veritec

COMPETITION COMMISSION PAYDAY LENDING MARKET INVESTIGATION

SUBMISSION FROM VERITEC SOLUTIONS LLC

CONTENTS

ABOUT VERITEC

Veritec Solutions LLC ('Veritec') provides a system that enables regulators to capture transaction data and effectively enforce regulation of consumer lending rules in real-time. The company has over 12 years' experience of working with US regulators in 14 different states[1] specifically on high cost, short term credit products such as traditional payday, payday instalment, and logbook loans. Veritec's system covers:

- 88 million consumers
- Over 1,000 licenced lenders
- 7,200 store locations
- Internet lending
- 300 million-plus credit transactions

No other organisation in the world has such a store of unfiltered data documenting borrowing in the high cost credit market. The accumulation of such extensive data has allowed Veritec to provide empirical evidence to governments to ensure their policies are fit for purpose.

In addition to its work in the United States, we have also advised the Provincial Governments of Ontario and British Columbia in Canada, and the Federal Government of Australia. We have also been working with a number of consumer groups, MPs and others in the UK.

[1] Alabama, Delaware, Florida, Indiana, Illinois, Kentucky, Michigan, North Dakota, New Mexico, Oklahoma, South Carolina, Virginia, Washington, Wisconsin.

We recognise that there are differences between the UK and US markets but it should be remembered that many of the operators, the business models and product features are the same regardless of the jurisdiction.

PARALLELS BETWEEN THE UK AND THE NORTH AMERICAN PAYDAY LENDING INDUSTRY

The development of the UK's high cost credit sector has followed the same trajectory as the US, with a number of US payday lenders now operating in the UK. Indeed, many US companies generate more revenue from their UK operations as weaker regulation and a nascent market allow for greater growth. Five of the seven largest payday lenders in the UK are owned or controlled by US companies.

Concerns about short term credit first surfaced in the US over 10 years ago and both the New York Federal Reserve and the Federal Deposit Insurance Corporation have studied the market in recent years.

Many of these concerns focused on similar issues to those subsequently seen in the UK, Australia and Canada:

- Affordability – consumers end up borrowing more than they can reasonably pay off on payday.
- Multiple loans – consumers borrow from several lenders at the same time.
- Rolling over – consumers extend their loans indefinitely while incurring new fees every 2 to 4 weeks.
- Cycle of debt – consumers unable to pay off the extended loan that has now been increased by outstanding fees, transforming a short-term, high cost product into a long-term, extremely high cost loan.

In many ways the debate in the US on how to regulate short term credit is more advanced than in the UK. In the US, responsibility for regulating short-term high cost consumer credit providers lies with the individual states. So far 14 states, with a total of 88 million consumers, have introduced some form of controls which allow a profitable short term product, but at the same time either ban loan roll overs or cap the number of loans able to be taken out at one time, as long as the total borrowed does not exceed some means type testing.

PRODUCT DEFINITION

Payday is often used as a cypher for a range of unsecured short term loans of varying length. The Competition Commission's issues statement defines payday loans to be "unsecured loans that are generally taken out for less than 12 months, and where the amount borrowed is usually less than £1,000”. We support this definition because it covers ‘product morphing’ where traditional payday loans are reconfigured into longer term products.

Product morphing is a trend that is well-established in the US where lenders have sought to avoid payday-specific regulation and has recently taken off in the UK as “payday” has attracted negative publicity. Lenders often state that payday is just one of a suite of short-term products on offer. However, payday instalment loans are, in effect, no different to traditional payday products; essentially they operate as a payday loan with three or four rollovers arranged at the point of sale.

Other products serving this market

There are a number of mainstream financial products including credit cards and personal current account overdrafts that could meet the demand for short-term consumer finance. However, these products can be distinguished from ‘payday’ by the nature of the lender’s relationship with their customer. For example, a consumer must have a bank account to have an overdraft facility and balances will differ depending on the individual’s credit history. Credit card providers will undertake significant affordability assessments and limit available balances for new borrowers.

The key factor to note is that these products are underwritten for each individual customer while, in contrast, most payday lenders will extend credit to all borrowers that meet certain general eligibility criteria.

