COMPETITION COMMISSION PAYDAY LENDING MARKET INVESTIGATION

RESPONSE OF WONGA GROUP LIMITED TO THE COMPETITION COMMISSION'S STATEMENT OF ISSUES OF 14 AUGUST 2013

23 SEPTEMBER 2013

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RESPONSE OF WONGA GROUP LIMITED TO THE COMPETITION COMMISSION'S STATEMENT OF ISSUES OF 14 AUGUST 2013

1. **INTRODUCTION**

1.1 This memorandum sets out the response of Wonga Group Limited ("**Wonga**") to the Competition Commission's ("**CC**") Statement of Issues of 14 August 2013 ("**Statement of Issues**") in connection with its investigation into payday lending and, in particular, Wonga's observations on the following areas highlighted in the Statement of Issues:

(a) market definition: Wonga welcomes the CC's intention to consider in further detail whether the sector for payday loans is separate from, or forms part of a wider market with, other forms of credit;

(b) market characteristics: Unlike other, more mature, financial services markets reviewed by the CC, the market for short-term credit is changing rapidly with the emergence of new products and entrepreneurial business models such as Wonga's, facilitated by sophisticated technology platforms; and

(c) the two theories of harm which the CC has provisionally decided to investigate:

(i) "Theory of harm 1": whether impediments exist in the market that are restricting customers from exercising effective choice, and specifically, with regard to potential barriers to accessing information, identifying best value offers and switching suppliers; and

(ii) "Theory of harm 2": the extent of concentration in the payday loans sector and the extent to which any significant barriers to entry or expansion exist.

1.2 This memorandum does not cover every point raised in the Statement of Issues. Wonga reserves the right to comment on these and other issues at a later stage, as well as to expand on the issues to which it has responded in this memorandum.

2. **EXECUTIVE SUMMARY**

2.1 Wonga believes that a wider market definition, encompassing a range of short-term credit options, is required for the CC's investigation. In particular, Wonga considers that there is substantial evidence that many customers do see alternative sources of credit as genuine substitutes to payday loans. Moreover, there is clear scope for supply-side substitution as well as evidence of actual entry from providers of other forms of short-term credit, which also supports a wider market definition which covers a range of short-term consumer loan products.

2.2 It will be important to capture as part of this investigation the dynamic aspects of the short-term credit market. The evidence outlined in this memorandum points strongly to a dynamic and constantly evolving market with vigorous competition through product innovation and low barriers to entry. Technology is key to both as technology can be leveraged across products and across markets. Players with a real-time data-driven technology platform can be nimble and challenge incumbents (for example banks, credit card companies, and traditional payday lenders) where they see an opportunity to offer a flexible, customer-focused product. This is what Wonga has done, and many of its key rivals have a similar diversified growth strategy.

2.3 Although the successful and innovative features of Wonga's core consumer loan product have remained broadly unchanged since launch, Wonga is continually evolving the offer through refinements in order to remain competitive. There has been a diffusion of certain aspects of Wonga's ground breaking business model which have proved to be popular and successful, in particular, the user-friendly and transparent interface, the control given to customers over the loan particulars and repayment requirements (particularly early repayment) and the use of data and analytics to make responsible but speedy loan decisions and to refine the offer more generally. Credit providers have sought to differentiate themselves through product choice and flexibility and through risk-based pricing.

2.4 As regards the ability of customers to access the information needed to make informed choices about payday lending products, Wonga considers that transparency, flexibility and ease of use are central to its proposition, and that its business model has been emulated by many rivals in this regard. It is straightforward for Wonga customers to get a clear idea of the full costs of a Wonga loan before making an application (including the costs which might arise in those cases where circumstances change post loan approval).

2.5 There is evidence indicating that customers are able to identify best value offers by making meaningful comparisons. For example, Wonga's product, user experience and application process are structured to facilitate customers undertaking comparisons. Wonga's commitment to transparency is also apparent from the significant investment it has made into the www.OpenWonga.com website which aims to meet consumer demand for more information about the Wonga offer. In addition, there are numerous free online sources of information on payday loans and alternative short-term credit options which enable comparisons of products, and third party research indicates that many customers consider loan terms and understand the information provided. As regards potential concerns relating to consumer bias, Wonga takes steps to minimise the risks associated with customers overestimating their ability to repay a loan.

2.6 The evidence of continual product innovation is consistent with a market where the risk of switching compels lenders to invest and evolve to remain competitive. Finally, Wonga considers that barriers to switching at the point of extension have been overstated.

3. MARKET DEFINITION

3.1 With regard to market definition, as outlined in Wonga's Initial Submission of 12 July 2013 ("**Initial Submission**"), Wonga believes that a wider market definition, encompassing a range of short-term credit options, is required for the CC's investigation. In particular, Wonga considers that there is substantial evidence that many customers do see alternative sources of credit as genuine substitutes to payday loans. Moreover, there is clear scope for supply-side substitution as well as evidence of actual entry, which also supports a wider market definition which covers a range of short-term consumer loan products.

3.2 Wonga is concerned that the overly-narrow scope of the reference could result in a partial review and, potentially, remedies focused on the narrow set of products which have been referred, which would risk distorting competition between the referred products and the wider set of products with which they actually compete. Wonga therefore welcomes the CC's statement that it will consider in detail whether the sector for payday loans is separate from, or forms part of a wider market with, other forms of credit.

3.3 Given the importance of this issue, Wonga highlights the following key points:

Many alternative sources of credit are available to online payday loan customers

3.4 Wonga's own customer research and third party research demonstrates that online payday customers have access to alternative sources of credit. For example:

(a) the Bristol University study quoted by the OFT in its market reference found that 76 per cent of online payday customers also used at least one type of mainstream credit.[1] Furthermore 24 per cent of online payday customers did have available to

[1] The impact on business and consumers of a cap on the total cost of credit ("**Bristol University Research**"), Personal Finance Research Centre University of Bristol, 2013, Table 4.4.

them unused mainstream borrowing capacity,[2] and the proportion would be expected to be even higher if all alternatives had been examined by the study;

(b) Wonga's own customer research found that [✂] per cent of its customers have access to bank overdrafts, [✂] per cent to credit cards and [✂] per cent to each of traditional payday lenders, bank loans and other forms of credit (see slide 21 of the Populus Customer Survey, March 2013, attached at Annex 1);[3]

(c) Research by Friends Provident/Policis conducted on behalf of the OFT found that "*just 20 per cent of payday borrowers had this as their only credit option, with the remaining 80 per cent having self-reported 'other options.*"[4]

Customers do see alternative sources of credit as substitutes

3.5 There is also substantial evidence that customers with access to alternative sources of credit do see these as genuine substitutes to payday loans.

