Evidence

Response to the Competition Commission Statement of Issues on the payday lending market

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Introduction

The Citizens Advice service provides free, independent, confidential and impartial advice to everyone on their rights and responsibilities. It values diversity, promotes equality and challenges discrimination.

The service aims to:

- provide the advice people need for the problems they face
- improve the policies and practices that affect people's lives.

The Citizens Advice service is a network of around 350 member bureaux that provide free, impartial, independent and confidential advice from more than 3,500 locations in England and Wales, including GPs' surgeries, hospitals, community centres, county courts and magistrates courts, and mobile services both in rural areas and to serve particular dispersed groups.

In 2011/12 the Citizens Advice service in England and Wales advised 2.03 million people on 6.9 million problems. This included 129,092 about financial products and services and 2,137,810 about debt.

Payday lending

We welcome the opportunity to respond to the Competition Commission's statement of issues published as part of its payday lending market investigation.

The Citizens Advice service has seen a ten-fold increase in the proportion of clients receiving casework help with multiple debts which included a payday loan debt in the last four years. In the first quarter of 2009/10 only one per cent of CAB debt casework clients had at least one payday loan and in the same quarter of 2011 this had risen to four per cent. In the same quarter of 2012, 10 per cent had at least one payday loan.

At its most fundamental level, we believe the key issue with the payday lending market is that the structure and characteristics of the market create competitive advantages for firms who engage in misconduct and fail to observe relevant regulations and law.

Competitive incentives to lend irresponsibly

Incentives to lend irresponsibly largely stem from the likelihood that customers and potential customers of payday lending firms are in urgent need of money and may not have access to any alternative sources of credit, or think they have no alternative[1]. We believe this leads to a greater degree of price insensitivity among payday lending customers than is seen among customers using other forms of credit. In turn, lenders

[1] 'The impact on business and consumers of a cap on the total cost of credit', Personal Finance Research Centre, University of Bristol: http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/total-cost-of-credit.html

appear to compete on the speed with which they can deliver the loan into their customers' bank accounts rather than the cost of their loans.

In and of itself this is not necessarily a problem, but it becomes one in this market because making a responsible lending decision for customers who may have a poor credit history can take time and involve checking documents.

A lender who pauses the application process to make certain a customer is able to repay their loan on time without incurring any extra costs or extending the term faces losing that customer to a lender who is willing to lend irresponsibly.

The latest analysis of the Citizens Advice payday lending survey[2], which now covers the three quarters from November 2012, found that only 38 per cent of respondents said they had been asked any questions about the affordability of their loan.

Price insensitivity

In a properly functioning market, irresponsible lending and competition on speed would see the operating costs of the riskier firms increase to the point where they would have such significant default rates on loans that they would struggle to remain profitable, but the reverse often happens in payday lending for a number of reasons.

As mentioned above, payday lending customers are relatively insensitive to price so the cost of a loan can be increased via interest rates or through fees and charges for extending the loan term or missing payments, without deterring customers.

Continuous payment authorities

Payday lenders have a mechanism of making collections which is both low-cost per transaction and gives a great degree of control over customers' bank accounts: continuous payment authorities (CPAs). These allow payday lenders to effectively install themselves as priority creditors given that they can take payments from customers' accounts almost as and when they feel like it.

We see evidence of payday lenders taking multiple payments on the same day without warning and repeating the process until there is no money left in the account, leaving their customer with no money to pay other bills. We also see evidence of firms doing this as soon as they believe a customer has hit financial difficulty. Effectively this also leaves them dependent on another payday loan to make ends meet.

> **A CAB in the South of England** reported a case where a woman with three dependent children was struggling financially after a payday lender had used a CPA inappropriately. She had fallen into arrears on her loan repayments but, rather than seek to agree an affordable repayment plan, her lender used CPAs to withdraw over £800 from her account the day she was paid. This left her in arrears on her rent and reliant on a food parcel to feed her family.

[2] Payday loan customers have provided Citizens Advice with feedback through an online survey, questionnaires in Bureaux and face to face surveys on high streets. The survey was promoted widely through national media, consumer organisations and financial institutions.

In July this year we added additional questions about the use of CPAs to the payday lending survey to mirror the BIS survey which took place from July until mid-August. Although from a smaller sample, we found that 43 per cent said they had repaid their loan via a CPA. However, a further 35 per cent believed they had repaid their loan via a direct debit, suggesting significant confusion about the use of CPAs and backing up the OFT's finding that customers were not always fully informed or aware of the method of repayment.