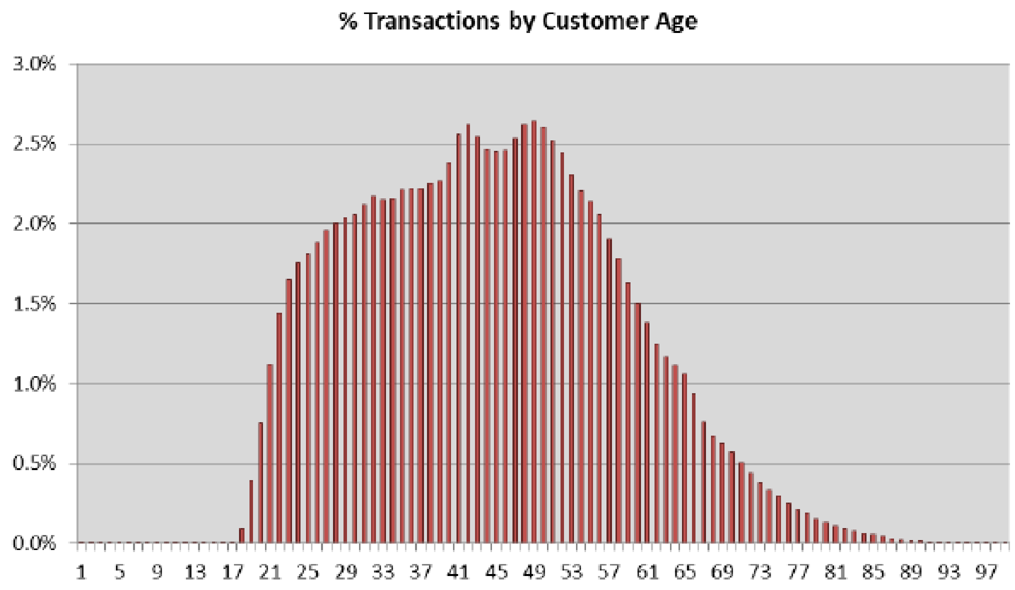
In addition, data from UK consumer advice groups show that most users of payday loans will have balances outstanding on other forms of credit, including credit cards, store cards, and bank loans. In these cases, payday products do not compete with these products but supplement them and give rise to additional detriment.

CUSTOMER DEMOGRAPHICS AND USE OF THE PRODUCT

Consumer type and behaviour has been subject to claim and counter claim in the political debates on payday regulation. For example, Wonga claims that its customers are typically “tech-savvy, employed young professionals” while consumer advocates argue that payday lenders target those who can least afford to repay these costly loans. It is likely that both claims are true; most lenders will insist that customers must have a bank account (for transmission and repayment purposes) and some form of income. However, these are eligibility criteria rather than a form of affordability assessments. Being tech-savvy essentially means having a smart phone or internet access and knowing how to use them.

There is no independent data to accurately identify current customer usage in the UK. Our data sets mean that we can extrapolate a neutral model of typical payday consumer behaviour in a market that regulates against the egregious effects of certain product features – i.e. when short-term, high cost loans remain short-term and outstanding payday charges do not accumulate in a spiral of debt.

Below is a graph showing the age spread of consumers taking out payday loans in Florida in 2012:



A typical consumer in the US:

- is 43 years old[2];
- is employed;
- earns $26,000 per annum[3]
- takes out 8.6 loans of loans per year[4];
- utilizes the product over a relatively short period of their financial life, Over a 60% decrease after 5 years (State of Florida long term usage study in comparison of the CFPB White Paper)

In the 14 states which track every single payday loan transaction, the average market size of payday loan consumers is under 10% of the total population[5].

The latter point is important for the UK as it suggests there is a limited total market for payday loans. The evidence points towards a maximum customer

[2] Florida State trends report, June 2013
[3] Consumer Financial Protection Bureau, 2013
[4] Florida State trends report, June 2013
[5] Based on data in state trend reports from Michigan, Kentucky, South Carolina, and Florida

base of approximately 10-12 per cent of the population, a fact that has important results for competitive pressures in the market because there is a finite number of customers for lenders to acquire, retain and monetise.

SIZE AND STRUCTURE OF THE MARKET

It is a disappointing feature of UK regulation of consumer credit that there remains uncertainty about the volume and scale of the payday lending sector.

Veritec has had several conversations with regulators about the size of the UK payday sector. Based on our knowledge of the capital deployed in the UK by US firms, our understanding of lenders' cost models, and conversations with consumer groups lead us to believe that the OFT's calculation of market size in its Payday Compliance Review[6] underestimates the size of the sector.

We note that Wonga alone granted 3.8 million loans in 2012, with total revenue of over £300 million. By comparison, Dollar Financial Corporation's (DFC) latest investor presentation[7] shows that payday loans granted to UK consumers through stores and internet channels account for approximately 37 per cent of its global revenue ($444 million or £276.4 million[8]). A crude assumption that the 9.4 per cent difference in revenues equates to a 9.4 difference in loan volumes would mean DFC granted approximately 3.44 million loans in the UK and these two firms alone issued 7.24 million transactions. When you take into account the difference in costs between Wonga and DFC (the latter has a large physical presence in the high street), the number of loans could be higher still.