(a) the Bristol University Research found that 18 per cent, i.e. almost one fifth of online payday customers, compare the costs of loans from non-payday providers before choosing to take out their loan.[5] A SSNIP (e.g. 5-10 per cent price rise) is likely to induce further search and switching by some customers who indicated they would not find this worthwhile at current prices;

(b) customers do perceive payday loans as functionally similar to other types of short-term credit. For example, the Bristol University Research shows that customers of payday lenders and pawnbrokers used their funds for similar activities;[6] and

(c) this finding is consistent with evidence from the USA which suggests that in states where payday credit expands, returned cheque and bank overdraft fee income decrease.[7] This demonstrates that, at the margin, payday credit is a substitute for alternative forms of credit.

Payday operators and credit industry commentators see alternative sources of credit as substitutes

3.6 The focus of Wonga's development has been to create a proposition which competes head on with the banks by delivering improved customer service and convenience. The evidence supports the fact that payday operators participate in a wider market:

(a) Wonga's own consumer research actively compares the performance of its lending product to mainstream and other credit products such as credit cards, overdrafts, bank loans and traditional payday lenders;[8]

(b) it is clear that industry commentators treat payday loans as an alternative to unauthorised overdrafts. A research note by Deutsche Bank characterises payday

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2 Bristol University Research, page 24.

3 See Annex 3 of Wonga's Initial Submission for the Populus Customer Survey results in their entirety.

4 OFT (2010) 1232c: Annexe C – Supplementary analysis from the OFT's consumer survey and other sources of data, page 41.

5 Bristol University Research, Table 5.1.

6 Bristol University Research, Table 4.1.

7 Morgan, D., Strain, M. & Seblani, I. "How payday credit access affects overdrafts and other outcomes", *Journal of Money, credit and Banking*, Vol. 44, No. 2-3 (March-April 2012), page 11.

8 Populus Customer Survey, March 2013 at Annex 3 of Wonga's Initial Submission.

loans within the wider unsecured lending segment (which also includes overdrafts, student loans, car finance)[9]; and

(c) many reports and articles directly compare the charges that customers would incur when taking out these two products. For example, the Chartered Institute for Securities & Investment has undertaken research which compares the cost of taking out a £200 unauthorised short-term overdraft from Lloyds Bank and NatWest with a similar loan from a typical payday lender (see Annex 2).

The costs of alternative sources of credit are comparable

3.7 The case for recognising a wider market for short-term credit is enhanced by the fact that the cost of alternative sources of credit such as unauthorised overdrafts or credit cards can be comparable. As noted above, the Chartered Institute for Securities & Investment identified that £200 borrowed from a payday lender would cost £66 compared to a charge for borrowing the same amount by way of an unauthorised overdraft of £84.22 for Lloyds Bank and £110 for NatWest.

3.8 Customers also consider and evaluate other features of short-term credit beyond price such as the potential impact of payment delinquency. For example, as highlighted by the OFT, "*payday borrowers report that missing payments can make credit cards more expensive, overdrafts can be more expensive and that credit cards can trap you into a debt spiral at higher levels than similar observations about payday borrowing.*"[10]

The scope for supply-side substitution supports a wider market definition

3.9 The close relationship between the payday lending segment and other short-term credit segments is clear in light of the extensive diversification that has taken place between these segments:

(a) for example, most retail lenders offer pawnbroking and payday lending, as well as other services such as the purchase and sale of gold, cheque cashing, foreign exchange, money transfer, and buying and selling second-hand goods;[11]

(b) similarly, a successful online business can be applied in a number of related product areas. Wonga itself has diversified into new business lines, for example, a business loan product and an e-commerce product. Wonga's Initial Submission also made reference to growth in peer-to-peer lending[12] and the potential scope for entry from intermediaries and payment processors;[13]

(c) the CC's evaluation of remedies imposed following its Home Credit Market Investigation demonstrates that, in response to market conditions, home credit suppliers have sought to innovate and develop new products such as shorter-term loans (of around 14 weeks duration) and online arrangements to facilitate

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9 Deutsche Bank Markets Research (2012), FITT for investors, Retail banking 2012: past, present and future, September 7, page 61, provided at Tab 19.1 of the response to the CC's request for off-the-shelf material (CC's First Day Letter to Wonga, 28 June 2013).

10 OFT (2010) – Annexe C – Supplementary analysis from the OFT's consumer survey and other sources of data, page 49.

11 Bristol University Research, page 6.

12 Peer-to-peer lenders connect investors with people seeking credit after screening the credit histories of potential borrowers. The P2P Finance Association indicates that Zopa, Ratesetter and Funding Circle have facilitated over £500m of loans between their lenders and their borrowers, of which over £100m has been facilitated in the first 5 months of 2013. See www.p2pfinanceassociation.org.uk.

13 Deutsche Bank Markets Research (2012), FITT for investors, Retail banking 2012: past, present and future, September 7, page 61, provided at Tab 19.1 of the response to the CC's request for off-the-shelf material (CC's First Day Letter to Wonga, 28 June 2013).

lending.[14] Indeed, as noted below, Provident (a large home credit provider) now offers a website lending facility that looks similar to Wonga's but which offers longer-term loans.

3.10 In summary, the evidence of alternative sources of credit which are available to, and seen as substitutes by, many customers, together with evidence of entry and the joint provision of various short-term credit products by many operators, supports the case for a wider short-term credit market.

4. MARKET CHARACTERISTICS - THE DYNAMIC AND INNOVATIVE NATURE OF THE MARKET FOR SHORT-TERM CREDIT

4.1 The CC observes that payday loans appear to represent a relatively small proportion of total consumer borrowing in the UK, which is consistent with the views of other commentators:

(a) the CC compares the OFT's estimate of new payday loans issued in 2011/12 (of between £2.0 and 2.2 billion) with the Bank of England's value for UK consumer credit gross lending in 2011/12 of £176.2 billion (excluding student loans)[15] implying a share of 1.1 to 1.2 per cent;

(b) Deutsche Bank, in its analysis of the UK Retail Banking sector, estimates that payday loan companies represent less than 0.5 per cent[16] of the total unsecured market of £207 billion[17] (including £47 billion of student loans).

4.2 Wonga considers that the short-term consumer credit market is characterised by strong dynamic incentives to invest and innovate. Unlike other, more mature, financial services markets reviewed by the CC, the segment is changing rapidly with the emergence of new products and entrepreneurial business models such as Wonga's. The sections below consider:

(a) the challenge posed by Wonga's entry with an innovative business model which has sought to provide an attractive alternative to customers poorly served by traditional institutions;

(b) dynamic market developments including product development, technological change and innovation in pricing structures; and

(c) the history of entry and the potential for further entry, including the role of technology in enabling new business models to emerge and the continuing threat of disruption from technology enabled start-ups.

