Competition Commission Statement of Issues – Think Finance UK's Response

Introduction

- Think Finance (UK), a wholly owned subsidiary of Think Finance (US), welcomes the opportunity to comment on the issues raised by the Competition Commission in its statement of issues document. Think Finance's goal in the UK is to offer consumers a legitimate alternative to traditional payday borrowing through products that address multiple areas of concern highlighted by regulators and consumer activists. Specifically, we focus on products that compete on fees, interest rates, transparency, facilitation of good decisions, repayment flexibility, and the total cost of borrowing to the consumer. In addition and not least importantly, we are publicly stating that we will cap our profit margins at significantly lower level than those reported by competitors.

- As a new entrant attempting to surmount the significant barriers to entry created by the strong positions of incumbent companies, we welcome the regulatory focus that appears to seek to create a competitive environment that lowers these barriers for companies entering the market with superior propositions for consumers. We believe the Competition Commission research will show that while a legitimate consumer need exists, it is incredibly challenging today for consumers to compare loan products, to model what happens to the total cost of borrowing if their repayment plans change, or to benefit if their risk profiles improve. The strong spend on branding and marketing channel domination by incumbents make it incredibly difficult and almost impossibly expensive for a new entrant to gain consumer consideration even with a superior product offering.

- In responding to the statement of issues we have taken the three sections of the statement in turn:
  - market characteristics and outcomes
  - market definition; and analysis of competition
  - and theories of harm

- We believe that the focus of the Competition Commission's investigation is broadly right though we would encourage a greater focus on the full range of marketing channels used by short-term lenders today to understand: a) the role the channels play at enabling or distorting true price comparisons, b) the role they play in driving up the total cost of borrowing for consumers, and c) the ability of a new entrant to compete in each of these channels. We also believe that a full investigation into the alternatives available to consumers must account for both formal options, such as unplanned overdrafts, and informal options such as family/friends, payments in kind, and loan sharks. We hope that in evaluating the various segments of consumers who choose short-term loans, the CC is able to identify all instances for each segment, beyond just short-term borrowing, in which individuals choose based on desire or need versus income optimization.

- We would welcome the opportunity to share specifics and insights that support our views directly with the Competition Commission and look forward to doing so formally in the next few months. We are content with this response being available to all in the public domain.

Market characteristics and outcomes

- Although short-term lending makes up just under two per cent of consumer credit in the UK today, it serves a range of consumers at all levels of income with varying degrees of financial awareness. Standards for simplicity should be high as should ease of loan comparison.

- Margins in this sector are driven by the fact that several players with deep experience and insight control the vast majority of the market and, while innovative in various ways, they do not appear to compete meaningfully on price. Think Finance believes we can offer the same or superior products to consumers at dramatically lower prices. Think Finance welcome the anticipated increase in regulation of consumer credit and the referral of the payday market to the Competition Commission, but we are concerned that regulation alone may not go far enough in addressing market failures of the payday sector. To encourage companies to develop practical alternatives to payday lending, regulation should foster an environment that compels and enables real competition on value-added consumer benefits (rates, fees and more)---not just on speed and convenience---all of which should lead to lower margins for lenders to the benefit of consumers, but still enable an innovative business to earn reasonable profits.

- Consumers need a clear and simple way to understand and compare the total cost of borrowing under more than one possible scenario, for instance they should be able to compare loans based on a likely repayment scenario and also under a scenario where things don't go according to plan. This will help them make better choices.

- Regulators can also improve competitiveness by forcing greater disclosures by various marketing channels on how or why a certain lender holds a specific position on their sites. Consumers may believe the ranking to be based on interest rate or total cost of borrowing when in fact this may not be the case.

- Rather than try and convince regulators that everything is fine in the industry, we have listened and have designed our new product, Sunny, in response to what we heard. Our goal is to disrupt the market by offering the potential for total cost of borrowing to drop to less than half of the cost offered by the leading competitors. Sunny aims to meet consumer and regulatory goals to be fundamentally different to typical payday loans through:

  - Transparency. Clear pricing with no fees of any kind; just interest
  - Risk Based Pricing that reflects the true underlying risk of the borrower to us as a lender
  - Flexibility to work with customers' changing situations
  - Elimination of rollovers
  - Going even further than compelled by the Consumer Credit Act ("CCA") to help consumers
  - Total cost of the loan (fees and interest) visible up front under multiple scenarios
  - Simplicity in design to help consumers make good decisions
  - Reasonable, ethical, profit margins

- In addition to regulatory reform, a culture change is also needed with firms recognising the obligation they hold to help consumers make good choices, not just informed choices. A commitment to simplicity in product design, flexibility in repayment terms, and financial education are critical to achieving this.