We estimate at least 10 to 15 million transactions are conducted annually in the UK market. Our estimate is based on a calculation of lenders' costs, including storefront or real estate costs and lead generation fees, against the aggregate profitability on each loan and the capital deployed by firms operating in this market. For more information please see the section on lenders' business models.

Despite the volume estimated above, US lenders consider the UK market to be 'considerably under-served'[9], a view supported by the investment bank JMP Securities which predicts UK payday loan volumes and fees will grow 212% and 246%, respectively, between 2010 and 2016.

Stephens Inc., an investment bank specialising in arranging capital for firms in this sector, estimates the size of the US market as 120 million transactions annually, representing over $48 billion in total borrowing. If the UK market, with roughly one-fifth of the population, reaches the same level of saturation as the US total loan volumes would reach 24 million transactions with a total loan value of $10 billion (£6.2bn) lent. However, due to the lack of rigorous borrowing

[6] £2.0-2.2 billion in 2011/12, corresponding to 7.4-8.2 million new loans
[7] http://ir.dfcglobalcorp.com/phoenix.zhtml?c=177357&p=irol-presentations
[8] At 1 USD = 0.622566 GBP (26/09/2013 12 noon)
[9] Dollar Financial investor presentation, 2012

restrictions in the UK market and no prohibitions of rollovers, lenders may report a loan which has been rolled over three to four times as a single loan transaction. Data from most US jurisdictions treats the roll-over as a new loan since the fees earned are the same for each time the loan is rolled over. Of that total over 15 million are conducted in states which have a real-time database.

TYPICAL LENDER BUSINESS MODELS

As explored above, short-term loans offered and delivered in a matter of minutes are expensive to borrow and expensive to lend. In the following section we set out the typical business models for US-owned payday lenders.

Online lending model

We recommend the Competition Commission reviews the 2012 report on online payday lending by JPM Securities, which identifies five core components of the online lending business model: 1) customer acquisition, 2) portfolio development and credit management, 3) customer retention, 4) back-end infrastructure, and 5) regulatory framework[10]. (This is further illustrated by Advance America and Stephens Inc. as described in a recent presentation to the Philadelphia Federal Reserve.)

However, for the purposes of this submission we will analyse only the costs involved in customer acquisition and portfolio development in more detail below.

Lenders acquire customers through a combination of purchased and internally-generated leads (via marketing etc.) though most online operators have relied more heavily on purchased leads as a means of accumulating customers and building loan portfolios[11].

Lead generators rank leads by quality and price them accordingly so that lenders paying the most commission get a first look at leads. Lenders evaluate lead flow by assigning a score to each lead based on the consumer's perceived creditworthiness, usually defined as the borrower's ability to repay the loan at maturity. The score is of "extreme importance to online lenders as they usually have only a matter of seconds to review a lead before making a purchase decision"[12].

Organic leads generated through marketing and social networking tend to be more brand loyal but are more expensive to source when the cost of advertising campaigns are taken into account. The balance may tip in favour of organic lead generation as purchased leads become more expensive.

JMP states that lead aggregators charge anywhere from $1 to $130 per lead in the US, with high quality leads commanding fees of $100-$130, while the figure

[10] JMP Securities, Online consumer finance for the under-banked, January 2012
[11] Ibid.
[12] Ibid.

for the UK is estimated to be between £25-£50 for a mid to high quality lead[13]. Note that this figure is from January 2012; we believe that the costs for high quality leads is now significantly higher given the growing loan volume, expanding number of suppliers and increasing saturation of the market. It is reasonable to expect that the upper end of the cost scale is comparable to that of the US market.

Not all leads will be converted. On average, online lenders can expect to convert 40% of mid to high quality purchased leads to convert into borrowers. As the simplified example below shows, this has important consequences for lending decisions:

- Lender A charges customers £25 per £100 in interest and fees for a 30 day term. It issues standard loans of £200 and therefore generates £50 of revenue per individual loan.
- Lender A pays £60 per high quality lead with a standard conversion rate of 40%
- Lender A buys 100 high quality leads for £6000; 40 leads convert into loans generating £2000 of revenue.
- In order to make this loan portfolio profitable these 40 leads need to be further converted into repeat customers either through new loans or rollovers, turning a one-off short term loan into a long-term but extremely high cost credit facility.

Retaining customers is a financial imperative for lenders operating in a market with a limited number of potential customers. Rollovers are a tempting way to generate additional revenue from the existing customer base without having to innovate or improve services to obtain new customers. Furthermore, as we go on to argue below, consumers of payday loans are not price sensitive (or sufficiently price sensitive to drive competition) but choose lenders on speed and convenience. Therefore it is in the interest of lenders to ‘acquire’ the customer by saying ‘yes’ to a loan even when the balance of risk might be against the customer being able to repay the loan on time.