Wonga's entry was motivated by a desire to offer a better alternative to the neglected customers of mainstream credit providers

4.3 Wonga's entry was motivated by disruption – i.e. to offer a fresh, innovative, customer-focused product in a short-term credit market which was crying out for alternatives. As stated in Wonga's 2012 Annual Report:

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14 Competition Commission (2013), Understanding past market investigation remedies, Home Credit, February, pages 11 to 12.

15 Statement of Issues, paragraph 13.

16 Deutsche Bank Markets Research (2012), FITT for investors, Retail banking 012: past, present and future, September 7, page 59, provided in response to the CC's request for off-the-shelf material (CC's First Day Letter to Wonga, 28 June 2013).

17 Deutsche Bank Markets Research (2012), FITT for investors, Retail banking 012: past, present and future, September 7, page 57, provided in response to the CC's request for off-the-shelf material (CC's First Day Letter to Wonga, 28 June 2013).

"*mainstream demand is not being addressed in a customer-friendly way by existing providers or their products. We have been successful because Wonga is clearly priced, makes rigorous checks, and is simple, controllable and available when you need it.*"[18]

4.4 [✂]

(a) [✂];[19]

(b) [✂];[20]

(c) [✂][21] [✂];[22] and

(d) [✂][23]

4.5 [✂] Wonga's aim is to offer products which are transparent, in contrast to many traditional financial products (such as bank accounts) which are ostensibly "free" or have low headline rates but where revenue is generated through charges which are not transparent and by keeping consumers in long-term debt. Wonga's code of practice (see Annex 4) states as its mission the following:

"*Our mission is to solve consumers' occasional, urgent and short-term cash flow problems with an equally short-term solution. We base our commitment to responsible lending on transparency, flexibility and extreme selectivity - believing it's possible to provide credit in a way that suits consumers, not lenders.*

We feel that for too long traditional lenders have been devising and marketing products with low headline rates, whilst generating most of their revenue by keeping consumers in long-term debt, or through charges hidden in the small print. Such is the lack of transparency that many financial products, including free bank accounts, would not be commercially viable without a significant portion of customers making mistakes, misunderstanding terms or using them irresponsibly."

4.6 Wonga launched its online short-term consumer loans service in 2007 after several months of technological development and the investment of significant personal resource by the founders.[24]

4.7 Wonga aimed to develop a distinctive product which would be attractive to customers as an alternative to using other forms of short-term credit such as overdrafts and credit-cards. The distinctiveness of Wonga's offer is attributable to the following innovations:

(a) <u>Wonga puts customers in control</u> – Wonga's customers choose the size and length of their loans (with interest applied daily) and they can repay early at no extra cost. This has been a key innovation which has been highly valued by customers

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18 Wonga Group Limited Annual Report 2012, page 7, provided to the CC by Ashurst LLP by email on 10 September 2013.

19 [✂]

20 [✂]

21 [✂]

22 [✂]

23 [✂]

24 As indicated in Wonga's Initial Submission, at paragraph 2.6, Wonga's financial backers have taken significant risks in supporting an entity which is using data and technology to revolutionise financial services, and which seeks to challenge the established UK consumer credit and business credit providers. Wonga's founders were unable, initially, to raise finance in the UK and their first line of credit was from the [✂]. Since then Wonga has grown but remains an entirely equity funded business.

and has been a market game-changer. The key elements of this flexibility are as follows:

(i) interest is applied per day rather than per loan (for example, as a fixed sum per £100 borrowed). Wonga's customers are not, therefore, forced to borrow a fixed sum they might not need;

(ii) Wonga offers short-term loans which are not tied to payday or pay cheques. Loan duration is chosen by the customer;[25] and

(iii) loans can be repaid early at any time with no repayment penalty. Wonga's customers do not, therefore, pay interest for any longer than necessary. [✄] per cent of Wonga's loans are repaid early without penalty. This is a clear differentiating factor from some other business models in the short-term credit market which actively hinder repayment.[26] The avoided interest is a significant benefit to customers;

(b) Wonga deploys innovative technological solutions to allow it to undertake identity checks and make highly selective lending decisions in seconds.[27] As stated in Wonga's Initial Submission, when Wonga launched its online offering in 2007, it was the first fully-automated risk, ID and decision system in the world.[28] Wonga states in its 2012 Annual Report: "*When we decided we wanted to provide short-term loans within 30 minutes, the incumbents told us it couldn't be done, but we found a way to do it responsibly, effectively and at scale*".[29] Customers are protected by the rigorous affordability checks which are performed by this decision-system. They also benefit as Wonga has further [✄], allowing access to credit to be widened; and

(c) a further key innovation (as noted above) is the emphasis that Wonga places on simplicity and transparency, in contrast to many traditional financial products. In this regard, Wonga has developed www.OpenWonga.com – a website where customers can find facts and figures about Wonga's business and provide and read customer reviews of its service. The website also provides links to press articles and other public comments regarding the company (both positive and negative) as well as providing Wonga's "*factual take on some of the hot topics involving Wonga*".

4.8 The success of this innovation (although not a given in 2007) is demonstrated by Wonga's significant growth since entry. From a start-up just six years ago, Wonga has become a leading digital financial service business which employs over 500 people (including over 100 software engineers and data analysts). In 2012, Wonga lent £1.16 billion in the UK (a 65 per cent increase on 2011).[30]

4.9 The success of Wonga's innovation is also demonstrated by high customer satisfaction identified in the Populus survey, with [✄] per cent of customers indicating that they

25 This is increasingly important as one of the key trends in the employment market is fewer steady, full-time jobs and more employees having multiple part-time jobs with variable incomes.

26 For example, the CC adopted a remedy making changes to early settlement rebates in *Home Credit* to address the customer detriment from low rebates and to reduce switching costs (thereby lessening incumbency advantages).

27 These systems are described in the Wonga's Initial Submission at paragraphs 4.5 to 4.7.

28 Wonga's Initial Submission, paragraph 2.6.

29 Wonga Group Limited Annual Report 2012, page 5, provided to the CC by Ashurst LLP by email on 10 September 2013.

30 Wonga Group Limited Annual Report 2012, page 7, provided to the CC by Ashurst LLP by email on 10 September 2013.

would recommend Wonga (see slide 8 of the Populus Customer Survey, March 2013, at Annex 1).[31]

4.10 As regards customer complaints, Wonga's performance is also very strong. As shown in Figure 1 below, in the second half of 2012, there were 49 complaints about Wonga to the Financial Ombudsman Service of which 28 were upheld (one complaint upheld for every 77,000 loans issued by Wonga). The largest number of complaints against a single financial institution in the same period was 45,727.

