COMPETITION COMMISSION MARKET INVESTIGATION INTO PAYDAY LENDING

CONSUMER FINANCE ASSOCIATION

RESPONSE TO COMPETITION COMMISSION STATEMENT OF ISSUES

1. Summary

The Consumer Finance Association (CFA) is a trade association representing the interests of businesses offering short term, unsecured personal loans, often referred to as payday loans, both online and through high-street stores. The CFA welcomes the opportunity to respond to the Competition Commission (CC) Statement of Issues (SOI) published on 14 August 2013.

The CC has been asked to review a sector that all stakeholders agree is in a state of flux. Its investigation takes place at a time when advances in self regulation such as the Lending Code for Small Cash Advances in July 2012, the Good Practice Customer Charter for Payday and Short-term Loans, and a stricter regulatory environment through new Government measures have yet to be fully absorbed within the wider short-term lending environment. This presents particular challenges as the CC comes to review the evidence that it collects in the course of its inquiry – a snapshot of the sector as it now is will not reflect the effects of the actions that have recently been taken or may yet be taken by other regulators or through self-regulation – all of which have the potential to influence significantly the dynamics of competition.

As the CC has indicated in its SOI, a core question for the inquiry is the extent to which consumers of payday lending are in a position to make informed choices. Consumer research, discussed further below, indicates that, contrary to popular perception, consumers for payday lending are well-informed and are content with the products and services they are using. From research conducted independently for the CFA it appears that payday customers are exceptionally astute borrowers who are capable of comparing rates and terms across different products and lenders. When customers are asked why they choose payday they often cite the fairness of the deal, clear explanation of charges and fees, and being treated with dignity and respect.

Consumers are increasingly presented with choices in short-term loans and other high cost credit products, including credit cards and bank overdrafts. Consumers of short-term loans use them as part of a toolkit of products to manage their finances at a time of economic uncertainty. Some are paying down longer term debts and are opting instead to take short-term loans over a period which is easier to predict. Other consumers have limited credit options and turning to short-term lenders in the full knowledge that there is a premium reflective of their financial status.

Short-term loans carry less risk of spiralling debt than store and credit cards, which are designed to ensure that there is always outstanding debt from which to levy fees. Short-terms loans are designed to manage short-term financial emergencies. Consumer satisfaction is high and research shows that loans are not for people without jobs or on very low incomes.[1]

[1] 95% of payday users are in work (Source: Policis)

Payday loans meet a specific consumer need. They are not becoming more popular because people have no other type of credit to turn to. Consumers simply do not want to borrow large and long any more, but small and short. Many of the most recent development in the market have not yet been absorbed properly into the industry. The CFA would caution the CC against conclusions based on non contemporary view of the industry.

2. Introduction to the CFA

Origins and membership

The CFA was established in 2008 with six companies represented by Dollar Financial Group, CashEuroNet, Axcess Europe, Cash Converters and National Cash Advance. In August 2012, National Cash Advance withdrew its membership and during 2013 five new firms were recruited into membership as the sector continues to change and evolve. The CFA currently represents twelve short-term lenders, which trade as: The Money Shop, Payday Express, Payday UK, Quickquid, Cash Generator, Cheque Centre, Cash Converters, Albemarle and Bond, Cash and Cheque Express, Think Finance (Sunny), Next Credit, and Cash on Go (Peachy). The CFA estimates that its members accounted for 60% of payday loans made in 2012.

Objectives

The CFA is the principal trade association representing the interests of a number of short-term lending businesses operating in the UK. The aims of the CFA are to promote responsible lending and borrowing, to keep members up to date on changing legislation and to build relationships with consumer groups, Government departments and other financial services organisations.

Activities

The CFA engages positively with Government, consumer groups and other stakeholders in furtherance of its objectives. By way of example, in April 2012 we worked with the Department for Business, Innovation & Skills (BIS) and three other trade associations to create the Good Practice Customer Charter for Payday and Short-term Loans (the "Charter") and the Addendum to Industry Codes of Practice (the "Addendum"), which were implemented across the industry in November 2012. The objective of the Charter is to give borrowers enhanced protections when taking out a payday or short term loan.