Market definition

- Think Finance believe the distinctions between payday loans and other forms of credit, such as bank overdrafts and credit union loans, should be acknowledged but the focus must extend beyond price comparisons alone to include terms, speed, and convenience. It is critical that alternatives are judged against the consumer need and whether funds arrive in time to solve the problem faced by the individual.

- We see the merit in the Competition Commission exploring whether to segment the payday lending sector further. There are problems of malpractice in the payday industry and in short-term lending overall as the OFT identified, but not all firms are the same. Firms that adhere to robust codes of conduct should be recognised apart from those that don't. Consumer benefits that should be considered are: the length and risk of the loan; the total cost of borrowing; repayment flexibility; and efforts to progress customers into mainstream financing. Painting all lenders with the same brush runs the risk of discouraging competition since innovation will not be recognized as being worthwhile to pursue.

- We believe that demand in the payday market will continue to grow rapidly. Bank regulation appears to continue to limit available credit that banks can extend and profit/reputational issues for the banks seems to lead to avoidance of dealing with customers who could threaten either of these areas of concern to them. Beyond bank regulation, changing consumer attitudes also will play a role in driving short-term lending. Our expectation is that the mix of the consumers borrowing short-term will continue to evolve with more and more people of higher income, diverse ages and diverse professions using short-term financing. Improved consumer savvy around the benefits of research will drive more online and away from the high street payday lenders and pawnbrokers, further heightening the need for a credible, objective comparison tool.

- More attention and more people borrowing will raise the consumers' expectation of lenders across the full customer experience. Technology, big data and analytics will also play an increasingly important role since lenders will need to offer competitive rates and services while minimizing potential losses on thinner margin businesses.

- Barriers to entry in short-term lending will look low on the surface but the reality is that they will remain high. Some barriers must exist by having standards for entrants in terms of service and compliance. Other barriers are created by the extensive investment required in risk underwriting and verifications technology and models. Where barriers seem unreasonably high for new entrants is in marketing as brand awareness and channel domination by incumbents makes it incredibly difficult to compete.

Analysis of competition and theories of harm

- Theory 1: *Impediments to customers' ability to search and identify the best value product, and switch supplier*

    - The OFT and CC found that that the payday market is concentrated, with the largest three lenders representing about 70 per cent of the market (by turnover). These companies have invested heavily in their brands over several years. To cut through the clutter of brand familiarity, consumers need a way to confidently, simply, and quickly compare these entrenched products with the potentially superior products of new entrants. Today, this venue of comparison is non-existent. While comparison tools exist, none enables a consumer to evaluate on easily measurable factors and, equally critical, there is no consumer tool that compares loans based on what happens if things do <u>not</u> progress as the consumer may hope. As a result, some products which look good in very optimistic repayment scenarios, look considerably worse in less optimistic ones, but the consumer does not see this. Consumers need to be presented with both scenarios so that they can make the wisest choice.

    - Switching suppliers is challenging for consumers because of the lack of easy comparisons and because there is no credible central data source that measures each product on all relevant criteria. As a result, once again, it seems that consumers default to known-brands which may not be the cheapest or best alternative for them. It also encourages companies to invest in brand versus competing on price or other value-added consumer elements.

    - Another factor increasing the challenge for consumers is the lack of transparency from some marketing channels on how or why a certain loan is recommended to the consumer or why it is ranked first in a comparison table. We would encourage the CC to investigating these channels further to see if they operate in the best interest of consumers. For instance, due to the odd way in which APR is calculated, simply by offering a discount on the first month of interest for a loan, a lender can make itself look artificially “low priced” relative to other products that better reflect how the individual will use the loan.

- Theory 2: *Market power and barriers to entry*

    - Barriers to entry in short-term lending are incredibly high due to the high concentration of market share among the top few companies, the dominance of these companies in key marketing channels, the lack of easy comparisons for consumers, and due to the dominant position of incumbents in the consumer mind due to the heavy brand spend made over many years. While these brand investments can perhaps be respected for their ingenuity, they should not lead to an entitlement to entrenched revenues and profits when superior consumer options exist.

    - Market power can be seen in multiple marketing channels. 1) Lead Gen providers, where top companies dominate the top of ping trees by offering prices new entrants struggle to match. 2) Affiliate sites, where the size of incumbents allows them to purchase top tier positions, further establishing their dominance. 3) TV, where the quantity of marketing funds available to them gives them a disproportionate reach, share of voice, and share of consideration in the consumer mind. 4) Print, where high profits over many years have given them the ability to spend on blanket/saturation campaigns that no new entrant could hope to match.

    - Since no easy comparison tool based on fundamental and critical loan attributes exists, consumers default to familiarity. This, combined with statements from multiple sectors of the community that label all short-term lenders as basically the same, we believe disincentivises consumers from engaging in a meaningful effort at value comparison.

