Consultation Response

StepChange Debt Charity response to the Competition Commission payday lending market investigation statement of issues

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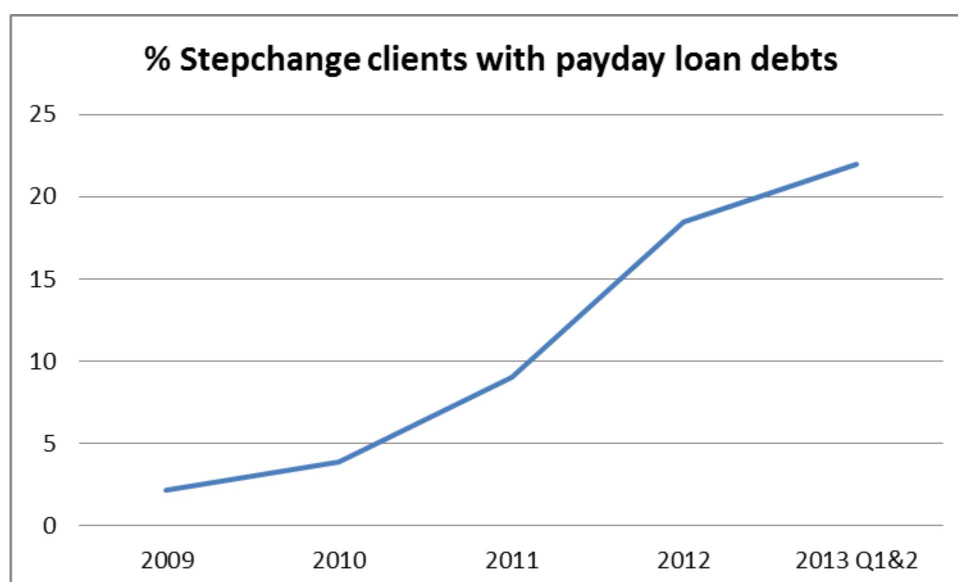
We are an independent charity dedicated to overcoming problem debt. Our advice and solutions are effective, tailored and importantly, free. Foundation for Credit Counselling. Wade House, Merrion Centre, Leeds LS2 8NG. Company No 2757055. Charity No 1016630. www.stepchange.org

Introduction

StepChange Debt Charity welcomes this opportunity to respond to the Competition Commission payday lending market investigation statement of issues. StepChange Debt Charity is the largest specialist debt advice charity operating across all four UK nations. In 2012 over 400,000 people contacted our telephone advice line on on-line debt remedy tool for free, impartial advice about problem debt. StepChange is also the UK's largest charitable provider of free-to-client debt management plans (DMP), having introduced DMP's to the UK in 1993. This experience of dealing with problem debt, and consumer credit debt in particular, makes us well placed to talk about current issues in the UK payday lending market.

Background on payday loan debt growth

StepChange Debt Charity has seen a very large increase in the number of people seeking help with payday loans in the last few years. In 2009 around 2 per cent of our clients (or nearly 4,500 people) had one or more payday loan debts. By 2012 this had grown to 18.5 per cent, or over 36,000 StepChange clients with one or more payday loans. In the first six months of 2013 alone nearly 31,000 StepChange clients had one or more payday loans, around 22 per cent of our clients.



The OFT estimate that the value of payday loans has grown from £900 million in 2008 to up to £2.2 billion in 2011/12. But while the market has more or less doubled in three to four years, the number of people we have seen with payday loan debts has grown roughly eightfold in a similar period. The total of all outstanding payday loan debts seen by the Charity has grown even faster, increasing from £5.3 million in 2009 to £60.3 million in 2012. Based on OFT estimates, StepChange Debt charity is now seeing payday loan debts equivalent to around 2.7 per cent of the value of payday loans issued.

Background to theories of harm: problems in the payday sector

StepChange Debt Charity has become increasingly concerned with the nature of problems we are seeing in the payday lending sector as the number of payday loan debts we see has grown. We believe that these problems can provide insight into the theories of harm set out in the statement of issues paper. A brief summary of these problems is as follows:

Irresponsible lending - poor affordability and suitability checking

The payday industry charter, published in November 2012, committed payday lenders to 'carry out a sound, proper and appropriate affordability assessment'[1] when granting or extending (rolling over) loans. But evidence from StepChange Debt Charity clients suggests that the payday lending sector as a whole is still doing a poor job at ensuring loans are affordable for borrowers and suitable for their needs. The following statistics show how many StepChange clients have become trapped in a cycle of increasing payday debts. In many cases payday borrowing was on top of large existing credit liabilities.