Bricks and mortar / storefront model

In overall terms, there is not too much difference between the costs incurred by store-based or internet-only lenders. Store-based lenders have significantly greater overheads from the real estate portfolios and staff required to service their customers. However, store-based lenders benefit from a local presence, a greater likelihood of repeat custom (see chart below) and lower default rates.

[13] Ibid.

Chart: customer use of lender locations, Florida, June 2012-May 2013

# Store Locations Used (TTM)	% Customers	
1	71.2%	89.2%
2	18.0%	
3	6.3%	10.8%
4	2.6%	
5	1.1%	
6	0.5%	
7	0.2%	
8 or more	0.1%	

A majority of consumers patronized a single store location during the same period. Approximately 89 per cent of consumers took out advances with 2 or fewer store locations during the trailing twelve month period.

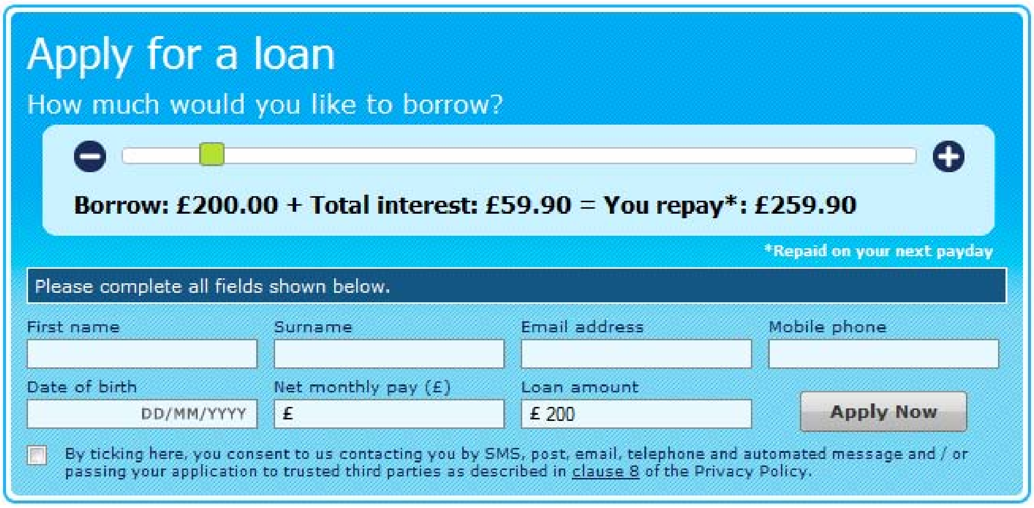
PRICING AND RISK

Lenders use a number of factors in pricing their loans. We would agree with the Competition Commission's issues statement when it says factors include:

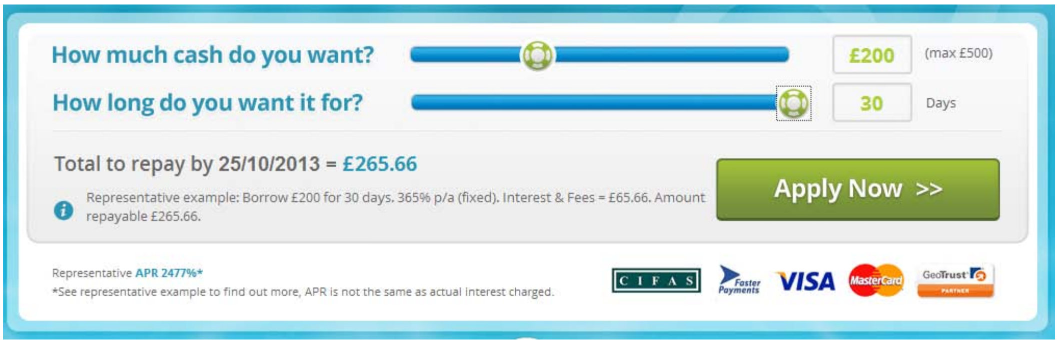
- Amount borrowed
- Duration of the loan
- Interest
- Transmission costs
- Risk

It is important to note that each lender aggregates their costs associated with these factors rather than calculate them on a case-by-case basis. An examination of operators' websites and loan offers shows that any lenders will charge two different customers the same price for the same loan no matter how likely the individual customer is to default. In addition, the price does not change for repeat customers with a perfect credit record; the total amount available to be borrowed increases instead.

