has been informative about issues such as the extent of access to other forms of credit and customer decision-making, these studies have left open a number of questions of central importance to our own inquiry, and have often suffered from certain methodological limitations (for example, limited sample sizes or a lack of representativeness of the industry as a whole). For this reason, in seeking to understand customer demand and what affects it, and the alternatives available to payday loan customers, we commissioned quantitative research on a sample of over 1,500 payday loan customers, as well as in-depth qualitative research interviews with a further 37 individuals. We publish the results of this research with this document—**Research into the payday lending market**.

29. We are also analysing information held by credit reference agencies for a sample of over 3,000 payday loan customers, drawn from our transaction database, to assess the extent to which those taking out payday loans have access to other forms of

[16] High street lenders refers to those lenders who offer loans from a store rather than exclusively online. These stores often offer other services such as pawn broking and money transfers services. The major high street brands include The Money Shop and Cheque Centres.
[17] Online lenders generally make lending decisions using automated systems though some will use staff to review applications and verify information in certain circumstances (see working paper **Payday loan products**).

credit; and to inform our analysis of borrowers' use of payday loans and use of multiple lenders. We will publish our preliminary results from this ongoing analysis in the next few weeks (**Analysis of Credit Reference Agency data**).

Demand for payday loans and some characteristics of borrowers

30. As has been widely reported, recent years have seen a large increase in the demand for payday loans.[18] Our provisional estimate is that in 2012 around 1 million people took out a payday loan in the UK.

31. One debt advice charity told us 'there is a need for short-term credit and there always will be'. Similarly, a mainstream lender noted that payday lenders fulfil a genuine customer need. Our analysis shows that, although we have seen some evidence of a slowing in the rate of increase in the demand for payday loans, growth remains relatively strong. These figures suggest that there is a clear demand for relatively small, short-term loans, a demand which is currently largely being met by payday lenders.

32. Our review of the lenders' transaction data[19] and our customer survey[20] suggest borrowers come from a broad cross-section of the population, although we observed some characteristics that are particular to payday loan customers:

- The average[21] age of a payday loan borrower is 35, with high street borrowers on average slightly older. Borrowers are more likely to be younger compared with the adult population as a whole: the proportion of payday customers aged 18 to 44 is higher than in the general population; the proportion of payday customers aged 45 and over is lower than in the general population.

- Borrowers are more likely to live in larger households and in households with children. They are also over twice as likely to be living in private rented accommodation compared with the population as a whole.

- Around 60 per cent of payday loan borrowers are male. Women are relatively more likely than men to borrow from high street lenders.

- The median net household income of a payday loan customer appears broadly similar to that of the general population, with around half of borrowers reporting net household incomes of below £24,000 per year.[22] On average, high street borrowers had substantially lower incomes than those borrowing from online lenders.

- The geographical distribution of borrowers is broadly similar to that of the general population, though take up is higher in localities categorized as having lower incomes and greater levels of deprivation.[23]

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[18] See paragraph 47.
[19] Customers and their loans (presentation).
[20] Research into the payday lending market report, TNS BMRB.
[21] Based on mean age of borrowers in transaction data.
[22] 35 per cent of payday loan customers have an annual household income (less than £18,000); 36 per cent have an annual household income between £18,000 and £36,000; and 29 per cent have an annual household income above £36,000.
[23] Borrowers are more concentrated in areas categorized as 'financially stretched' and 'urban adversity' under the ACORN classifications. ACORN (acronym for A Classification Of Residential Neighbourhoods) is a geodemographic information system categorizing some UK postcodes into various types based upon census data and other information such as lifestyle surveys. The population is divided into five categories from Wealthy Achievers (25.1 per cent) to Hard Pressed (22.4 per cent). They are also broken down into 17 categories from Wealthy Executives (8.6 per cent) to Inner City Adversity (2.1 per cent) and into 57 categories from Wealthy Mature Professionals, Large Houses (1.7 per cent) to Multi-Ethnic, Crowded Flats (1.1 per cent).

Use of payday loans

33. The amount that customers borrow using payday loans varies, but our analysis suggests the average amount of a payday loan is around £260. 25 per cent of loans are for £100 or less. The average duration of a payday loan is 22 days (excluding longer-term instalment products).[24]

34. We have found that around 65 per cent of loans are repaid in full on time or early. A relatively high proportion of those paid late appear to be repaid late by only one day.[25] We are continuing to assess the reasons for this and the extent to which these borrowers face additional fees and interest.

35. Our survey[26] explored borrowers' reasons for taking out a loan. Borrowers responded as follows:

- Around half said that they used the money they borrowed for living expenses, such as groceries and utility bills.
- Other reasons for borrowing were varied, for example: 10 per cent for expenses relating to a car or other vehicle; 7 per cent for clothes/household items; 4 per cent for a holiday; 4 per cent to pay off other debts (not including other payday loans); 4 per cent for rent or mortgage payments; and 2 per cent for going out or socializing.
- Only 2 per cent of those surveyed borrowed the money to repay another payday loan, though around one-quarter reported needing to have repaid another payday loan in the month before taking out the loan in question.