Figure 1: Customer complaints

4.11 [✂]

4.12 [✂]

4.13 Wonga's commitment in this regard reflects competitive pressures. In simple terms, a variety of alternatives exist for Wonga's customers and barriers to switching are low, therefore Wonga must pay very close attention to customer satisfaction.

Dynamic market developments

4.14 Wonga attributes its growth and success in recent years to its innovative, customer-focused offering. Wonga considers that the key features of the product which it developed in 2007 remain popular with customers today (as evidenced by the adoption of certain of these features by rivals), namely flexibility and customer control, transparent and simple pricing supported by a technology platform which enables speedy but responsible lending. This is also demonstrated by the recent accolade received from the Sunday Times in the "2013 Tech Track 100 League Table" (Annex 5), where Wonga was ranked sixteenth, with a special reference made to its credit assessment software.[32]

4.15 The impact on the competitive landscape of entry by a pure online credit provider with a strikingly innovative offering using advanced technology has been very significant, particularly as regards the following:

(a) improvements to quality, more specifically, improvements to user experiences and customer service, greater accessibility of products and more flexible products;

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31 See Annex 3 of Wonga's Initial Submission for the Populus Customer Survey results in their entirety.

32 See (correct as at 16 September 2013): www.fasttrack.co.uk/fasttrack/leagues/dbtechDetails.asp?siteID=3&compID=3164&yr=2013.

(b) wider use of technological solutions;

(c) evidence of price competition; and

(d) new product development.

4.16 QuickQuid describes the competitive impetus for these developments as follows: "*With the competitive landscape changing so rapidly, our products and lending policies also have to change.*"[33]

Continual improvements in product quality

4.17 There is vigorous competition in the short-term credit market through product innovation, in particular, by increasing the value of products to customers through improvements in product flexibility, product accessibility and the user interface as described below.

Continual improvements to product flexibility

4.18 Wonga pioneered a flexible approach to short-term lending which puts customers squarely in control of the length and duration of their loans and allows early repayment without penalty. This contrasts with the inflexibility of many traditional credit products as well as traditional payday loans that do not permit flexibility in the duration of the loan term but instead offer loans with a single payment typically due on a customer's payday. Until recently, therefore, Wonga regarded this differentiating factor as a unique selling point.[34]

4.19 This has now changed with the development by many providers of new, more flexible products, or the adaptation of existing products to offer greater flexibility in response to the success of Wonga's flexible model. For example:

(a) Airdries Savings Bank has begun offering short-term "Express Loans" to existing customers. Up to £500 may be borrowed, with flexibility over repayment which may be either weekly, fortnightly, four weekly or monthly;[35]

(b) QuickQuid has developed a broad suite of products which offer its customers a range of options in relation to loan duration, repayment terms and pricing, for example:

(i) Pounds to Pocket offers longer term loans (of up to 12 months) to customers for whom this would be suitable. The loan is repaid through monthly repayments and can be repaid early with no repayment penalties. QuickQuid describes the product as follows "*During Q3 of 2010, QuickQuid introduced the 'Pounds for Pocket' product to offer longer-term loans to potential payday customers that have better credit scores than typical payday loan customers or whose affordability characteristics dictated a longer repayment term*";[36]

(ii) FlexCredit (launched in June 2013) is a running account product which offers flexibility to the customer as to when and how to pay off the loan. One of the payment options is to make instalment payments over a period of up to 10 months, though early repayment in full is also an option. QuickQuid describes this product as "*a running account product with a price similar to payday loans but with daily interest accrual rather than a flat fee. FlexCredit behaves like a credit card with a much higher minimum monthly principal*

33 QuickQuid Initial Submission, page 4.

34 See, for example, [✂]

35 See airdriesavingsbank.net/exloans for further details.

36 QuickQuid Initial Submission, page 5.

payment (10%). Repayment of a FlexCredit balance is flexible, and customers can make payments as needed to match disposable income";[37]

(c) like QuickQuid, DFC Global has widened its suite of products to offer its customers greater choice over loan duration. Inventive Finance (which is part of DFC Global), for example, focuses on longer term lending – it offers a single product of medium-term loans of £500 - £1500 for 6 to 18 months;

(d) Think Finance has recently announced that it will discontinue offering its traditional payday loan products in order to focus on a new product (now launched and trading under the name Sunny[38]) which will compete head on with Wonga and other market participants. The product is designed to put customers in control by allowing them to choose a repayment schedule and by providing an opportunity to pay lower interest rates. The product is described by Think Finance as being differentiated on "*tangible customer benefits*" namely "*interest rates, fees, repayment flexibility and financial education, resulting in a significantly lower total cost of borrowing*".[39] The key features are described below:

(i) repayment flexibility – as with QuickQuid's FlexCredit product, this product provides "running account" flexibility. Customers can repay with a single payment or multiple payments. If the latter, customers choose a repayment schedule at the outset but there is flexibility to change to an alternative option during the course of the loan or to repay in full at any point (without penalty); and

(ii) interest rates/fees – no fees are levied, and interest is charged only on sums which are borrowed. Interest rates start at 29 per cent per month and can reduce to 15 per cent depending on the "Sunny points" attributable to the customer. Customers typically start on 100 points but can increase their points (and reduce their interest rates) by making repayments on time and by watching financial literacy videos.[40] The website states "*By making as few as three months' worth of repayments on time and passing one quiz, you can get at least a 2% rate drop, down to 15% per calendar month, the next time you borrow from us*". Think Finance makes it very clear in its initial submission to the CC that "*Our new product will compete on price*."[41]

4.20 As described above, short-term loan products which act as running accounts have emerged in recent months which provide customers with flexibility to draw down funds from a pre-approved maximum limit. [✂].

4.21 Wonga has also responded to customer demand for flexibility in relation to repayment dates. In particular, Wonga has moved from a position where it previously declined to offer any extensions to a position where a limited number of extensions are available (subject to affordability checks at the point of each extension). Wonga changed its position in response to consumer demand and because it believes that it is in the interests of customers to be able to apply for a short extension at certain times. For many customers, this simply provides additional flexibility where funds are available but a little later than anticipated. The alternatives in some cases (namely default after one loan or borrowing from less responsible/reputable sources) impose significant costs on vulnerable customers which can be avoided.

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37 QuickQuid Initial Submission, page 5.

38 See sunny.co.uk for further details.

39 Think Finance Initial Submission, page 1.

40 Late payment reduces customer points. A maximum of 20 points is available by watching the videos and passing a "mini quiz".