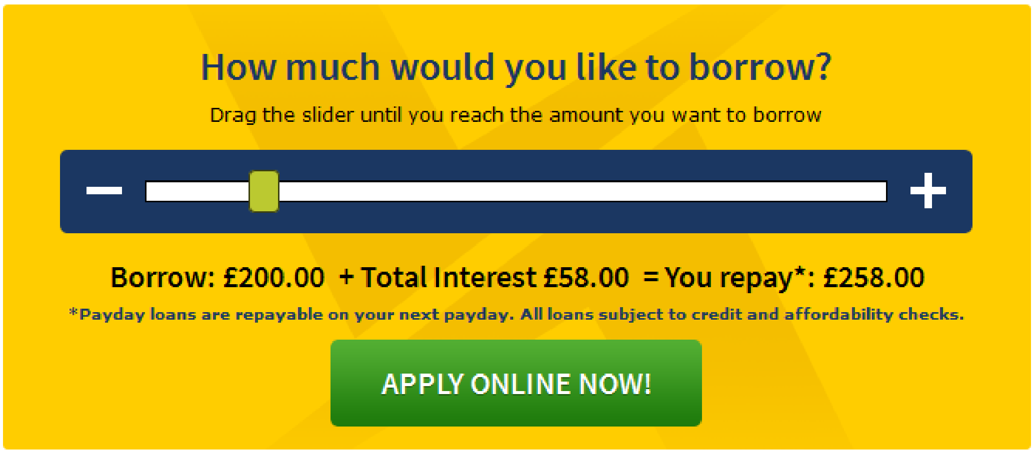
Example: PaydayUK loan application



Example: Lifeboat Loans application



Example: Payday Express



In addition, the industry practice of ‘rolling’ unpaid loans over to a new term and charging only interest effectively amounts to the lender re-pricing the risk of the loan after it has been written. If a lender has accurately assessed the borrower's ability to repay the loan then it should have priced the risk into the original cost charged to the customer. It is for this reason that US states with effective regulatory regimes have all decided to limit lenders charging for rolling over loans.

On a sector level, prices are broadly similar because customers are not price sensitive. (We also recognize that for a substantial portion of potential customers, other credit options are even more expensive). This is especially true when comparing firms with similar business models, for example comparing two online firms or two 'bricks and mortar' lenders.

DISCUSSION ON THEORIES OF HARM

Theory of Harm 1: impediments to customers' ability to search and identify the best value product

There are a number of reasons why consumers use payday loans instead of cheaper financial products. Some consider cheaper credit to be a longer term, more costly obligation (e.g. making minimum repayments on a credit card debt) while others make a rational decision that in certain circumstances it makes economic sense to take out a short term loan, for example when threatened with utility disconnection and penalty fees.

However, in most cases consumers are using these expensive loans because they are not able to access cheaper forms of credit, either because they are not eligible or because they have used up their allowances. Consumers in that situation cannot exert meaningful market power because the main concern is obtaining credit from somewhere quickly, rather than shopping around for the best offer.

It is important to note here that internet and storefront transactions can be completed in 15 minutes or less. "Payday lenders rarely perform time-consuming credit checks or evaluate the borrower's ability to repay the loan on the due date. Instead, the borrowers are required to provide information easily available to them, such as identification, proof of residence, recent pay stub and checking account information."[14] The lack of adequate affordability checks is both a consequence of intense competition and a cause of substantial consumer detriment down the line.

Shopping around on price

We do not agree that consumers are misled by the use of APR but they may cease to take them into account in making decisions. Lenders across the board are spelling out the actual price of a loan in order to mitigate any sense of soaring costs engendered by the APR display. In addition uniformly high APRs

[14] California Department of Corporations, California Deferred Deposit Transaction Law: Report to the Governor and the Legislature, 2007

may serve to create a perception that there is little difference in the cost of lenders' offers but consumers know that these loans are expensive; often they simply have little choice.

Lenders respond to a captive audience of limited size in two ways. Firstly, with high prices (in part reflecting the risks attached), and secondly by using less conservative affordability criteria in making their lending decisions. For example, it has been widely reported that Wonga rejects two-thirds of first time applicants. We believe that figure includes those whom are turned down for a loan on the grounds that the requested amount is too high but who are then offered a lesser amount. As stated above, with a limited market size, it is imperative for lenders (especially those considering an IPO) that they seize and hold market share.

We do not believe that there are particularly high search costs for consumers given the proliferation of lenders and the intense competition between firms to acquire market share. However, impediments to shopping around occur because consumers are likely to go ahead with the first lender that approves the individual for a loan rather than seek approval from several firms before choosing the best offer. This behaviour is caused by consumers' limited ability to access cheaper mainstream finance, and their desire to have the sums delivered to them swiftly.