In parallel with the Charter, the CFA launched the Lending Code for Small Cash Advances in July 2012 (the "Code"), which also took effect in November 2012.[2] The Code, which is specific to CFA members, provides borrower protections beyond those set forth in the pan-industry Charter; the Code also sets standards for CFA members that exceed those imposed by applicable law. For example, the Code limits the number of rollovers and requires members to give "a 30-day breathing space" to borrowers in financial difficulty plus restrictions on the use of continuous payment authority. These self-regulatory tools commit our members to delivering better communication, robust affordability

[2] The full text of the Code (and the Charter) are available on the CFA's website: http://www.cfa-uk.co.uk/our-standards/codes-of-practice.html

assessments, clearer information about price and payments, and practical help for those in financial difficulty.

The Code is monitored by an independent panel, the Short-term Lending Compliance Board (SLCB). The remit of the SLCB is to audit firms against the Code, monitor standards and compliance, identify deficiencies in lending practices and recommend improvements. This is still a relatively new regime within payday lending but is already making a difference to how our members interact with their customers.

In addition to developing and implementing industry standards, the CFA conducts in depth research exercises to further understanding of the sector and its consumers in light of the changing market place. The CFA recently commissioned the largest study of UK payday customers to investigate the UK's changing attitude towards finances and spending. This report explores the reasons for the growth of short-term credit and identifies the users of this form of consumer credit. It is discussed further below.

3. Overview of the evolution of the payday loan sector

The payday lending sector has undergone dramatic changes over the years but particularly in recent times. Any investigation by the CC needs to be conscious of the fact that payday lending is a dynamic form of short-term lending and is continually evolving to meet the needs of its customers in a changing regulatory landscape.

The Cheque Act 1992 enabled the development of third party cheque cashing. The offer of delayed presentation of personal cheques led to the growth of short-term loan products in the UK. It began with a basic 30-day loan product, which was originally developed and refined in the United States. The first payday loan store was set up in 1990, but the sector grew exponentially following the 2008 credit crunch as high street banks tightened their lending criteria and focused on meeting their capital requirements according to the Basel III.

A further impetus for the sector was the Consumer Credit Act 1974 (Electronic Communications) Order 2002, which came into force in 2004 and enabled credit transactions to be conducted online. The new opportunity was embraced by short-term lenders and entrepreneurs, which identified an unmet consumer demand for credit that the banks did not adequately serve.

The original payday loan did not have a facility for rolling over or extending a loan and generally had to be repaid when a borrower received their pay cheque. This feature was introduced in response to consumers who requested a slightly longer term repayment period without registering a default on their credit account. Payday loans have continually developed to meet the changing demands of consumers be it in relation to on-line services or providing longer term repayment options.

CFA members have adapted with a range of business models. For example, high street-based lenders have moved into town centre locations with a mixed offer of cheque cashing, rent-to-buy, second-hand goods, pawn broking, currency exchange and money transfer services. Many are developing longer term loan products up to 12 months with lower interest rates and higher maximum loan levels. Product offerings have improved over time in response to consumer demand and competitive pressures.

The apparent concern in the SOI that payday products are not "straightforward"[3] is in reality a reflection of the development of different short-term loan products to meet differing consumer needs. An obvious parallel might be made with mortgage products – the basic components that make up a mortgage, including upfront fees and interest charges are reasonably well understood, but a variety of different types of product exist and compete effectively. The key information for the customer is to understand their overall financial exposure over the life of the product (not always best reflected by APRs). The evidence from our customer surveys indicates that customers are financially astute and enter into their loan agreements with their eyes wide open, with 92% saying that they understood the total cost of the loan before they committed to it.[4]

The payday lending sector is a growing and dynamic industry and has experienced a number of new entrants that have achieved considerable success in a short time period. This expansion has been led by multi-national American companies, but entrepreneurs from within the EU have recently entered. Examples include the successful entries of Wage Day Advance Limited and Wonga in 2008, driven by product innovation. CFA member, pawn broker Albermarle and Bond, has launched an online short-term loan product this month (September 2013) under the trading name Cash Window. Equally there have been significant exits from the sector. That includes ten payday lenders who exited the market this year as they were unable to demonstrate compliance with the law and OFT guidance, but the OFT also revealed that Cash Advances, which traded as Handycash and Wagestoday, is one of four business to have surrendered its licence following the payday lending review. In August 2013, the regulator reported that 19 firms had pulled out of payday lending after it wrote to them to request they improve their practices. Cash Express, Post Box Express. Keyring Ltd and Paydaycredit Ltd, which traded as Submenow, also surrendered their licences.