    - Barriers to Entry and Market power also exists in the form of the technological and risk model investments that these companies have made over several years. To make decisions fast on people with a range of credit profiles requires extensive technical and risk related investments. While the barrier created by these investments is a more understandable and even defensible advantage for the companies who benefit today from those investments than the advantages they enjoy from heavy brand spend, they still should not entitle the companies to entrenched revenues and profits. Facilitating information flow to aid all companies---incumbents as well as new entrants---in credit decisioning, would encourage new entrants to compete on a more equal footing with the large competitors.

    - As a new entrant to the market we are experiencing the challenges first hand. Despite a product that even at the entry point is considerably cheaper for consumers in every way than the leading competitor in the market and which is potentially more than 60% cheaper for consumers compared to this same competitor if re-use is frequent, the challenge of building awareness and attracting consumer attention is incredibly difficult amidst the market saturation in advertising of this competitor.

    - While the incumbent companies were created to serve legitimate consumer needs brought about by a variety of economic and social factors, and while these companies have tried to meet those needs in various ways and with varying effectiveness, we believe that the needs and expectations of consumers have evolved while existing business models have not. There is a real opportunity for an alternative to these companies that is superior for consumers.

- Theory 3: *Consumer Detriment*
    - Finally there may be a view that consumer detriment is apparent in this market, and another possible theory of harm. The Government analysis of current consumer sentiment via the University of Bristol study found that this is in fact inconclusive. Our own experience gives us confidence that if the product characteristics are right, and the technology in place to make the right decisions on the customers' needs, then consumers can be well served in this market.

Overview of Think Finance

- Founded in the United States in 2003, Think Finance is a digital finance company that uses technology and risk analytics to bridge the gap between payday and mainstream consumer financing. We are a new entrant to the UK market and have recently launched a new, innovative product, Sunny.

- We believe the future of short-term lending in the UK is going to evolve rapidly away from traditional "payday" loans that compete purely on speed and convenience. We differentiate Sunny on fundamental consumer benefits - interest rates, fees, repayment flexibility and financial education, resulting in a significantly lower "total cost of borrowing".

- We have saved US consumers over $1bn versus payday loans and believe we can save UK consumers £500m or more, annually, within 2-3 years, by reducing the cost of borrowing by 50 per cent. In the US our portfolio of alternative loan products start with rates just below typical payday rates and drop progressively to loans costing $0.14 in daily interest.

- Backed by top tier investors including Sequoia Capital (early investors in Google & Yahoo!) and Technology Crossover Ventures (Netflix), we were recently named No. 2 on Forbes' Most Promising Companies in America list and as one of eight top innovators in financial services to watch by American Banker in 2013.

History of Think Finance in the UK

- In 2011, Think Finance began reshaping Fortress Capital, a UK payday loan company that it had recently bought. The purpose of this acquisition was to gain insight into UK-specific risk factors and to better understand the local compliance regime. The product operated by Fortress was called OneMonthLoan, and was a typical payday loan product. Think Finance then began to explore a move away from payday with the introduction of Quid, a line of credit product. Neither product however, went far enough to meet evolving consumer needs, nor did they represent enough change to truly disrupt the existing short-term lending industry of the UK.

- In an effort to truly focus only on disruptive products, we are shutting down both of these products. 1ML will be shut down by September 2013 and Quid by March 2014, in order to focus the company fully on a new product that we believe can transform essential elements of short-term lending, save consumers hundreds of millions of pounds, and build a legitimate and moderately profitable business for Think Finance.

- As a demonstration of our commitment to the transition away from "payday" and into a new form of lending, based on risk-based pricing and payment flexibility, we are proactively moving <u>all</u> our existing customers with whom we have a strong payment history onto a NEW pricing which is less than HALF the total cost of borrowing that they paid on the old payday products. This migration began in July 2013.

- Think Finance's new product Sunny has recently launched. It competes on fundamental features of concern to consumers and regulators: risk-based rates, fees, no rollovers, payment flexibility that works with customers' changing circumstances and the treatment of financial education. It is in the early days but we see encouraging signs.

We believe we can compete in the rapidly evolving short-term market now because the increased regulatory attention clarify where short-term loans are legitimate financial service offerings and where they are not. We also believe that the more robust regulatory environment can create a more level playing field in which an innovative new entrant can compete with the entrenched dominant big players and build a profitable business---provided that entrant focuses on fundamental consumer value drivers that affect the Total Cost of Borrowing.

We believe Think Finance can build a solid business with reasonable, ethical profit margins in the UK, while charging less than half of what typical payday loans cost today. We want to partner with the regulators to be a new type of lender for the UK. Simplicity in product design, helping consumers make good decisions, true risk based pricing, flexibility in repayment, and financial education are critical to achieving this.

We recently provided the Competition Commission with the material requested about our customers and business model. We would welcome the opportunity to come and discuss our plans, product, and processes at any time with the Competition Commission.

Kind Regards,

John-Paul Savant

For more information on any of the issues raised above, please contact:

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