36. 60 per cent of respondents said that the loan was for something they definitely could not have gone without. 70 per cent said that their need for a loan was linked to a change in their financial circumstances. Of these, over 90 per cent thought that this change in circumstances would be temporary.

37. Repeat use of payday loans, either through rolling over a loan or taking out a further loan, is prevalent. Our initial view is that there is little difference from either the borrower's or lender's perspective[27] between rolling over a loan and taking out a further loan of the same amount shortly after the first loan is paid off. The principal loan amount provided by the lender is the same in both scenarios and both the new loan and rollover facility attract similar charges and interest.[28] We observe a higher proportion of regular repeat use of payday loans compared with use of rollovers.

38. Our initial analysis[29] of repeat customers suggests that:

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[24] Further descriptive statistics from our analysis of the transaction data are published in a separate presentation: Customers and their loans.
[25] We estimate that around 16 per cent of loans not repaid on time were repaid only one day late.
[26] Research into the payday lending market report, TNS BMRB.
[27] There are potential advantages to the borrower from rolling over a loan because he or she does not have to repay the principal at the end of the first loan period.
[28] To illustrate: a borrower taking out a £100 loan for one month who repays in full at the end of the loan period may repay, for example a total of £130 (including interest and charges). If they take out the same loan the following month and repay on time, they will have paid a total of £60 in interest and charges after two months for a single £100 loan owed to the lender over the two-month period. A borrower rolling over the first loan and paying it back at the end of the second month will have paid the same amount in interest and charges and also received £100 (assuming the charges and interest on a rolled over loan are the same as those for a new loan of the same amount). Our analysis of pricing suggests this is generally the case though some lenders charge additional fees for rolling over a loan.
[29] See working paper and presentation: **Repeat customers**.

- Approximately half of new customers (ie customers that have never taken out a loan with a given lender before) either roll-over their first loan, or borrow further amounts from the same lender within 30 days of the original loan.

- The proportion of new customers that roll-over their first loan is similar to the proportion of all loans that are rolled over, at around one fifth. Loans made by high street lenders were more likely to be rolled-over than those made by online lenders. The overall proportion of loans that were rolled over decreased slightly over the period.

- Looking over a longer period, around 60 per cent of new customers go on to take at least one further loan with the same lender within a year of the first loan.[30] On average, our estimates suggest that a payday customer will take out between 3 and 4 additional loans with the same lender within a year of their first loan from that lender.[31]

- Taking into account borrowing from multiple lenders, repeat use of payday loans is likely to be even more widespread. Preliminary results from our analysis of CRA data suggest that a large proportion of payday loan customers take out more than five loans in the space of a year.

39. TNS BMRB's **Research into the payday lending market** provides more information on borrowers' attitudes to payday loans and the alternatives.

The payday lenders

The size and structure of the sector

40. On starting our investigation, we sought to identify the main firms that are active in the payday lending sector, and their size. A single database of payday lenders was not available[32] because, although all lenders must hold a consumer credit licence, the licensing regime did not categorize payday lending separately from other forms of consumer credit until relatively recently.[33] In addition, some lenders hold multiple licences, often operated under different names, and information on whether licences are in use, and the number of loans issued under a licence, was not available. As a result of this, and the absence of a uniform definition of payday lending, we have gathered our own information to estimate the scale of payday lending and its growth over time.

41. We used information from various sources to identify a list of potentially active payday lenders: a list of companies involved in payday lending provided by the OFT; lists of lenders provided by trade associations; desk-based research; and lists of competitors provided by lenders.

42. In gathering evidence from lenders, we sent questionnaires and obtained detailed financial and customer data from 11 major lenders, including both high street and online lenders, and including lenders that collectively provide a range of single

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[30] Including those topping-up, but excluding rollovers.
[31] Again, including top-ups but excluding rollovers.
[32] Such a database will be available in the future. In order to offer loans from April 2014, lenders must have sought and received interim permission from the FCA. The application process for interim permissions includes details on whether lenders offer payday loans. The FCA plans to publish its list of lenders on 1 April 2014.
[33] We note that as part of its preparations for assuming its responsibilities for consumer credit in April 2014, the FCA has been collecting information from different lenders including those defining themselves as involved in payday lending. We will continue to liaise with the FCA to ensure there is broad consistency in the population of companies we are considering and the population of payday lenders on 1 April 2014 as categorized by the FCA.

repayment and instalment loans. The lenders included in this sample operate 16 separate companies in the UK and market loans under around 22 different brands. Collectively, we estimate these lenders accounted for over 90 per cent of both loans issued and payday loan revenue in 2012. We are also analysing financial data and questionnaire responses collected from around a further 100, generally much smaller, lenders.

43. On the basis of the information we have received and analysed to date, we note that, although there appear to be a large number of small lenders operating in this sector, the largest lenders account for most loans issued. We publish separately a working paper, **Background information on the main payday loan companies**, which includes detailed descriptions of some of the major lenders. The three largest suppliers of payday loans in the UK are:

- CashEuroNet UK, LLC (CashEuroNet), a subsidiary of Cash America[34] which is a US-listed company with a market capitalization of approximately $1 billion. CashEuroNet has developed three online lending products: QuickQuid, a payday loan service launched in 2007; Pounds to Pocket, an instalment loan product launched in 2010; and FlexCredit, a running account credit facility launched in 2013. CashEuronet does not have a physical presence in the UK, with no high street stores, and all operations are managed from Chicago.