Payday lending appears to be a sector which is considerably more dynamic, with lower barriers to entry, exit and expansion than more traditional forms of lending. New entrants have been able to enter and expand successfully, overtaking incumbents where they have brought innovations that consumers value. Consumers can and have switched suppliers without difficulty as new options have emerged.

4. Regulatory context

All consumer credit is regulated, with common standards throughout the EU, payday lenders are no exception. All payday lenders must have a Consumer Credit Licence and are therefore regulated by the Office of Fair Trading. As the CC recognises in its SOI, the regulatory picture in this area is certainly an evolving one.[5]

[3] SOI, paragraph 43

[4] http://www.cfa-uk.co.uk/media-centre/press-releases/current-press-releases/payday-borrowers-have-their-say-in-new-yougov-research.html

[5] Paragraphs 15-18 and 27-31 of the CC SOI highlight just some of the changing regulations facing the industry.

Many of the initiatives undertaken by the Office of Fair Trading (OFT), the Financial Conduct Authority (FCA), BIS and others, address concerns which are to some extent different to those which fall to the CC. As acknowledged in the SOI, it is not the CC's role to enforce compliance with the existing regulatory regime, or reach judgments on the affordability of short-term credit for individual consumers and people's access to it.[6] However, the CC also recognises that it needs to consider whether any aspects of regulation may influence competition for payday loans.[7] It is the view of the CFA that there has been considerable change with an anticipation of more to come, whose impact will not be reflected in a current snapshot of payday lending.

In particular, the CC should be aware of the increasing amount of self-regulation that many payday lending companies and particularly CFA members have committed themselves to.

On 25 July 2012, the CFA, the Consumer Credit Trade Association, the BCCA and the Finance and Leasing Association published the Charter, Addendum, and the Code referred to above. The Charter came into effect on 26 November 2012 and incorporates some key commitments from all members of the associations. According to BIS, at the time that the Charter was implemented the associations represent over 90% of the payday lending sector[8]. The key commitments in the Charter include:

- to inform the consumer how a short term loan works including the total cost of the loan (including an example of the price for each £100 borrowed together with fees and charges);
- to undertake a sound, proper and appropriate affordability assessment on each application for a loan and before the loan is extended; and
- to set out clearly how a continuous payment authority (CPA) works, including the consumer's right to cancel a CPA and an agreement to notify the consumer before using CPA.

The Addendum was also implemented in November 2012 and sets out additional commitments for consumer protection, including:

- detailed commitments in relation to extending the terms of a loan to avoid unmanageable debt accruing;
- detailed provisions in relation to robust credit assessments;
- increased transparency about loan repayments to provide more options;
- additional commitments in relation to the use of CPA;
- assistance for customers in financial difficulties including a commitment to freeze interest and charges if the customer makes repayments under a reasonable repayment plan or after a maximum of 60 days of non-payment)

[6] SOI, paragraph 19
[7] SOI, paragraph 31
[8] http://news.bis.gov.uk/Press-Releases/Payday-lenders-make-progress-protecting-vulnerable-borrowers-67d99.aspx

While the Charter gives consumers a choice of lenders who are meeting a certain level of standards, the Code which was agreed in July 2012 applies to CFA members only. It offers borrowers additional protections that exceed those set out in the Charter. The purpose of the Code is to "ensure compliance by members with the minimum standards set by the CFA" and thus to protect and benefit consumers. The Code was implemented in November 2012. Specifically the Code provides that:

- CFA members are required to comply with certain general obligations including to trade honestly, responsibly and to treat customers with respect (paragraphs 3.1 to 3.14 of the Code);
- CFA members will undertake a sound, proper and appropriate assessment of the creditworthiness of the customer and highlight to the customer the short term nature of the loan (paragraphs 4.5.1 and 4.5.2 of the Code);
- CFA members will never extend the period for repayment of interest or fees due on a short term loan but only principal sum (paragraph 4.6.1 of the Code);
- CFA members will undertake appropriate and proportionate affordability assessments before an extension of a loan is granted (paragraph 4.6.2 of the Code);
- CFA members will not allow customers to extend a short term loan on more than three occasions (paragraph 4.6.4 of the Code);
- In relation to CPA, CFA members will ensure that customers will be provided with full and adequate explanations of the CPA including the right to cancel (paragraph 4.8.1 of the Code);
- CFA members also agree to give consumers at least three days notice by telephone, email or SMS before attempting to recover outstanding amounts due under CPA (paragraph 4.8.3 of the Code);
- CFA members agree to submit annual compliance audits and to being monitored for compliance by the CFA. Breach of the Code may ultimately lead to suspension or expulsion from the CFA.

Compliance with the Code is to be monitored by an independent Short-Term Lending Compliance Board (SLCB) made up of highly qualified and respected individuals, namely Robert Rosenberg, Nick Lord and Seymour Fortescue.[9] The Board is supported in performing its functions by KPMG, which conducts compliance annual audits on CFA members. The audit includes an assessment of internal processes, visits to stores, monitoring call centre calls, staff interviews and desk research.

The Board's monitoring of compliance with the Code has already started as pilot exercises on two firms. The compliance regime and the audit approach has been designed and established by KPMG. The aim is to have the compliance regime fully developed by the end of 2013.

5. Customers and payday lending

[9] Seymour Fortescue is the former Chairman of the Portman Group and former Chief Executive of the Banking Code Standards Board. Seymour is supported on the panel by lawyer and leading financial regulatory expert, Robert Rosenberg and consumer advocate, Nick Lord.

CFA members frequently consult their customers to find out about their experiences, good and bad, as a way of improving customer service and to help maintain high standards in the industry.

The CFA recently commissioned the largest study of UK payday customers to investigate the UK's changing attitude towards finances, borrowing and spending.. The research looked at the reasons for growth in the market and customer demographics.[10]

From this study it is apparent that consumers for payday lending are well-informed and are content with the products and services they are using. Many payday customers are exceptionally astute borrowers who are capable of comparing rates and terms across different products and lenders. When customers are asked why they choose payday they often cite the fairness of the deal, clear explanation of charges and fees, and being treated with dignity and respect. Over ninety per cent of people surveyed said they were satisfied with their overall payday loan experience and the same number felt payday loan companies provided a very useful service for people such as themselves.[11]

Consumers face a higher cost of living and find it increasingly difficult to predict their financial future. Therefore, they are opting to pay down outstanding credit card and loan debts and planning their finances on a shorter term. The research identified three specific groups of customers whose lives have been impacted by the credit crunch. All three groups require access to money and relatively short notice at a time when traditional credit streams have been reduced. The people identified are not vulnerable or the unbanked, as popularly portrayed.

- The first group were identified as the Skinny Jeans and Smart Phones cohort. These are young people, typically aged between 25 and 35. They do not have large financial commitments and do not plan far into the future. They borrow for emergencies as well as day-to-day living. They have embraced the financial services available through new technology, which they can access on the internet and via smart phones. They are tech-savvy and their financial attitude is shaped by their unique economic circumstances. For example, they do not have access to the free flow of credit that was available from credit cards and pre-completed cheques that accompanied most people’s post bag before the credit crunch. Many of these young consumers had access to student loans at university but found their options dramatically reduced when they left further education. Saving for a deposit for their first homes is all but impossible and rent and rates are rising. This generation is financially aware, but expect instant gratification and value the speed and convenience of online services. They do not frequent banks and prefer to conduct their transactions online.