The Commission is right to identify the potential difficulties that can arise when customers need to forecast future income and expenses. Problems arise when consumers overestimate their ability to repay the original loan and become caught up in a spiral of debt as charges and interest mounts up. However, it is not this factor that causes an adverse effect on competition but rather the incentive for lenders to acquire a customer by offering the individual a loan that they may not be able to repay at the end of the original term. In these cases, lenders generate revenues by rolling over consumers with the result that they have a longer term relationship with the original lender; have a poorer credit record; and are, in many cases, grateful for the rollover facility because it is promoted by many lenders as 'good customer service'. These features combine to further degrade borrowers' ability or willingness to shop around for a better offer.

Switching

Payday loans, when used appropriately, are not revolving forms of credit and so are unlike credit cards or bank account overdrafts. When coupled with price insensitive customers, this poses challenges to the traditional concept of consumers causing beneficial outcomes and driving competition by switching between providers.

There are two possible scenarios for consumers when consumers could switch between payday providers.

First, a consumer might choose to obtain a new loan from a new provider after he or she has paid off the original loan. However, we have already seen that consumers value speed and convenience over price considerations and that lenders strive to keep customers by making it as easy as possible for existing customers to secure repeat loans. Evidence from the US shows that a majority of consumers use a single licensee company for payday loans. During the period from June 2012 through May 2013 over 99 per cent of consumers took out advances with two or fewer licensee companies during the period.

Chart: customer use of multiple lenders, Florida, June 2012-May 2013

# DPP Companies Used (TTM)	% Customers	
1	94.1%	99.7%
2	5.6%	
3	0.3%	0.3%
4	0.0%	
5	0.0%	

(DPP = deferred presentment provider, i.e. a payday lender. TTM = trailing twelve month period)

Second, a consumer could switch between suppliers while he or she has an outstanding balance but we question whether this delivers an optimum outcome for borrowers. Costs in this sector can increase quickly and transferring an outstanding balance to a new supplier would effectively compound interest and fees. Due to compounded fees the second lender (to which the consumer has transferred the balance) would have to offer significantly cheaper rates than the original lender for it to be economic for the borrower.

In all probability a borrower is likely to roll over loans from the original lender several times before switching because it will be easier than transferring his or her balance. The more times the original loan is rolled over, the cheaper the second loan has to be for it to make economic sense. However, multiple rollovers are usually a sign that a borrower cannot repay the full sum. The second lender is therefore lending a larger sum than the original lender but at a higher risk. In order to recoup their outlay and hedge against default, the second lender would have to charge more fees or increase the duration of the loan, neither of which is ideal for the consumer.

Theory of harm 2: market power and barriers to entry

Veritec is of the opinion that there is strong competition between lenders in the UK market but this competition manifests itself in a drive to acquire customers by being the first to offer a loan rather than offering a loan at a lower price. This level of competition over a limited number of consumers carries risks to lenders because default rates become higher the more the market is exploited.

For example, lender A may have a portfolio of high quality borrowers with relatively low levels of indebtedness but the default risk in the portfolio increases as these same customers will be targeted by other lenders who offer to meet demand when lender A refuses because lender A is concerned the consumer might be overextending himself.

In order to compete effectively lenders operating in this market need to have considerable capital resources that can meet operating costs such as staffing and facilities, provide the principal loan sums, and cover the high default risk. The requirement for substantial capital backing is both a barrier to entry and a factor in the consolidation at the top of the sector. However, we do not believe that it is significant enough to cause an adverse effect on competition, principally because there is a high level of demand from investment banks, private equity and hedge funds for opportunities to invest in this sector. This is best illustrated by the recent example of Zebit, a UK lending brand, attracting $30 million investment to grow its operations in this country. (See box 1 below.)

BOX 1: US investment in the UK short term high cost credit industry

Dollar Financial

- Dollar Financial Corporation (DFC) is one of the leading payday lending companies operating globally. It receives 50.2% of its total revenue from the UK, the largest of any country in which it operates. DFC's total annual revenue is $1.2 billion.

- The UK is now the country with the second-highest number of DFC's payday lending stores (578), versus 304 in the USA, 104 of which are located in Florida. DFC anticipates opening or acquiring approximately 50 to 75 additional retail stores in the United Kingdom during the 2013 fiscal year.

- Dollar Financial has the largest pawn book in Europe and the third largest pawn book in the worldwide market. They are now targeting the UK in new ways such as high-end pawn lending and small business advances.

- These figures will increase further as Dollar Financial is now investing in more technology and personnel to increase its share of the internet based market.