- DFC Global Corporation (DFC)—a US-listed company with a market capitalization of around $400 million which operates in the UK as Dollar Financial UK Limited (Dollar). Dollar has three subsidiaries offering payday loans on the high street and online within the UK: Instant Cash Loans Limited (ICL), trading as The Money Shop, which is a high street outlet; and MEM Consumer Finance Ltd (MEM), trading name PaydayUK, and Express Finance (Bromley) Limited (EFL), trading as Payday Express, which are both online operations.

- Wonga—a private UK company, backed by venture capital investors. Wonga was founded in October 2006 and launched its short-term consumer loans, ‘Little Loans’, in 2007. It is an online-only business.

44. Other significant lenders include SRC Transatlantic Limited which operates as Speedy Group Holdings and trades as Speedycash and Wagedayadvance; Global Analytics trading as Lending Stream and Zebit; CNG Financial Corporation trading as the Cheque Centre; Oakam Limited; Txt Holdings Limited trading as MYJAR; CFO Lending, which also trades as Payday First; and PDL Finance trading as Mr Lender.

45. Based on our information and data gathered, and our analysis of it, we have made some preliminary observations on the size of the sector and recent growth trends:[35]

- Based on our analysis, during financial year 2012,[36] payday lenders issued approximately 10.2 million new loans worth around £2.8 billion. The revenue

[34] Enova International Inc is a separately incorporated, 100 per cent subsidiary of Cash America through which worldwide online based activities are operated.
[35] This information summarizes information from two forthcoming working papers: **Profitability of payday lending companies** and **Concentration in the payday lending sector**. More detailed information about payday loans including about customers, duration of loans, rollovers and repayment patterns are set out in: **Customers and their loans.**
[36] Includes financial years ending July 2012 to June 2013 inclusive.

generated by lenders from these loans was around £1.1 billion. Payday lending therefore remains a relatively small proportion of overall unsecured debt.[37]

- The figures for payday lending in financial year 2012 represent significant growth compared with 2011: the volume of loans increased between 2011 and 2012 by over 35 per cent; the value of new loans issued increased by around 45 per cent; and the revenue generated increased by around 40 per cent.

- The rate of growth in payday lending appears to be slowing though it remains relatively high. For example, our analysis indicates annual revenue growth for the major online lenders between 2009 and 2010 exceeded 130 per cent. Annual revenue growth slowed to around 40 per cent for this group in 2012 and the limited data currently available for 2013 suggests that rates of revenue growth may be slowing further.

- Around 80 per cent of total payday loan revenue in 2012 was generated by online lending.

- Of newly-issued loans in 2012: the largest three lenders accounted for nearly 70 per cent of loans and 75 per cent of loan value; and the largest ten lenders accounted for just under 90 per cent of loans and value.

Costs and profitability

46. We sought to understand the business models and costs to firms of providing loans, such as, default costs and the costs of customer acquisition; and the profitability of payday loan companies. This analysis will inform our understanding of how competition works.

47. We will shortly publish our working paper, **Profitability of payday lending companies**. This looked at the period since 2008 across a range of lenders. It sets out our methodology and approach. Some preliminary observations from this work are:

- Overall, lenders have derived an increasing proportion of revenue from fees and charges over the period though interest income was the major source of revenue, representing on average around 80 per cent of total revenue in the financial year 2012. In considering further the revenue of payday loan companies, we are taking into account our analysis of the pricing of payday loans (see below).

- The most significant costs faced by lenders are the costs of default and customer acquisition costs.

- Return on equity has varied considerably across the period and varied between lenders. Some lenders have achieved returns of between 15 per cent and over 100 per cent; other major lenders are not profitable.

48. We are considering these costs in more detail. Levels of default appear to have generally fallen in 2012. The principal loss rate, which takes into account the proportion of the principal lent which is recovered,[38] is currently our preferred

[37] According to the Bank of England, the total amount of unsecured lending to individuals outstanding at 30 September 2013 was £158.7 billion, of which £57.2 billion was credit card debt and £101.5 billion was other forms of unsecured debt, including payday loans.
[38] The principal loss rate is defined as 1-(loan principal collected/loan principal issued) for a given financial year.

measure on which to judge risk. This appears to vary between companies from less than 10 per cent to 50 per cent. We are considering evidence which suggests there is a link between the number of loans issued by a company and its principal loss rate, that is, the more loans a company makes over time, the lower its principal loss rate; and how other factors, such as levels of repeat borrowing, may be affecting profitability.

49. Customer acquisition costs take the form of advertising expenditure and, for online lenders, payments to third party sources, especially 'lead generators'.[39] The split between these costs between different online lenders varies considerably.