- The second cohort, Buggies and Bigger Bills, are aged 35-44 years with young families. They use banks, post offices and loan stores on the high street. These consumers borrow predominantly for their family commitments rather than for their personal needs. Many of the borrowers are women who prioritise payment of outstanding utility bills, paying off debts and purchasing food and childrens’ goods. According to the survey, married women with children borrow on average £198 per loan. They are low to middle income with little opportunity for saving for the future. However,

[10] A copy of the full report, Credit Crunched, is available here: http://www.cfa-uk.co.uk/information-centre/payday-facts-and-research/payday-facts-and-research/credit-crunched-a-commentary-on-the-uk%E2%80%99s-changing-attitude-towards-borrowing-and-spending.html

they are able to manage their budgets providing they do not face unexpected expenses, such as car or home repairs.

- The third demographic group are middle age, middle income couples – the Burdened Baby Boomers. They are between 45 and 55 years old with older or grown up children and parents who are increasingly dependent on their support. These consumers have one or two holidays a year and spend to their means. They are the 'bank of mum and dad' when their children have high value needs, such as cars or funding while at university. They are also squeezed by the needs of older parents, such as care facilities, who are on average living longer into old age. For this group of consumers short-term loans are an active, informed choice. 40% of Burdened Baby Boomers earn more than £20,000 a year and 7% earn more than £40,000. These consumers typically have no difficulty repaying loans.

There isn't a typical payday loan customer; customers come from variety of different backgrounds, are either in permanent employment or have access to a regular income. They all have a bank account.

The CFA and its members are mindful of the fourth group of consumers who face extremely difficult financial circumstances. These people do not class themselves as vulnerable, but exhibit symptoms of vulnerability at different times and more frequently than the majority of borrowers. Making assessments about whether to lend to this group is most difficult because their circumstances fluctuate. For example, a borrower on a zero hours contract may be perfectly able to qualify for a loan on one day and then during the course of the loan find their income unexpectedly reduced or encounter other domestic emergencies that dramatically alters their credit status.

For this reason, lenders have introduced a range of measures in the Code to support customers who get into financial difficulty during the term of the loan due to unexpected circumstances, such as reduced employment hours. For example, lenders will give a 30 day breathing space in which an individual can seek debt advice and help to manage their situation. They will impose a freeze on fees and interest on outstanding loans and refer people to free debt counselling. A debt cannot balloon inexorably because lenders have capped the number of times a customer can extend their loan and will not charge interest beyond 40 days. CFA members have dedicated hardship teams to help resolve problems with repayment and work with debt advisers.

In the short-term lending sector the risk of default increases because changes in circumstances in the short term have a more profound impact on a person's ability to pay down a small debt.

6. Concluding comments

The CFA looks forward to engaging with the CC over the course of the inquiry and encourages the CC inquiry team to consider the features of the industry as set out in this document as the inquiry progresses.

[11] Research conducted between July and November 2012 and undertaken independently by Harris Interactive on behalf of CFA

The short-term lending sector is diverse and competitive, which through innovation is constantly evolving. The nature and speed of this growth has presented challenges to the industry and new choices for consumers.

Consumers are increasingly presented with choices in short-term loans and other high cost credit products, including credit cards and bank overdrafts. Consumers of short-term loans use them as part of a toolkit of products to manage their finances at a time of economic uncertainty. Some are paying down longer term debts and are opting instead to take short-term loans over a period which is easier to predict. Other consumers have limited credit options and turning to short-term lenders in the full knowledge that there is a premium reflective of their financial status.

Short-term loans carry less risk of spiralling debt than store and credit cards, which are designed to ensure that there is always outstanding debt from which to levy fees. Short-terms loans are designed to manage short-term financial emergencies. Consumer satisfaction is high and research shows that loans are not for people without jobs or on very low incomes.[12]

Payday loans meet a specific consumer need. They are not becoming more popular because people have no other type of credit to turn to. Consumers simply do not want to borrow large and long any more, but small and short. Many of the most recent development in the market have not yet been absorbed properly into the industry. The CFA would caution the CC against conclusions based on an outdated view of the industry.

[12] 95% of payday users are in work (Source: Policis)