Of those who said they had used a CPA, 79 per cent did not feel the payment method was explained to them and 95 per cent said the process for cancelling a CPA was not explained.

35 per cent of respondents who repaid using a CPA said their lender had contacted them three days before payments were taken but only 18 per cent said they had been sent reminders that a CPA was in use. This anomaly further backs up the notion that customers are often not fully informed about CPAs and how they work.

Because payday lenders know when their customers get paid they can ensure they are at the front of the queue of other creditors – a position they do not deserve when looked at in the context of priority creditors where the consequences of non-payment can be severe, such as eviction of a customer from their home or having their gas and electricity supply cut off.

Rollovers form a key part of lenders' business model

Drivers of payday lending behaviour can be seen in the OFT's compliance review of the market finding that 50 per cent of lenders' revenues came from customers who rolled over a loan. This shows emphatically that customers who can't afford to repay on time and roll over loans are attractive propositions, and lending to them is in the interests of payday lending firms if they are willing to behave irresponsibly. It demonstrates unmistakably that there is a competitive disadvantage for firms who obey the relevant regulations and law.

Looking at it another way, it also shows that the people who can afford it least end up paying the most to payday lenders.

Forbearance is rarely given

Citizens Advice evidence also suggests lenders use rollovers in lieu of forbearance and proper affordability checks. Our survey found that 76 per cent of respondents said that they had difficulty repaying the loan. Of these respondents, 54 per cent said it was not easy to contact their lender, 18 per cent said their lender dealt with them sympathetically, and only 17 per cent said their lender offered to freeze charges and interest if a reasonable repayment plan was agreed. Worryingly, only 9 per cent said they were advised to seek debt advice.

Of customers who had difficulty repaying the loan, only 18 per cent said the risks of extending their loan were explained to them while 37 per cent reported that they had the costs of extending the loan made clear. Only 6 per cent said their lender made any checks on their ability to repay an extension or rollover.

> **A CAB in the North East** advised a man who had two payday loans, for £224 and £285. He had rolled both loans over twice and their balances had reached £554 and £453 respectively. He was not able to afford to pay either loan back and feared they would be taken from his account via a CPA, leaving him without money and dependent on another loan to pay his bills.

Lack of transparency of the costs of payday loans

The ability of customers to compare costs is impaired by the variety of ways in which the total cost of credit may be presented. While typical APRs and the cost to borrow £100 offer a useful comparison for loans paid back within the original loan term, a large proportion of payday loans are rolled over, incurring additional fees and charges as well as interest. These vary between lenders and make it hard to fully understand how much a loan will cost, as well as difficult to compare the cost of switching to another lender to pay off a loan which would otherwise be rolled over.

Incumbent lenders also have an advantage over their competitors in as much as they know when a loan term ends and can proactively seek to encourage or even pressure borrowers into extending the term of the loan before they have a chance to look at alternatives.

Market concentration

The concentration of the market in a small number of firms can be seen in the responses to our payday lending survey. In the first full three quarters, the top ten most frequently mentioned payday lenders accounted for nearly seventy per cent of responses[3]. In total there were over 180 lenders mentioned in responses.

Brokers and lead generators

As mentioned in the Competition Commission's statement of issues, many people access payday loans via credit brokers. We see distinctive detriment caused by credit brokers, who are often very difficult to differentiate from payday lenders and do not make it clear that they are in fact a brokerage. We regularly see clients who have been charged an upfront fee by a credit broker which they typically were either told would not be charged until a loan has been offered, or were not aware about at all.

Analysis of calls regarding credit brokers to the Citizens Advice Consumer Service in June and July 2013 found that 23 per cent of cases regarded an undisclosed upfront fee and a further 18 per cent regarded other deceptive practices by broker, such as claiming the upfront fee would not be charged until a loan was offered but charging the fee immediately without offering a loan.

[3] This analysis excluded responses where multiple lenders were mentioned.

OFT guidance gives credit brokers up to six months to find a loan before they must refund the upfront fee (minus £5 for administration costs), which can make reclaiming the money very difficult for consumers.

We also see evidence of customers' card details being passed by brokers to other firms and additional upfront fees being taken. This happened in 19 per cent of cases we analysed.

Multiple broker fees can also occur where a customer appears to be a victim of card fraud. We found that 13 per cent of cases appeared to involve fraud, suggesting the brokers are not doing enough to prevent fraudulent transactions.

We would urge the Competition Commission to include these aspects of the market in their investigation.