- The average total payday loan balance for StepChange clients with one or more payday loans in H1 2013 was £1,665. But the average net household income was £1,298 – £367 less than the amount owed on loans that generally will have a monthly repayment term.
- 65 per cent of clients with one or more payday loans had contractual credit repayments equal to more than 100 per cent of their net household income. This compares to around 13 per cent of clients without a payday loan. So a high proportion of the people we see with payday loans were experiencing acute payment difficulties.
- The average total payday balance held by StepChange clients has also grown sharply in recent years; from £1,188 in 2009 to £1,665 in 2013 – an increase of around 40 per cent in four years.
- StepChange clients with payday loans tend to have lower levels of total unsecured debt on average than clients without payday loans, but still owe around £10,000 in total.

Payday lending linked to wider financial difficulty

Contrary to the idea that payday loans help people manage ups and downs in household budgets, our evidence also highlights how StepChange clients with payday loans are more likely to be in arrears with essential household bills (priority arrears) than other StepChange clients.

- In 2012, around 21 per cent of StepChange clients had council tax arrears compared to 13 per cent of clients without payday loans
- Around 14 per cent had rent arrears compared to 8.5 per cent of other clients.
- 11 per cent had electricity arrears compared to 9 per cent of other clients

[1] Good practice customer charter for payday and short term loans

- People with payday loans also seemed to be slightly but significantly more likely to have a county court judgment than non-payday borrowers: 7.8 per cent compared to 6.5 per cent

We also see a higher proportion of borrowers of other high cost credit products (such as home credit) with priority arrears compared to other StepChange clients.

Multiple payday loan balances cause debts to spiral

The OFT compliance review highlights finding that 28 per cent of new loans issued in 2011/12 were rolled over or re-financed at least once. Our data does not allow us to identify rolled-over loans, but we are able to identify people who have more than one payday loan at the time of seeking advice. Holding multiple payday loans is relatively common among those StepChange clients with one or more payday loans, as the table below highlights for 2012.

One or more payday loans, 2012				
	Number	%	Cumulative %	Average total balance
1	11,917	33%	100%	£685.82
2	7,855	22%	67%	£1,109.23
3	5,560	15%	46%	£1,583.04
4	3,860	11%	30%	£2,032.97
5+	7,221	20%	20%	£2,753.23
Total with payday	36,413	100%		

- Over two thirds of StepChange clients with a payday loan had more than one payday loan
- One in five of those people who had taken out a payday loan had five or more outstanding at the time the sought advice about their debts.
- As people took on more payday loans the total outstanding payday loan balance tended to rise quickly, from £686 for those with one payday loan debt to over £2,700 for those with five or more.
- 78 per cent of those with more than one payday loan had total contractual debt repayments over 100 per cent of net monthly household income, this rose to 96 per cent of those with five or more

Payday balances inflating for those in financial difficulty

The OFT compliance review found an average payday loan to be £265-£270 in 2011/2012. But for StepChange clients in 2012, the average individual value of a payday loan was £552 and the average outstanding balance for people with a single payday loan was £686. So for heavy users of payday and people facing financial difficulties payday loan balances appear much larger than the average.

We believe that there are three likely explanations for this:

- **Payday balances are inflating as people roll-over or refinance previous loans**
- **Existing loan balances inflate due to default interest and charges.** StepChange Debt Charity continues to see cases where payday loan balances have inflated massively due to interest and a variety of default charges imposed by the lender. The following case gives one of many examples we have seen:

  A payday loan company issued a 44-year old man with a claim for £1,830 in penalty charges incurred for default on a loan of £120. The claim detailed two overdue penalty charges totalling £80, a debt recovery fee of £100 and a total of £1,650 in charges for 330 unsuccessful attempts to recover payment. The lender also charged £178 in interest, or 1 per cent on the original loan principal every day.

- **Regular repeat payday borrowers are allowed to borrow more through 'low and grow' type lending strategies.** But these appear to take little account of ability to repay for our clients.

Misuse of Continuous Payment Authority (CPA) and aggressive debt collection practices

We are concerned the unfair and aggressive debt collection practices by payday lenders are compounding the debt problems of people facing financial difficulties. Misuse of continuous payment authority can be a particularly severe example of this. The following cases highlight how this has caused problems for some StepChange clients:

A man told StepChange that he had fallen into difficulties with a payday loan. He tried to cancel the continuous payment authority and then changed banks. The firm then wrote to him and told him if he re-financed the loan they would write some of the debt off and this would stop a default. The man agreed to this but was then turned down for the loan. The firm proceeded to take £1500 from his new account causing him to get in to arrears on his mortgage and all his bills.