50. Spending by lenders on acquiring potential new customers through online auctions operated by lead generators is likely to remain an important focus of our investigation. We observe that lenders are willing to pay substantial amounts to lead generators for high quality leads, a proportion of which will not result in a loan being taken out. The amount paid for these leads is, in some cases, greater than the total amount of interest and fees charged by most lenders for a £200 loan. This amount is reported to have increased substantially over recent years, as competition in lead auctions has increased. We note the possibility that lenders' willingness to bid large amounts for leads may be indicative of the expected profitability of the customers sourced. We are continuing to consider what this tells us about profitability and competition between payday lenders and propose to explore this issue further with lenders.

51. Our analysis suggests the profitability of some of the major lenders, including the three largest lenders, has been high across a significant part of the period under review. We are considering the extent to which the industry is continuing to develop and how this might be relevant for our interpretation of the high level of profitability observed; and whether additional approaches to evaluating profitability may be appropriate for any period associated with the higher risks inherent in start-up companies.

Competition in the payday lending sector

Competition from other forms of credit

52. As part of our assessment of competition, we are considering the extent of the constraint on payday lenders from providers of other forms of credit (see working paper: **Competition between payday lenders and other credit providers**). Our analysis of this constraint is framed around three key issues. First, we are considering whether other credit products have similar characteristics to payday loans. The more similarities that potential alternatives share with payday loans, the more likely customers will be to switch to these products if payday lenders were to worsen their offering. Second, we are assessing borrowers' access to other credit products. If payday loan customers are unable to access other forms of credit, perhaps because of poor credit ratings, they will not be able to switch to these alternatives. Third, we are assessing the extent to which there is any direct evidence showing payday lenders competing with non-payday lenders.

53. Our analysis to date suggests:

[39] Lead generators are credit brokers which provide lenders with customer applications, generated via websites that they operate, in return for a fee.

- Credit cards and overdrafts share a number of characteristics with payday loans. Other credit alternatives generally differ more significantly in that they do not allow small amounts to be borrowed; do not enable customers to access funds as quickly as when using a payday loan; and may require borrowers to put up some security against the loan.

- Nevertheless, our survey suggests that only a very small proportion of payday customers (around 2 per cent) would have used a credit card or overdraft to borrow the money had their payday loan not been available, and that instead, borrowers would generally have either gone without the loan, or borrowed from friends or family.

- One possible reason for this is that many payday customers do not have access to other forms of credit when they take out their payday loan. Around 40 per cent of survey respondents said that they could not have used any alternative credit source to borrow the money (excluding borrowing from friends and family); 18 per cent said that they could have used a credit card and 20 per cent said that they could have used an overdraft. Our survey also showed that many borrowers had experienced problems using other types of credit in the past: 29 per cent had been turned down for credit in the last 12 months; and 52 per cent had experienced debt problems in the last five years.

- Other possible reasons for the limited extent to which payday customers appear willing to substitute to overdraft and credit cards which were highlighted by our qualitative research were the lack of discipline associated with borrowing on a credit card, the high cost of borrowing using an unauthorized overdraft, and a dislike of hidden charges.

- We have seen little evidence of payday lenders taking the actions of providers of other credit products into account when setting their own offering, or of other credit providers changing their own behaviour to compete directly with payday lenders.

54. Our current view is that the lack of substitutability and access to other credit products suggests that providers of other forms of credit will provide little competitive constraint on payday lenders.

55. The working paper, **Competition between payday lenders and other credit providers**, summarizes the evidence and analysis to date and includes a comparison of the pricing of payday loans and other forms of credit under different scenarios.

Competition between payday lenders

56. We are assessing the nature of competition between payday lenders and the product dimensions on which this takes place. This includes a consideration of price competition and product innovation as a non-price aspect of competition. This analysis is summarized in two working papers: **Pricing of payday loans** and **Competition in product innovation**.

Price competition

57. We have undertaken a detailed analysis of pricing structures and levels, examining the current cost of borrowing using a payday loan, and how this has changed over time. As part of this analysis, we are publishing a working paper which reviews the

different pricing structures that exist in the payday lending sector; and compares variation in prices across lenders within and across different representative customer scenarios. We are also publishing a slide pack showing our analysis of the pricing of payday loans over time.

58. Our preliminary observations from the analysis of payday lenders' prices include:

- Each payday loan product carries its own set of charges, each with its own conditions and rates. Those rates may be calculated differently across lenders, products and customers.

- For many lenders, prices cluster around £30 for a one-month £100 loan repaid on time. However, we do observe some significant variation, with some lenders charging over £45 (primarily due to expensive optional faster payment fees[40]), and others charging £25 or less. This continues to be the case when only traditional payday products are considered. Some lenders are significantly cheaper for loan durations shorter than one month.

- The variation in the prices of different lenders where loans are repaid late is very substantial. The total cost, including fees and interest, to a customer of a £100 one-month payday loan that is repaid 11 days late can vary from around £40 to over £90, depending on the product.

- There are some changes in price rankings as loan duration or borrowing behaviour changes: some products that are relatively cheap when used to borrow for short periods or when repaid on time become relatively expensive when borrowing for longer or when repaid late, and vice versa.

