Payday Lending Market Investigation – Statement of Issues

Comments submitted by Debt Advice Foundation

1. Motivation of the payday loan borrower

Consumer credit is never a standalone purchase, desired or required of itself. People seek consumer credit because they do not have access to sufficient cash to buy what they want or what they need at a particular point in time.

The level of what we could categorise as "credit stress" depends on the social acceptance of the type of credit and the borrower's ability to make the repayments. Thus a mortgage has high social acceptance, and someone with a low ratio of repayment to income will be under relatively low credit stress.

Payday loans are at the opposite end of the credit stress spectrum. For many who are aware of the rising tide of media and political condemnation of the sector, there is a high level of shame attached to taking out a payday loan (as opposed to other kinds of credit). Research quoted by the CC shows that these loans are "mainly used for household expenses (including emergency expenses) and bills, or to pay for a special occasion such as Christmas or birthday". These are not the equivalent of the occasional luxury taxi fare on a Saturday night out, as they have been categorised by the industry. In very many cases they are a desperate last resort.

This high level of credit stress will have a significant effect on the consumer, and makes the search for a payday loan very different from that for most other kinds of credit – and completely different to most other purchasing situations.

There will be very high levels of anxiety, which will cloud the judgement even of those most able to navigate the marketing of financial services. There will be great time pressures if bills are outstanding. And there will be a wide range of additional personal pressures driving the need to find more credit.

We believe that this high level of credit stress has the effect of putting the potential payday loan borrower in a much more vulnerable position than people considering other kinds of credit. Speed and availability of credit, at any cost, becomes not a chosen priority but an imposed one – and a highly threatening one in many cases. In these circumstances the easy availability of a payday loan ("cash paid in ten minutes") means that all other considerations may well be overlooked.

Whilst the speed of delivery is not in itself a bad thing, it is more often than not only possible due to inadequate credit checking, which then creates a distortion within the wider credit industry. We would all expect a high street bank to suitably appraise our credit worthiness, why not a payday lender? Importantly, the delivery of the product also creates something of a demand inelasticity, where price is no longer a key decision metric.

We believe that the very different mindset of the consumer seeking a payday loan should be considered carefully by the Competition Commission.

2. Market evolution

At para 41 the Statement of Issues talks of "...some product innovation within the broad criteria of loans..." and gives as an example products which allow customers to draw down funds.

We believe it is extremely important that any examination of the activity of short-term lenders has the flexibility and scope to examine new product developments and the evolution of the market.

Inevitably companies will move faster than regulators, so the Competition Commission should cast as wide a net as possible over current developments. For example, in addition to the drawdown products mentioned, we have particular concerns about the growth of guarantor loans in this market. We have experience of many people who were not aware that they would become immediately liable for the whole of a loan; we also have difficulty putting debt solutions in place for some people because they want to shield a guarantor from their responsibilities for one of several debts.

3. Marketing

At para 17 the Statement of Issues says that BIS has commissioned qualitative research into how payday lending advertising affects customer behaviour. The online survey element of this research closed only on 14 August and there is no indication of when the findings will be available to the Competition Commission.

In para 72 there is reference to the role of advertising expenditure as a possible barrier to entry into the market by new providers.

There is no mention at either of these points of investigation into the detailed market research carried out by advertising agencies and other marketing specialists for payday lenders. This will be a significant and highly relevant body of work which is bound to assist in any consideration of the market context of payday lending.

We believe that the creation and maintenance of a soft-focus market for payday loans, which fundamentally misleads consumers about the serious implications of high-interest credit, is at the heart of the problem. We would urge the Competition Commission to investigate how the marketing of these products has prevented, restricted and distorted the ability of consumers to manage their financial affairs in a more responsible way.

4. The activity of brokers and lead generators

These are “noted” in in paragraph 50. We believe they warrant more than simply noting.

In our experience, some of the most outrageous examples of marketing of payday loans have come from lead generators. The output of many of these companies would be laughable if they were not leading to such misery for so many people.

For the vast majority of people, in the vulnerable state described above, it is impossible to differentiate between the marketer and the subsequent lender. The concepts of broker and financial service provider are murky enough in the relatively well-lit arena of insurance; the activities of lead generators in payday lending descend to the realm of dark arts.

We believe that the lenders should ultimately be responsible for the advertising practices of the lead generators, often registered overseas, from whom they source a proportion of their business. At present it is far too easy for them to absolve themselves of any responsibility or wrongdoing.

We believe that the consumer’s experience of the payday lending market is made significantly more difficult and risk-filled by the activity of lead generators. Their contribution to and effect on the market should be included in the investigation.

5. Credit progression and market segmentation

In para 49 you state that you will “consider whether there may be alternatives for payday loan customers…” and “…will assess whether borrowers have access to these other forms of credit.” You also say you will consider whether “any direct evidence exists of competition between payday lenders and other credit providers.”

The issue of choice and market segmentation in the realm of credit is another that is clouded by misleading marketing.

You refer to research that suggests people turn to payday loans because they are unable to borrow from anywhere else.

In our experience of people struggling with unmanageable debt, we almost never find that people have made deliberate, informed choices from the full range of credit available. Rather, they follow a kind of credit creep, which starts at one end of our credit stress spectrum – mortgage, household utility bills and so on – then moves to credit cards and personal loans, overdrafts, consolidation loans and payday loans.

By the time they reach payday loans, there is usually no other choice – hardly a functioning credit market.

We believe that, while the payday loans sector is causing untold difficulties, the problems are rooted higher up the credit food chain.

For example, the open-ended, life-long thrall of credit cards – where, like an interest-only mortgage, it is perfectly possible to continue to make the minimum payment until retirement and then be faced with bankruptcy – is the backdrop against which most payday loans play out.

It is important that the Competition Commission views the payday loans market in a context which is not so narrow that it excludes the earlier stage of most people’s credit journey.

Debt Advice Foundation

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Further information

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About Debt Advice Foundation

Debt Advice Foundation is a charity registered in England and Wales (1148498).

The charity's telephone helpline service is available six days a week on 0800 043 40 50. Lines are open 8am-8pm Mon-Fri and 9am-5pm on Saturdays.

Debt Advice Foundation's primary objects are:
The prevention or relief of poverty for the public benefit and, without prejudice to the generality of the foregoing, this may include:

- the provision of free, impartial and appropriate debt advice to people with unaffordable debt;
- to help people with debt problems to gain access to appropriate solutions that will help them;
- to promote education, for the public benefit, in financial capability and money management so as to reduce the likelihood of debt misuse;
- to undertake or fund research to understand why problem debt happens and its effect on individuals, families and the wider United Kingdom economy and to disseminate useful results.

The charity is a member of AdviceUK, the UK's largest support network for free, independent advice centres and all of the charity's advisers are associate members of the Institute of Money Advisers, a charitable body that aims to promote free money advice and develop professional standards

The charity is also a registered supporter of the All-Party Parliamentary Group on Financial Education for Young People and the All-Party Parliamentary Group on Debt and Personal Finance.