Zebit

- Zebit is one of the leading providers of online, short-term, small-balance loans to under-banked consumers located in the UK through its Lending Stream and Zebit brands. Zebit is a Big Data underwriting open platform backed by Global Analytics Holdings, Inc. that powers financial products bridging the gap between payday loans and traditional bank credit.

- On June 19, 2013, Zebit refinanced its existing venture capital debt line with a new $30.0 million term debt facility fully funded at close.

- Zebit intends to use the net proceeds from this transaction to fund loan portfolio growth.

EZCORP

- US firm EZCORP has taken large stakes in two leading payday firms.
- In November 2011 EZCORP paid A$70 million to increase its stake in Cash Converters to 53%.
- EZCORP also owns 29.95% of AIM-quoted pawnbroker Albemarle & Bond (A&B)

Competition from other alternative lenders

The role of potential alternative providers, particularly credit unions, has been overstated in the political debates on payday lending in the UK.

Credit unions are well-established in the US, and the sector is more mature there than in the UK, but payday lending still exists in the US, in fact it started there. The ability of private venture capital-backed payday firms to innovate, create new technologies, and deploy capital speedily and flexibly means that the industry now serves millions of consumers both in the US and the UK.

Credit unions offer a different model to the credit product mix but they find it difficult to compete with payday firms in the market for very short-term, non-underwritten loans. Credit unions are an important part of a diverse financial services sector but it is unrealistic to believe that the UK credit union sector can grow to a size, quickly enough, where it can challenge payday firms' position in the high cost, short-term credit market. While there are several examples in the US where credit unions have successfully offered payday loan product substitutes, those credit unions are either being directly subsidised against loan losses, or are adding other fees such as application processing to obtain a return to compensate for the risk. We would urge the Commission to review the recent study conducted by the University of California at Davis for information about the US credit union market being able to compete with the payday lending industry.

Payday firms are not going to be 'competed out of existence' – but they can be properly regulated so that the vast majority of problems in the market are eradicated.

POLICY RESPONSES AND EFFECTS ON COMPETITION

We have covered how, in certain sectors of high cost credit including payday lending, there is intense competition between lenders to secure customers. This is not competition on price but on speed and convenience**.** When combined with irresponsible lending practices – repeated rolling over, multiple loans – and/or unaffordable borrowing, this competition has resulted in severe consumer harm.

Borrowers that have restricted or no access to cheaper credit elsewhere a captive market for lenders, who are competing for revenues but not based on prices: they are charging the same price to each consumer despite any credit risk assessment.

Therefore, it would be wrong to overstate the negative effect of regulatory intervention on competition when competitive pressures that benefit consumers are non-existent despite the proliferation of payday lenders.

The immediate short-term effect of placing restrictions in payday credit (rollovers, caps or lending limits), will reduce the volume of credit available to some consumers, and reduce the number of lenders by eliminating irresponsible practices. However, the payday industry can grow safely and sustainability in a regulatory regime that includes product rules.

On its consultation paper *High-level proposals for and FCA regime for consumer credit,* issued on March 2013, the FCA has concluded that, with the general low incremental costs on firms, the wider impacts on competition of the proposed new regime are expected to be very limited.

In particular FCA expects minimum impact on competition in consumer credit market; market exit due to the proposed regime and increases in barriers to entry are expected to be minimal for lenders; however, consumers will still have access to a very large number of intermediaries and this should not constraint credit supply.

We agree with FCA market analysis and its conclusion on how limits and rules would not lead to a significant impact on competition nor would affect availability of credit, lending volumes or credit prices in the long-run. Payday lenders would be able to continue to compete on the issues they do nowadays.

Case study: Florida

Florida has nearly 19 million residents. These residents take out a cumulative total of 570,834 loans per month from 1,500 licensed stores operated by 192 companies.

In 2001, Florida implemented new regulations on payday lending that stipulated a maximum sum of $500, limited transaction fees to $10, banned rolling over, restricted loan terms to a maximum of 31 days, and imposed a cooling-off period of 24 hours between loans.