41 Think Finance Initial Submission, page 2

4.22 A responsible approach to extensions can avoid the risk of customers getting into financial difficulties.[42] In particular, Wonga has no interest in providing extensions in circumstances where they are likely to result in financial difficulties, and Wonga's policies and results are consistent with this aim. In particular, extensions are limited to three and Wonga has a policy of undertaking a thorough re-assessment of affordability before the term of the loan is extended. Wonga provides the information customers require when considering whether to apply for an extension, highlighting any risks they may face, the costs associated with extension and the requirement that customers must pay the interest and fees on the original loan. Only [✂] per cent of Wonga's loans in 2012 were extended and Wonga does not pro-actively encourage extensions.

More accessible products with a user-friendly interface

4.23 There has been significant innovation to improve the accessibility of short-term credit products and improve the user experience throughout the loan process.

4.24 As regards <u>access to services</u>:

(a) Wonga's product was first accessible via a PC and then later via an iPhone app (when Wonga deemed that enough of its customers used the device) but further capability has been added to allow access from mobiles via an Android app and a website that is optimized for people who view it from their mobile phone to reflect the high proportion of Wonga customers who access the site using their mobiles. Currently, [✂] per cent of Wonga loans are taken out via a mobile device;

(b) the new products being offered/launched by rivals are widely accessible on a range of devices. For example, Inventive Finance (part of DFC Global) is intending to launch a new product called Kyzoo.[43] Kyzoo will use a financial software solution provided by a third party (namely Axcess Canada)[44] to allow customers to apply for, and repay, loans either via the web or Smartphone on either Android or iPhone platforms;

(c) in March 2013, QuickQuid launched a UK mobile phone app which allows customers to track the status of loan applications, update account information, receive relevant push notifications and access 24-hour support services. In the news release announcing the development, the head of marketing, Greg Hohnstein stated that "*As a leader in the online lending industry, we wanted to build on the state-of-the-art technology our credit products were founded on and meet demands of customers wanting to access our services quickly and efficiently*";[45] and

(d) commentators have highlighted the pressure on banks to innovate further in this area. The major banks have developed their own mobile phone applications such as Barclay's Pingit in 2012 (an application available on Android, Blackberry and iPhone devices which allows users to check balances and instantly send and receive funds using their mobile phones) but these fall short of the innovations seen elsewhere:

(i) Deutsche Bank states "*Increasingly there is pressure on banks to improve customer experience and service, particularly in the area of mobile & online*

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42 Wonga's Initial Submission, at paragraphs 4.41 to 4.42, outlines Wonga's responsible policy to extensions.

43 Wonga understands that this will be a line of credit product which will establish a maximum loan balance up front and then allow the customer to draw on available funds as and when required as long as the maximum limit is not exceeded. The Kyzoo brand is also available in countries such as Poland and Canada.

44 See www.axcesscanada.com/ARMnetHistory.html for further details.

45 QuickQuid press release of 11 March 2013, mb.cision.com/Main/3017/9383628/101477.pdf

banking. Having mobile phone apps that are simple and can provide credit transfers in short timeframe are clear examples of this".[46]

(ii) A recent article in City AM (see Annex 6) highlights the importance of ease of access as follows: "*Payday loan company Wonga's results last week showed how digital strength can help profits. Three-quarters of a million people in the UK now have the company's app on their phone, and this ease of access has helped the lender gain market share – despite the controversy over the interest rates charged on some of its loans. Larger, less nimble banks and credit card companies have yet to come up with an app which can establish market dominance.*"[47]

4.25 As regards <u>improvements in the customer interface and user experience</u>:

(a) All the leading UK retail banks[48] now use almost identical "sliders" on their websites to those pioneered by Wonga to allow their customers to choose loan duration and loan amount for their personal loan products. Figure 2 and Figure 3 below provide just two examples;

Figure 2: Lloyds Bank slider[49]

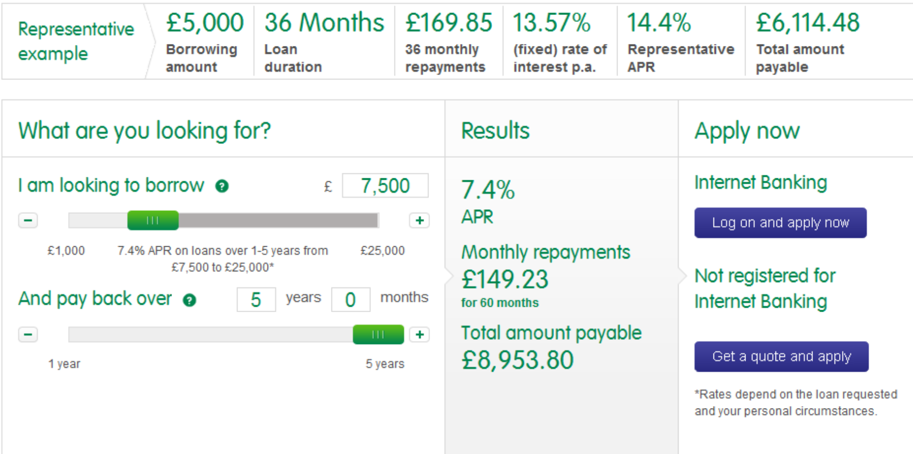


Figure 3: Barclays slider[50]

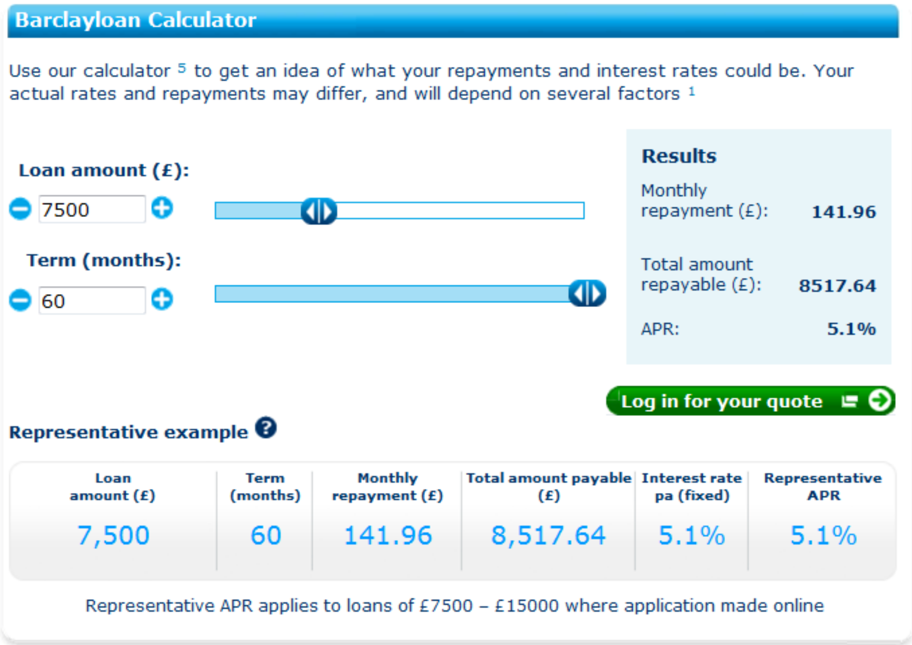
46 Deutsche Bank Markets Research (2012), FITT for investors, Retail banking 012: past, present and future, September 7, page 61, provided in response to the CC's request for off-the-shelf material (CC's First Day Letter to Wonga, 28 June 2013).