StepChange was contacted by a woman who was very upset after two payday loan companies had taken payments from her bank account even though a cancellation of CPA form was sent recorded delivery to both payday loan companies and the bank were also notified of this cancellation. The bank told her that there was nothing they could do either. £300 was taken from her account leaving her with nothing to live on.

A 39 year old woman sent a template letter to a payday loans company, explaining she was getting help from StepChange Debt Charity for her financial problems. The letter withdraws authorisation for lenders to recover monies owed via continuous payment authority. However, the lender ignored the request, saying it would "need to try for payment" as per the loan's terms and conditions. The lender subsequently took £400 out of her bank account when she received her pay, leaving her unable to pay for food or rent.

Comments on the theories of harm

Theory of harm 1: impediments to customer's ability to search and identify the best value product, and switch supplier.

The cases cited above (and the experience of StepChange clients more generally) demonstrate how consumers in financial difficulty are often surprised and disadvantaged by default and other contingent charges. Although these may be stated in terms and conditions they will not be transparent to consumers who do not believe that the contingent circumstances are relevant to them.

We have also seen evidence highlighting how difficult it is for consumers to understand the multiple layers of charges applied by some lenders. The following case gives an example:

> *A woman told StepChange that she had taken out a payday loan for £170 and after realising she would be 2 days late with the payment called the lender and requested that they freeze the loan and accept a late payment. She was informed that they would add £25 per day for this. She paid the loan in full, including these charges, on the day she had informed them that she could pay, only to be told they had added another £37 of charges, which she refused to pay as did not see these as fair. Later she received a letter informing her that she owed £779. After reading their terms and conditions, she could not establish where this figure had come from.*

When payday borrowers fall into difficulties and are unable to pay they will sometimes have no control of the way default charges are applied. In some cases lenders continue to apply large charges in full knowledge that the borrower is in difficulties, inflating the debt in the process. It is hard to see how this outcome could be factored into a consumer's decisions on value at the outset. The following provides another example of balance inflation over which the borrower had no control:

> *StepChange heard from a woman who had borrowed £400 from a payday lender approximately two years before and the balance had grown to £4000. The lender was contacting her every day to advise her of more charges and she said they were unkind on the phone. She had to give up work due to ill health and was under psychiatric care due to the amount of stress the company had caused her. She had a disabled child to look after and she couldn't pay them anymore.*
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> *A woman told StepChange that a payday lender had threatened to send bailiffs to her property to remove anything of value without notice, even though they did not have a court judgment. The lender also said they would charge £200 interest on the account unless she closed her debt management plan and paid them £10 per week. They said if she agreed to this they would reduce her balance from £1500 to £800 when this was originally a £450 loan.*

So we support the Competition Commission theory that consumers face difficulties identifying the value of products at the outset. This is particularly difficult for consumers who have difficulties repaying payday loans, who can see default charges inflate the loan balance massively.

However we are not convinced with the theory that consumers currently face significant difficulties switching between payday lenders. The evidence cited above on borrowers with multiple payday loans suggests the opposite; that borrowers can access payday loans fairly easily, even where they are in severe financial difficulties and where the loans are likely to make their financial difficulties worse. The experience of StepChange clients highlights the problems that ready access to payday loans, without proper affordability and suitability checks, can cause for consumers:

> *A man told StepChange that he had 8 payday loans that were agreed with no affordability checks. He regularly received texts offering him money which he took up as he was in financial difficulty.*
>
> *A StepChange client's bank statement showed that nearly £2,900 had been paid to two payday lenders. On the same day the two lenders advanced further loans totalling £2,500, with a third payday lender advancing £1,000. The man was earning around £3,500 a month but was in a payday loan trap. He was borrowing his total month's income in payday loans, and with interest was paying more out just on these than his total income.*

The exception to this, where we have seen some evidence akin to barriers to switching is where payday lenders are offering existing customers that they know are in financial difficulty a new loan to stop default interest and chargers accruing on an existing loan. For instance:

> *A man sought help from StepChange with his debts. A payday creditor refused to accept the affordable payment offer he had worked out with StepChange or reduce interest/charges accruing on the loan. But the lender did text him to offer an additional £150 loan on top of his account. The lender said if he takes this out they would take off all the interest and charges that he had incurred.*

So rather than consumers facing a 'barrier to switching' as such, the problem we regularly see is consumers who have become 'captured' payday borrowers. In some cases this might involve pressure in their relationship with a particular lender. In other cases borrowers are locked into a 'payday trap' where they must constantly take out new payday loans to replace income used to clear previous short term balances. They might have a choice of several or many payday lenders, but they feel they do not have the choice 'not to borrow' to keep their finances going for another month.