59. Based on our analysis of how prices have changed over time, we observe:

- headline price changes are infrequent and there are very few reductions in interest rates and fees in the period since 2008;

- prices for loans repaid on time have, while increasing over time, also exhibited some convergence over the period; and

- price promotions are used by all of the larger lenders to varying extents. Few of the small lenders use discounts.

60. We are continuing to analyse the evidence on those occasions where pricing changes have been made and the use of discounts by lenders. We are also working to put our observations on pricing in the context of any changes in costs to lenders. However, we note that the infrequent price changes we observe are despite the context of substantial changes in the size of the lenders' operations in recent years and the ongoing development of the market. The evidence that we have seen to date suggests that the extent to which lenders compete on prices is limited.

Non-price competition

61. We also considered the extent to which we observe lenders altering the non-price attributes of their loans in order to win customers. We are publishing a working paper, **Competition in product innovation**, that underpins this assessment. This

[40] These are charges for faster transfer of funds into a borrower's bank account.

paper considers the most significant product innovations introduced in the market in recent years, as well as evidence on the rationale behind these innovations.

62. We observe a number of occasions where lenders have introduced new products or made changes to existing products in the period since 2008, most significantly:

- a number of lenders have introduced the facility for customers to draw down further funds during the term of a loan;
- although they remain only a small proportion of the loans offered by the lenders we considered, instalment loans are becoming increasingly available and a number of lenders have introduced either loans specifically designed to be repaid in instalments or the option to do so; and
- over the years lenders have introduced faster payment services, and these are now offered by the majority of providers. Many, though not all, have also removed the fee charged for this service.

63. Lenders have told us that, on many occasions, the rationale behind these changes has been to win and retain customers. Our consumer survey supports the importance that customers place on repayment flexibility and the speed of access to funds.

64. Taken together, the evidence suggests that there has been some competition between lenders on non-price loan attributes in the period since 2008, meeting customer demand for quicker access to funds and greater flexibility over repayments and drawing down funds.

The relevant market

65. As set out in CC3, and our original issues statement, in defining the relevant market, the CC identifies the participating firms and customers and the traded products in the market(s) that are the subject of the reference. This enables the CC to focus on the sources of any market power and provides a framework for its assessment of the effects on competition of features of a market.

66. Market definition is thus a useful tool, but not an end in itself, and identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of the CC's competitive assessment of a market in any mechanistic way. The competitive assessment will take into account any relevant constraints from outside the market, segmentation within it, or other ways in which some constraints are more important than others. Our definition of the relevant market provides the framework within which we make our assessment of competition.

67. In considering the relevant market, we assess:

(a) whether any products other than payday loans are sufficiently strong competitive constraints to be included within the same market;

(b) whether within payday lending, there are distinct geographic markets; and

(c) whether within payday lending, there are distinct markets for different types of payday loan product, or for different groups of customers.

68. On the basis of our analysis to date, we are not presently minded to define the product market as being wider than the definition of payday loans we have adopted. As set out in paragraphs 53 and 54, the evidence that we have seen suggests that other types of credit are likely to offer little competitive constraint on payday lenders.

69. The evidence that we have seen to date also does not suggest that we should consider geographic markets smaller than the UK. We will shortly be publishing a working paper, **High street competition**, on the local dimension of competition between payday lenders and competition between high street lenders and online lenders. Our initial observations are:

- Around 80 per cent of payday customers take out their loan online. For these online loans, the relevant market will be UK-wide.
- Apart from the way in which customers apply for their loan, high street and online payday loans share many characteristics and are priced at similar levels. There are, however, some differences in the customer groups served, with high street customers generally having lower incomes and being older than online customers.
- Our survey suggests that half of high street customers that have taken out more than one loan have also used an online lender.
- There is little direct evidence to suggest that high street lenders compete particularly strongly with each other. We note that very few high street lenders (and none of the largest ones) vary any aspects of their offering locally.

70. As discussed in paragraph 97, initial evidence suggests that local barriers may not be significant for existing payday lenders looking to move into a new area.

71. We note that, in considering segmentation within payday lending, although we do observe differences in the products offered by different lenders, most products allow customers to borrow similar amounts for similar lengths of time and competitive conditions appear similar across the different products meeting the payday definition. Similarly, although there is a clear difference between online and high street loans in terms of how customers apply for the loan, a significant proportion of high street customers have either used or considered using an online lender. Given this we are not presently minded to treat these as distinct markets.

72. We welcome comments on these initial views.

Our theories of harm

73. We summarize above some initial observations on payday lending including the evidence we are considering on market characteristics and outcomes, such as, prices and profitability, levels of innovation, product range and quality. As noted in our guidance, such outcomes of the competitive process in their different forms can provide evidence about the functioning of a market. Evaluating these outcomes helps us determine whether any features of the market give rise to an AEC and, if so, the extent to which customers may be harmed by it.

74. To provide focus and structure to our assessment of the way competition is working in a market, we set out one or more ‘theories of harm’. A theory of harm is a hypothesis of how harmful competitive effects might arise in a market and adversely affect customers. Focusing the competitive assessment on the testing of theories of harm helps us understand the market and to evaluate evidence so as to be able to

decide the statutory question of whether or not there is a prevention, restriction or distortion of competition and, if so, identify what features are causing it.