47 City AM article dated 10 September 2013.

48 These include Lloyds Bank, Barclays Bank, RBS Group/NatWest, Santander, Nationwide, Co-Op Bank and TSB.

49 See www.lloydstsb.com/loans.asp.

50 See www.barclays.co.uk/Howtoapply/BarclayloanPersonalloans/P1242591272078.



(b) consistent with the value which customers attribute to control, round-the-clock availability and to anonymity,[51] Wonga has adapted its website and automated certain functions, thereby allowing customers to serve themselves at any time rather than needing to speak to an individual. Wonga implemented a "My Account" section on its website within a year of operating in response to customer demand for self service. Initially this was limited to reviewing loan details and changing customer details. Additional functionality was subsequently added to allow customers to manage their loans. For example:

(i) customers can check their eligibility to make an application to top up or extend a loan;

(ii) customers wishing to take advantage of Wonga's early repayment policy may repay anytime online (as well as via a call centre if they prefer). Previously, customers were only able to repay via a call centre during office hours. The information available via "My Account" allows customers to compare interest accrued at any stage with the total cost of credit on the agreed repayment date. Customers are clearly shown, therefore, how much they could save by repaying early; and

(iii) customers can use online self-service tools to create their own repayment plan which is affordable given their financial situation.[52] The Online Repayment Arrangement allows customers to set for themselves the number of instalments, their frequency, the size of the payments (based upon their own assessments of their affordability) and how soon to start paying. Wonga introduced this option to provide greater choice and more control to its customers and allow them to benefit from interest free repayment arrangements using a simple automated tool. The innovation demonstrates that Wonga's commitment to transparency, choice and product flexibility extends throughout the lifecycle of the loan. The reaction of groups

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51 This noted in the Statement of Issues as follows "*Based on its* [the Bristol University Research] *in-depth interviews, the study highlighted that the relative anonymity offered by an internet-based service was a particular consideration for online payday loan customers*", paragraph 36.

52 This fully automated tool is not, however, available to those customers deemed to be in serious financial difficulty. These cases are handled by Wonga's specially trained hardship team who will contact customers proactively in order to discuss their arrangements

representing customers (like the Citizens Advice Bureau) to this innovation have been very positive. The popularity of the option with customers is shown by the [✂] use of online repayment arrangements over the course of this year as compared to arrangements agreed with a customer service agent (as shown in Figure 4 below).

Figure 4: Repayment arrangements by source

[✂]

(c) following customer surveys aimed at providing Wonga with information on customers' financial requirements and practices, Wonga designed a range of solutions (in the form of a mobile app usable on multiple platforms) to address the problems described. QuickQuid has also positioned itself to assist customers with financial matters more generally. The company operates a website called "Quick Corner – your financial resource centre" which provides customers and the public with financial advice (extending to, for example, information on writing cover letters for job applications); and

(d) DFC Global announced in its 2012 Annual Report significant investment in its global collections technology including implementation of a company-wide automated dialler system. The Annual Report states "*The investments we are making in this area should enable better customer contact resulting in more efficient debt collections performance and an improved ability to mutually agree on repayment schedules if necessary. The new dialler system and inherent strong additional caller capacity should help us maintain stronger customer relationships through the automated pre-calling of customers to remind them of the future due date of their loans.*"[53]

Wider use of technology and rapid technological change

4.26 The advantages, demonstrated by Wonga, of deploying real-time, data-driven risk technology has influenced the behaviour of rivals.

4.27 Banks have access to vast amounts of data and use analytics to refine their lending rules and post lending performance. As in the case of customer service, however, some commentators suggest that the success of entities such as Wonga, attributable in large part to its innovative data-driven business model, may spur the banks towards greater investment in technology. City AM states:

> "*For much of the past few years, the focus has been on the fallout from the higher-stakes poker games played before the financial crisis. But now retail banks face the prospect of a significant shake-up across the board, particularly focused on their use of cutting-edge technology. The need for "significant" renewal in banks' IT systems was recently highlighted in research by Deutsche Bank analysts. They have estimated that most of the big banks now need the kind of technological overhaul that would drive up costs by around 10 per cent initially. Revamped systems should eventually lead to more efficiently run banks, with a smaller high street presence, fewer staff in branches and lower costs. But an initial outlay will have to be made. Whether or not they can get ahead of the pack will be a key determinant for the relative success of individual banks…. As those trying to spearhead change are aware, the consequences for industries which don't embrace the digital age quickly enough can be dire. Ask anyone working in the music or "old media" industries.*"[54]

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53 DFC Global Corp, Annual Report 2012, available at phx.corporate-ir.net/phoenix.zhtml?c=177357&p=irol-reports.

54 City AM article dated 10 September 2013.

4.28 Both DFC Global and Enova/QuickQuid now have internet-based product delivery platforms in the UK which use similar technology to perform risk assessments to that of Wonga. For example, Enova/QuickQuid states in its initial submission to the CC:

> "*QuickQuid has always used its own proprietary and automated creditworthiness and affordability assessment model to evaluate applicants for credit. We believe that one of our key competitive advantages arises from the effectiveness of our creditworthiness and affordability assessment, which determine who is likely to be able to afford the loan (and hence not default).*"[55]

4.29 Enova also describes its decision system, proprietary data, models and underwriting in a 2011 prospectus filed with the Securities and Exchange Commission (relating to a proposed sale to the public of the online financial services businesses in the USA, UK, Australia and Canada):[56]