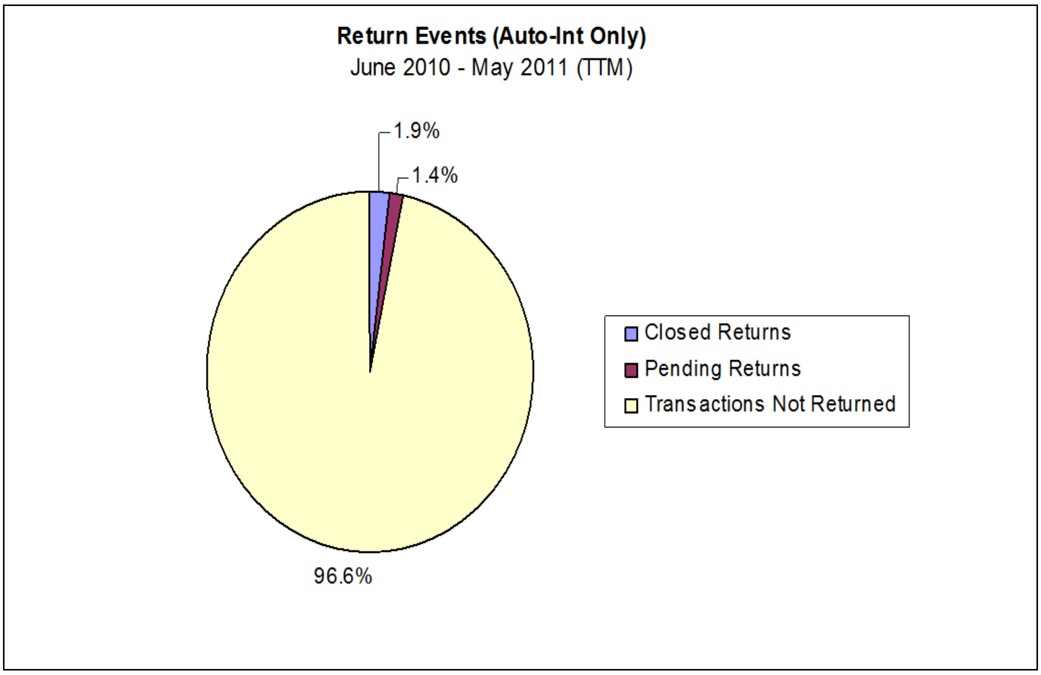
The effects have been dramatic:

- Florida authorised 6.8 million loans in 2009/2010 in which not a single loan was extended beyond the contract for additional fees.
- Over 90 per cent of borrowers repaid those loans within 30 days of the due dates.
- Over 70 per cent of borrowers repaid their loans on their contract end date.
- The level of consumer complaints of mis-selling and over-indebtedness has dropped dramatically and complaints about high interest rates have all but disappeared.
- In fact, not one loan issued in 2011 violated any portion of the Florida statutes governing short term credit.
- Not one borrower was indebted more than $500 at any given time in the State.

- The average Florida consumer borrows only $390 when they do borrow.

Just as the database simply enforces jurisdictional prescribed rules, the database also enforces the benefits of those rules. For example, in states which do not allow any additional borrowing when the borrower is locked into a work-out repayment plan with a lender, the entire lending market benefits from a lower loan loss rate.

It is very interesting to look at the total cost to the lender when operating in a real-time enforcement jurisdiction with prescribed rules. **Loan losses are dramatically lower in those jurisdictions than what industry reports overall.** Using figures from the State of Florida, the diagram below shows the annual loan losses in the State of Florida.



As the diagram above shows from 2011 Florida data, less than 2% of loans at the end of the reporting period were loans where lenders had effectively written off as bad debt (closed returns). Considering that industry reports that bad debt averages in the US are closer to 7% of total transactions, this is a dramatic drop. If a UK lender is experiencing on average a 20% bad debt loss, the savings of a real-time database enforcing very basic consumer protections would dramatically decrease the cost of a payday loan. This is one of the most serious issues facing the UK market. With more and more entrees into the market chasing a small percentage of consumers, lenders are offering more and more riskier loans to make up for the large charge off rates. This is actually increasing the cost of credit. In fact, Wonga recently spoke in the media about their increased charge off levels. It is very clear from the data in the US that certain prescribed rules enforced by a real-time database will drastically lower default rates.

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The program has been so successful that in over 10 years, the Florida legislature has not sought to change ANY of the current Florida short term loan statutes.

The Florida approach does not require credit rating agencies. Instead, all lenders are required to input applications through a point of sale system overseen by the State and managed by a 3rd party technology firm. This system uses central data to provide live eligibility information, telling lenders what individual customers are able to borrow.

The key advantage of the system is that it prohibits customers from taking out a payday loan and then taking out another before a credit rating agency has updated its records if lenders choose to report transactional information.

The system provides regulators with up to the minute records of transactions, making it easy to spot non-compliant behaviour and focus resolutely on loan sharks.

The estimated drop in transaction volume when the database was implemented was between 20 per cent and 30 per cent of previous transaction activity. This initial drop in volume was due to the effectiveness of the database in preventing non-compliant loans. The transaction volume recovered to pre-database levels after approximately 12 months. Since implementation, the average year on year loan transaction volume increase in Florida has been over 18 per cent, clearly demonstrating that a sustainable, responsible lending model is viable. However, during this same time frame, there were not any calls to further restrict the product or eliminate it outright.