75. In our August 2013 issues statement, we identified two theories of harm: impediments to customers' ability to search and identify the best value product, and switch supplier; and market power and barriers to entry and expansion. In this section we provide an update on our thinking on these theories of harm and how this has developed in light of the evidence we are considering and analysis we are carrying out. We describe how the evidence summarized above might inform our assessment of these theories of harm and describe how we are proposing to bring together our various pieces of analysis to test these theories. Where we are able to do so at this stage, we provide an indication of issues which might be giving us cause for concern, and therefore where we are concentrating our analysis, and areas where we are less concerned.

76. On both issues, we will shortly publish working papers in which we will set out in more detail the evidence that we have reviewed to date and some discussion of the potential implications for how competition is working (see working papers: **Shopping Around**; and **Entry and Expansion**). We will develop this work further in the light of responses to this document and the working papers, and our further analysis.

77. Our theories of harm are not mutually exclusive, and aspects of the market, that may have an impact on how customers shop around or switch lenders, may also have an important influence over the dynamics of entry and expansion by new lenders, and vice versa. In our provisional findings, we will present an analysis of how the market is working and whether there are features, or a combination of features, within the market which we provisionally consider are preventing, restricting or distorting competition.

78. We have not identified any new theories of harm as a result of our work to date; and our consideration of the evidence has not led us to discount either theory of harm at this stage in the investigation.

Impediments to customers' ability to shop around and switch supplier

79. In a market in which competition is working effectively, firms will be incentivized to keep their prices down and the quality of their products high because if they do not do so, customers will choose alternative suppliers. If barriers exist in the market that prevent customers from effectively shopping around for their loan or from switching lender, then firms may be able to exploit these barriers and exert market power.

80. In assessing this theory of harm we are considering a number of related issues. These include assessing how much shopping around by customers we observe; whether there are costs to them in doing so; and whether there are barriers which make it difficult to identify the best loan for them. In assessing switching, we are similarly looking at the extent of switching between payday lenders by customers and whether there are costs associated with them doing so and/or factors that reduce the perceived benefits of doing so.

81. Our consideration of these issues will be informed by a range of analysis and evidence including our customer research, both quantitative and qualitative; the analysis of transaction data including our sub-sample of borrowers for whom we have credit reference agency data; and an assessment of how lenders present information to potential borrowers. In what follows we present our preliminary observations on these issues to date.

The extent to which payday loan customers shop around for their loan

82. The evidence that we have reviewed suggests that there are a number of different information sources which are used by payday loan customers prior to taking out a loan. These include: advertising; web searches; lenders' websites and, where relevant, high street stores; comparison websites; and personal recommendations.

83. Our customer survey suggests that a large proportion of payday loan customers do not shop around prior to taking out a loan. Seven out of ten customers reported that they had not shopped around prior to taking out their most recent loan, and six out of ten customers reported never having done so. Online customers are more likely to shop around than high street customers.

84. We are continuing to consider the effectiveness of the shopping around that does take place. Of the minority of borrowers that did shop around, our survey suggests that most found out how much it would cost to borrow the amount required from another lender (nine out of ten) and how quickly the other loan would be granted (eight out of ten). Of those who told us that they compared loans with different lenders, around two-thirds found out the charges from different lenders if they did not pay back on time. Of the approximately three in ten online customers who shopped around, half reported visiting the websites of more than three lenders.

Potential barriers to shopping around

85. We are considering three potential barriers which could inhibit the extent to which customers effectively shop around prior to taking out their loan. In all cases, we propose to explore the potential impediments further in our ongoing analysis and in our discussions with lenders and other parties. We summarize below the issues we are considering in relation to these three potential barriers.

86. First, we are considering whether customers have weak incentives to shop around effectively for a payday loan. Most importantly, this could be the case because of the value customers put on speed and the perceived, or real, urgency to obtain credit quickly. Most products allow funds to be accessed within a matter of minutes or hours, and we note that the speed of access to funds is often given a large degree of emphasis on lenders' websites and in their promotional materials. If the value that borrowers place on speed is high—as this initial evidence suggests—then we may expect customers to perceive time spent shopping around to be costly.[41]

87. Second, we are examining the information available to borrowers and the extent to which restrictions may exist on the availability of—or ease of access to—the information required to shop around effectively (see **Review of online lenders' websites**). Our review suggests that key information on the cost of a particular loan, assuming it is repaid on time, is available, and can generally be easily found on lenders' websites.

88. Compared with other financial products, traditional payday loans are relatively straightforward. Our qualitative research suggests that some customers, with access to either a payday loan or an unauthorized overdraft, considered the charges of an overdraft to be hidden compared with those of a payday loan. Most parties told us that the representative annual percentage rate (APR), which payday lenders are required to display, is not particularly helpful in helping borrowers to compare short-

[41] For example, when asked to indicate the importance of different product characteristics, speed was most often chosen as the most important.

term loans or work out the total cost of credit. We note that banks are exempt from the requirement to display a representative APR when publishing their overdraft charges.