> "*We have developed a fully integrated decision engine that rapidly evaluates and makes credit and other determinations throughout the customer relationship, including automated decisions regarding marketing, underwriting, customer contact and collections. Our decision engine currently handles over 50 algorithms and over 500 variables. The algorithms in use are monitored, validated, updated and optimized on a periodic basis to continuously improve our operations. In order to support the daily running and ongoing improvement of our decision engine, management believes it has assembled a highly skilled team of over 50 data and analytics professionals.*
>
> *Our proprietary models are built on seven years of history, using advanced statistical methods that take into account our experience with the millions of transactions we have processed during that time and the use of data from multiple third-party sources. As of the date of this prospectus, we have over 2.75 terabytes of internal data to consider for modeling use. Management believes the ability to manage and analyze the tremendous breadth of data we have acquired since 2004 is a distinct competitive advantage.*
>
> *We continually update our underwriting models to manage risk of defaults and to structure loan terms. We believe our system provides more predictive assessments of future loan behavior and results in superior loan performance when compared to traditional credit assessments, such as FICO.*
>
> *Our underwriting system is able to assess risks associated with each customer individually based on specific customer information and historical trends in our portfolio. Our system completes these assessments within seconds of receiving the customer's data. Additionally, we continuously test new third-party data sources and run sampling tests to improve these systems.*"[57]

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55 QuickQuid Initial Submission, page 4

56 The proposed initial public offering of Enova's ordinary shares was not eventually carried out, as Cash America withdrew the SEC Registration Statement on July 2012 before any shares had been sold. As at the date of this memorandum, Enova remains wholly owned by Cash America. See Cash America's press release of 26 July 2012: www.cashamerica.com/docs/default-source/press-releases-2012/Enova_IPO_Withdrawal.pdf.

57 www.nasdaq.com/markets/ipos/filing.ashx?filingid=7785977#D228493DS1_HTM_ROM228493_4, page 94.

4.30 DFC Global acknowledges the significance for competitive success of technological capability as follows:

> "*In order to maintain our position as the leading global provider of financial services to the unbanked and under-banked consumers, we need to be on the leading edge of the technological revolution.*"[58]

4.31 Technology is also clearly at the heart of the new unsecured consumer loan product recently launched by Think Finance (described above) which offers significant product flexibility and innovative risk-based pricing. Think Finance describes its capability in this regard as follows:

> "*We believe we have the technology and analytical sophistication to build a successful business by offering consumers a product better suited to their needs than anything in the market at the moment*."[59]

4.32 Finally, although technology, data and analytics have been central to Wonga's business model from the outset, [✂]. This continual refinement ensures that Wonga can make the most accurate and responsible lending decisions possible.

<u>Price competition</u>

4.33 Recent innovations by rivals have included innovative pricing models, such as QuickQuid's risk-based pricing for its payday loan products. QuickQuid describes this as a development which has been motivated by the need to differentiate itself and to compete more effectively. It states "*QuickQuid is increasingly introducing risk-based pricing in order to be able to price most competitively in a highly diverse market with many different borrowers. QuickQuid payday loan price tiers are risk-based and designed to offer cheaper credit terms to those customers we have determined as having lower risk of default. We feel that the favourable prices that we offer to 'Good' and 'Excellent' tier customers provides a competitive advantage in customer classes that we find to have a lower risk of default*."[60] QuickQuid's website includes a section where customers can compare prices with Wonga (as described in Section 5 below).

4.34 Think Finance has laid down the gauntlet by launching the Sunny product (described above) which combines both flexibility and low pricing in order (as described by Think Finance) to bridge the gap between payday lending and mainstream credit options for customers who value speed, convenience and anonymity.

4.35 Wonga [✂] has sought to highlight the difference between lower headline interest rates elsewhere and the actual cost of credit if customers are unable to reduce their costs through early repayment (as they are with Wonga). In addition, new product development is of central importance to Wonga's business strategy in order to retain competitiveness (as described below).

<u>New product development</u>

4.36 In addition to the improvements to Wonga's core product which have been driven by the need to be responsive to customer demands (particularly in light of the emergence of alternative pricing models and more flexible rival products), Wonga has sought to remain competitive through new product development. Wonga is developing a range of new online and mobile products which provide solutions to meet consumers' financial requirements. These developments have been customer driven (i.e. based on feedback

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[58] www.businesswire.com/news/home/20110706005911/en/Dollar-Financial-Corp-Completes-Acquisition-Risicum-Leading .

[59] Think Finance Initial Submission, page 2.

[60] QuickQuid Initial Submission, pages 4 to 5.

from surveys and customer responses to trials) as well as being informed by Wonga's market intelligence and monitoring of rivals. Set out below is a non-exhaustive list of products which have been developed by Wonga:

(a) Loan guarantor: Wonga developed a short-term loan product, similar to that offered by Amigo, whereby loans are offered to customers but are guaranteed by a third party (usually a family member or friend). These guarantor loans were offered to [✂];

(b) [✂];

(c) PayLater: This product has been launched by Wonga in response to demand for credit at the point of sale but via a controlled and transparent payment method which (unlike credit cards) gives customers a set date for full repayment of the balance owed and clarity on the total cost of credit. Currently Customers are charged a one-off transaction fee which equals 7 per cent of the purchase total, followed by three equal monthly payments, allowing them to spread the cost of online shopping. PayLater is currently available at a selection of online retailers (currently about 20). It can be used to buy goods costing up to £1,000 and the service is powered by Wonga's automated platform and algorithms. Lending decisions can therefore be made very quickly and the facility is fully integrated into retailers' online checkout pages. [✂]; and

(d) WongaforBusiness: Wonga launched a loan product for small businesses in May 2012. This was in response to demand from small businesses for short-term credit to enable growth in the context of constraints on bank lending to these customers. Until September 2013, the WongaforBusiness service was only available to Limited Companies and Limited Liability Partnerships ("**LLPs**"), however, Wonga now offers the service to sole traders as well. Limited Companies and LLPs can borrow up to £30,000 for up to a year and sole traders can borrow up to £10,000. WongaforBusiness charges an upfront 3 per cent (of principal borrowed) loan fee plus 0.5 per cent a week in simple interest, with payments due weekly.

Entry, expansion and the potential for further entry

Recent evidence of successful entry and expansion

4.37 There has been significant entry to the short-term consumer credit market in recent years. The OFT identified up to 131 firms that issued payday loans in 2011/12. Of these, only 106 were operating in the previous year and only 77 were operating in 2009/10.[61]

4.38 In particular, there has been rapid diversification into online lending and the development (or acquisition) of real-time data analytic and transaction processing capabilities by DFC Global, Enova/QuickQuid, Think Finance as well as peer-to-peer lenders. These entities have successfully entered the consumer credit market and have subsequently expanded without encountering significant barriers to entry or expansion:

(a) Enova[62] (parent company of CashEuroNetUK, LLC and trading under the name QuickQuid) entered the UK as a provider of online lending in 2007 (with a further online trading entity, Pounds to Pocket, which offers an instalment loan product, launched in 2010);

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61 OFT's final decision on making a market investigation reference, paragraph 3.102. The OFT has recently stated that, of the 50 payday lending firms that were asked to prove they have addressed areas of non-compliance following the 2013 compliance review, 19 firms have informed it that they are leaving the payday lending market. In addition, a further three firms have had their licenses revoked, and another three have surrendered their licenses.