Once stuck in this cycle of repeat borrowing additional interest, charges and default charges can quickly accelerate indebtedness.

Theory of harm 2: Market power and barriers to entry

StepChange Debt Charity is not convinced that barriers to entry into the payday market are a significant cause of consumer detriment. While the market is highly concentrated, the OFT compliance review identified 190 payday lenders who were active in the market

Here we also note the recent report evaluating a pilot scheme by London Mutual Credit Union to test the viability of an alternative affordable payday product. The Credit Union was able to enter the market relatively quickly and with a product priced

significantly below prevailing commercial payday rates. The report concludes that such a product could be viable[2].

We are particularly concerned at any suggestion that regulatory standards might be reduced to encourage more participants to enter the market. We believe that the evidence we have cited above shows how bad business conduct and unfair product features are driving severe consumer detriment. As such we believe that the UK payday lending market needs to be more tightly controlled not less.

While technological investment and client acquisition may create hurdles for new entrants, we do not believe that prospective payday lenders should be allowed to get round such hurdles by skimping on the technological and business processes necessary to lend responsibly or by employing harmful and sometimes illegal marketing techniques like cold calling, texting or other high pressure selling to captured borrowers in financial difficulty.

Theory of harm 3: Credit can be a consumer bad.

StepChange debt charity would ask the Competition Commission to consider a third theory of harm: that in certain circumstances consumer credit is not a consumer good but a consumer 'bad'. While we believe that credit is generally a force for good, in certain circumstances credit products can actually harm consumers. As seen in the evidence above, credit can leave consumers heavily over-indebted, without the means to live or struggling under severe pressure and anxiety.

We believe that this problem is significant. For instance, in 2012 the combined total unsecured debt liabilities of StepChange clients came to around £3.6 billion. But around 60 per cent of this (or £2 billion) was owed by people where credit repayments equated to more than 50 per cent of their income. Around a third (or £1.2 billion) was owed by people whose monthly credit repayment commitments represented more than 100 per cent of their net monthly household incomes.

Many StepChange clients will have suffered recent income shocks that will have made previously affordable credit unaffordable, but the size and nature of the debt problems we see suggests that many consumers have been using credit to pay other credit, or more precisely to fill the hole in household budgets left by existing credit commitments.

This finding is much more pronounced among clients who had taken out one or more payday loans. Here over 70 per cent of the total unsecured debt was held by households where contractual credit repayments were more than 100 per cent of net income, and over 90 per cent was held by households where credit repayments were more than 50 per cent of net monthly household income. Given the short term nature of payday loans, the income shock effect will be much less pronounced. As such we believe that as much as 97 per cent of the payday lending to these households could be classed as a consumer bad that delivered costs but little or no benefits to the borrowers.

Therefore we would ask the Competition Commission to consider the circumstances that allow this situation to have occurred. We would suggest the following as possible drivers of 'bad credit'.

[2] Can payday loan alternatives be affordable and viable? An evaluation of London Mutual Credit Union's pilot scheme. (2013) Financial Inclusion Centre.

- Consumers under intense financial pressure may have a willingness to pay that may be well in excess of any actual benefit they will receive form the loan
- Consumers under intense financial pressure may therefore be price insensitive in the very short term.
- This may be created by a number of biases including, but not limited to biases resulting from a lack of information about credit products. Consumers may lack information about alternatives to credit to deal with bill payment problems, or may be driven by a fear of failing to meet existing commitments.
- Unsolicited marketing targeted at financially vulnerable consumers may take advantage of consumer biases in a negative way.
- Once consumers are trapped in a cycle of payday borrowing it can be extremely difficult for them to get out. They may be able to switch freely between individual providers, but are trapped in the market as a whole (as in the case of multiple payday borrowers).
- Excessive 'contingent' default interest and charges can inflate existing payday balances and drive the need for further and larger loans.
- Aggressive debt collection practices and particularly the use of Continuous Payment Authority that removes borrowers' control over repayments, can trap borrowers in a cycle of repeat borrowing and also reduce the incentives on lenders to ensure they only make loans that are affordable by the borrower and suitable for their needs.

We believe that this theory of harm suggests the need for a robust intervention by regulators to deliver a payday market that is competitive, fair and works well for all its customers.