89. Although payday loans are relatively straightforward and the way information is displayed about the total costs to be repaid is often clear, customers may encounter difficulties comparing the attributes of loans from different lenders. This may be the case if they try to take into account potential additional charges, such as late payment fees, and where different lenders have different pricing structures.[42] We are considering the role of comparison websites in easing these comparisons.

90. The prevalence of lead generator websites, which are visually similar to those of direct lenders, may also make it difficult for lenders to compare. A web search for payday-related terms will often generate a mixture of direct lenders and lead generators. Typically neither the name of the product or lender, nor the text accompanying these search results, will identify the target website as belonging to a lead generator rather than a lender.[43] We note that responses to our survey suggested that only 7 per cent of new payday loan customers reported having applied via a third party—this is substantially lower than our estimates based on the transaction data that 35 per cent of all new customers apply via a lead generator.

91. Also, we note that one of the key pieces of information,[44] that is not available to a borrower until they have applied, is whether they will be approved for a loan. When set alongside the importance that customers attach to speed, as discussed above, this may result in customers basing their decision on which provider they consider will approve their application, rather than on the merits of the different loans on offer. To the extent that customers have an understanding of the service offered by lead generators, the significant number of applications that come via these websites suggest that the uncertainty is leading many customers to forgo a comparison of different lenders' products entirely.[45]

92. Third, some borrowers may be over-optimistic about their ability to repay and, if so, they are likely to pay insufficient attention to the fees and charges associated with repaying a loan late. This is because they may underestimate the relevance of these charges to themselves. We note that, as set out above, a significant proportion of payday customers repay late or rollover.[46] There is also evidence from our survey that some customers may not compare late fees between lenders or be fully aware of late fees until they come to pay them.[47]

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[42] The pricing complexities are set out in our working paper: **Pricing of payday loans**.
[43] Although the nature of the service offered by the lead generators will generally appear on their websites at some point.
[44] Our evidence suggests that for a large proportion of customers, the level of uncertainty about loan approval may be substantial. For example, the rate of refused loans is often well over 50 per cent for many of the major lenders. A significant number of prospective borrowers are therefore likely to see an application refused by some lenders before being approved.
[45] Customers using a lead generator will not find out which lender they have been matched with—and so the terms of the loan that they are being offered—until after the online auction between lenders (known as the ping tree) has been completed. The ping tree process takes place in real time but is not visible to the borrower who is simply referred to the website of the lender which has bid the highest price for the lead.
[46] Of the loans issued by the 11 major lenders, 20 per cent were rolled over in 2012 and around 35 per cent of loans issued in 2012 were repaid in full late, or never repaid in full.
[47] Around 40 per cent of respondents had ever shopped around for a payday loan. Of these, 91 per cent gathered information on the total cost of the loan; 64 per cent collected information on late payment fees. The qualitative research suggested that some customers become aware of late payment fees only if they end up paying them.

Potential barriers to switching

93. We are also examining potential barriers to customers switching lender.[48] Our preliminary assessment of the evidence suggests that a very substantial proportion of loans issued by lenders are to borrowers that have previously used payday products.[49] These repeat customers may face a different choice—and experience different trade-offs—to new customers. Initial evidence also suggests that a significant proportion of borrowers have experience of multiple lenders.[50] A key issue that we will continue to assess is the extent to which use of multiple lenders is being driven by a lack of availability (ie customers being unable to access additional credit from lenders that they have used previously, or lenders that they are using at the same time), rather than customers changing lender in order to get a better deal on their loan.

94. We are examining three potential barriers to switching:

- First, borrowers may be deterred from switching by the perceived inconvenience associated with doing so. For those customers rolling over an existing loan, this may include the potential complexities involved in arranging the transfer of funds such that a new loan is received in sufficient time to repay the outstanding debt.

- Second, we have noted that many customers are likely to face significant uncertainty about whether or not they will be approved for a loan. This may act as a disincentive to switch lender. A borrower that has been approved for a loan by a lender in the past is likely to expect to be approved if they seek to borrow a further amount from that same lender in the future, assuming they repaid the previous loan on time. However, that borrower may face greater uncertainty about whether or not they will be approved for a loan if they are to use an alternative lender, who may take different factors into account in their credit assessments, and will generally not have access to detailed information on that customer's repayment history.

- Third, lenders may offer repeat customers an incentive to stay with them. In particular, it is relatively common for payday lenders to allow repeat customers to borrow greater amounts.[51] Rival lenders may not be able to match these terms, if they do not have access to the credit history information of individual customers, potentially locking customers in to their incumbent supplier.

95. We are continuing to consider these issues in more detail and will explore them further in our working papers.

Market power and entry and expansion

96. As set out above, the payday loan market is relatively concentrated, with the three largest lenders accounting for nearly 70 per cent of payday loan revenue. Nevertheless, we note that there are a large number of suppliers active in the payday lending sector. In considering this theory of harm, our focus is on the extent to which

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[48] Our work on switching will be informed by the analysis summarized in the forthcoming presentation on **Repeat Customers**, based on analysis of the transaction data, and the **Analysis of the Credit Reference Agency** data.
[49] Around 80 per cent of loans issued by the major lenders are to customers to whom they have lent previously.
[50] In our customer survey, we found that 44 per cent of respondents reported having used more than one lender, and nearly one-quarter reported having used three or more lenders. Preliminary results from our analysis of CRA data also suggest that a significant proportion of payday customers have used multiple lenders.
[51] Some lenders offer repeat customers lower interest rates although we only observe a very limited amount of pricing of this type among the largest lenders.

there are barriers to entry and expansion by new and existing lenders which adversely affect competition. In particular, we are examining barriers to expansion by new entrants or smaller lenders; that is, whether barriers exist which make it difficult for new and smaller lenders to exert a competitive constraint on larger, established lenders. Our working paper on entry and expansion sets out the potential barriers which we have identified and summarizes some of the evidence that we have received to date.

97. In considering this issue we note that the payday loan market is developing and has grown in size very significantly in the period between 2008 and 2012. We have observed continuing entry by smaller lenders throughout the last five years particularly online. There has also been significant growth on the high street, particularly by existing lenders. For example, large numbers of new high street stores were opened between 2010 and 2012, particularly by Cheque Centre and Dollar. There are some signs that many of the high street lenders have slowed the rate at which they have been opening stores since 2012. We are continuing to examine the evidence on entry costs, which varies, but our initial analysis suggests that the costs of entering new local areas has not been a major barrier to entry in recent years.

98. We are considering whether conditions are such that entry, or expansion by existing new, small lenders, either online or on the high street, would be more difficult than it was at the time when the major lenders entered and grew their businesses. The proposed changes to the regulation of payday lending, and the impact of these changes on the reputation of the sector, are factors which we are taking into account in our assessment. We are primarily concentrating on three potential barriers: those relating to customer information; customer acquisition; and reputation.

99. The customer information that is available is important for lenders because it is a significant contributory factor to the extent of their likely default rates, a key driver of costs and therefore profitability. We estimate that these costs make up nearly half of total industry operating costs, suggesting that differences in lenders' ability to assess risk may have a significant impact on their ability to compete.

100. We find that payday lenders reject a significant proportion of customers. In deciding which applications to approve or refuse, the companies use a combination of information from their own databases, and information purchased from CRAs. We note that for a given set of applicants, and assuming identical risk appetites, a new entrant is likely to face higher default rates, and therefore costs, than an established lender. This is because the new entrant:

- will hold less information on customer behaviour, and so it will be less able to accurately predict defaults; and
- will be reliant to a greater extent on higher-risk new customers.

101. Our consideration of customer acquisition costs is focusing on the costs of building a brand primarily through advertising or acquiring customers through third parties (the second largest category of costs for most lenders). Both routes may be affected by changes in regulation. We are considering the extent to which established lenders may have an advantage, having already established their brand presence as the market emerged, such that the investment required by a new entrant to challenge them would be prohibitively large. We are also considering whether established lenders may have an advantage when competing to acquire new customers from lead generators.

102. We are considering the extent to which the political and media attention centred on disreputable lending practices and the social costs of payday loans may deter or restrict lenders that are considering entering the payday market. Reputation risk has been highlighted as a constraint to entering the market by some mainstream lenders, such as banks. A further barrier related to the sector's reputation may arise from restrictions on new lenders' access to banking services, or if this leads to an increase in the cost to firms of funding entry or expansion in the sector. We are assessing the extent of any lack of access to banking services among possible entrants and, if so, what may be motivating it.

103. We are considering how widespread the concern is about the reputation of the industry among mainstream lenders and whether they would enter absent this concern. We will take into account the potential implications of greater regulation which is intended to drive out some of the lending practices which have been highlighted in the media.

104. We are also considering the extent to which any other factors might impede lenders' ability to enter or expand in the payday sector, including whether there are any restrictions on lenders' ability to access finance, and the effect of the FCA's proposed changes to the regulatory regime on the regulatory uncertainty facing lenders and their costs of compliance.

105. We propose to explore these barriers further in our ongoing analysis and in our discussions with lenders and others.

Next steps

106. We will continue to consider these issues further, taking into account our analysis and responses to this statement and our working papers. This work will inform our provisional findings which we propose to set out in May/June 2014.

List of working papers and other published documents

Paper/document	*Publication*
Research into the payday lending market—results of quantitative and qualitative research undertaken by TNS BMRB	31 January 2014
Customers & their loans—presentation based on analysis of the transaction data	Mid-February
Repeat customers—working paper and presentation based on analysis of the transaction data	Mid-February
Background information on the main payday loan companies	31 January 2014
Concentration in the payday lending sector	Mid-February
Payday loan products	31 January 2014
Competition between payday lenders and other credit providers	31 January 2014 (annex on pricing comparisons to follow)
Local competition	Mid-February
Pricing of payday loans	Mid-February
Competition in product innovation	31 January 2014
Shopping around	Mid-February
Review of online lenders' websites	31 January 2014
Analysis of Credit Reference Agency data	To be determined
Regulation of payday lending	31 January 2014
Entry and expansion	Mid-February
Profitability of payday lending companies	Mid-February