62 Enova International Inc is owned by Cash America which has provided pawn broking and customer loans in the US since 1983 and first moved into e-commerce in the US with the acquisition of www.CashNetUSA.com in 2006. CashNetUSA was acquired as a subsidiary of Enova.

(b) DFC Global (Dollar Financial)[63] has had a retail presence in the UK since the acquisition of 11 "The Money Shop" stores in 1999 (which grew to 555 stores by June 2012). In 2009, it acquired Express Finance, a UK internet lending business which trades under the name Payday Express. Month End Money Consumer Finance Ltd, another internet consumer lending business with a number of brands (in particular, Payday UK), was acquired in 2011;

(c) DFC Global expanded its internet capability in 2011 by acquiring Risicum Oyj (the leading provider of internet loans in Finland). It has since expanded its internet lending business in Poland (from February 2012), Czech Republic (from October 2012) and Spain (from March 2013) using the Risicum platform. DFC Global's continuing geographic expansion appears to be focused on internet-based delivery on the basis that this allows it to be more nimble where it is launching in new countries (although it has also been successful in substantially growing a small retail-based consumer lending business in the UK in recent years).[64] It states:

> "*We believe one of the most efficient and cost-effective ways to enter new markets and access the growing ALICE* [asset limited, income constrained, employed] *population is through an internet-based product delivery platform as it enables quicker access to these customers without having to construct a more expensive "brick and mortar" store network*";[65]

(d) in 2011, Think Finance entered the UK through an acquisition of a small online UK lender called Fortress Group. Think Finance is a financial technology company whose backers include Silicon-valley based Sequoia Capital and Technology Crossover Ventures; and

(e) a growing source of finance for consumers and businesses is peer-to-peer lending (offered by providers including Zopa, Ratesetter and Funding Circle).[66] Peer-to-peer lenders connect investors with people seeking credit after screening the credit histories of potential borrowers. Peer-to-peer lenders currently tend to focus on longer-term loans but this market is developing rapidly and it is plausible that such a model could be developed for short-term loans as well. It is reported by the BBC that the peer-to-peer market is growing at 250 per cent per annum (see Annex 7).[67]

4.39 Both Dollar Financial UK and Enova/QuickQuid have successfully expanded in the UK, in particular:

(a) Dollar Financial UK has successfully expanded its retail business from 11 branches of "The Money Shop" (at acquisition in 1999) to 555 stores by June 2012. Revenues for Instant Cash Loans Limited (the subsidiary of Dollar Financial UK which incorporates "The Money Shop") have grown significantly from £2.9m in 1999 to £172.3m in 2012.[68] Revenues for internet lender Express Finance

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63 A US company founded in 1979 under the name Monetary Management Corporation.

64 In its 2012 Annual Report, DFC Global describes the following as one of the principal components of its near-term growth strategy: "*we intend to continue opening de novo stores in our European business units, as these countries have the least number of retail financial services in relation to the under-banked population as compared to the US and Canada*". DFC Global Corp, Annual Report, 2012, page 2, available at phx.corporate-ir.net/phoenix.zhtml?c=177357&p=irol-reports.

65 www.businesswire.com/news/home/20110706005911/en/Dollar-Financial-Corp-Completes-Acquisition-Risicum-Leading.

66 The P2P Finance Association indicates that Zopa, Ratesetter and Funding Circle have facilitated over £500m of loans between their lenders and their borrowers, of which over £100m has been facilitated in the first five months of 2013. www.p2pfinanceassociation.org.uk/

67 BBC online, "Peer-to-peer lending tempts hard-hit savers", 4 May 2013, www.bbc.co.uk/news/business-22401744.

68 Instant Cash Loan Ltd annual accounts 2008 to 2012.

(Bromley) Ltd (which trades under the name Payday Express) have more than tripled from £14.3m in 2009 when the company was acquired by Dollar Financial UK to £51.8m in 2012; and

(b) Enova/QuickQuid has also seen a significant increase in UK revenues since entering the market from £12.5m in 2008 to £195.6m in 2012.[69] Enova (in the 2011 prospectus referred to above) indicates that "*Our launch into the United Kingdom in 2007 and Australia and Canada in 2009 demonstrate that we can quickly and efficiently enter new markets*."[70] Enova also states "*The scalability and flexibility of our technology platform allows us to enter new markets and launch new products quickly, often within three to six months from conception to launch.*"[71]

4.40 Other recent entrants that do not form part of larger US corporate entities have also experienced rapid growth following entry, for example:

(a) CFO Lending entered the payday segment in 2008 and has grown to revenues of £19.6m in 2012; and

(b) TxtLoan has grown from approximately £4.6m gross revenue in 2010 to approximately £22m in 2011.

Potential entry

4.41 In view of the recent history of entry to the UK by US financial companies, and the ease of geographic expansion as outlined above, Wonga considers it likely that other US entities would consider entry to the UK payday segment. US entities which might consider such a diversification include the following:

(a) World Acceptance Corporation: a large consumer loan provider that operates in the United States and Mexico. In addition to small short-term loans, it also provides larger medium-term loans, credit insurance products and income tax preparation; and

(b) ACE Cash Express: ACE Cash Express offers a wide range of online and retail services (including payday loans and instalment loans) in the US and Canada.

4.42 Beyond this, there are a number of established businesses that may be interested in, and capable of, entering the payday loan segment including:

(a) peer-to-peer lenders, which are a growing source of finance for both consumers and small businesses. There are strong synergies between the online business model developed in relation to short-term lending and a peer-to-peer model. In particular, both use real-time, data driven risk technology;

(b) banks, where, in the US, a number of deposit-taking institutions are offering an "advance deposit" product;

(c) other credit providers with existing online products. For example, Provident offers a website lending facility that looks similar to Wonga's but which offers longer-term loans; and

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69 Cash America 2012 and 2010 Annual Reports. Figures have been converted to pounds sterling using Bank of England exchange rates.

70 www.nasdaq.com/markets/ipos/filing.ashx?filingid=7785977#D228493DS1_HTM_ROM228493_4, page 94.

71 www.nasdaq.com/markets/ipos/filing.ashx?filingid=7785977#D228493DS1_HTM_ROM228493_4, page 93.

(d) online gaming or commercial entities, which already have in-house access to the requisite technical expertise, a strong online presence and funding to set up an online payday business.

4.43 As regards the issues which the CC will investigate in relation to barriers to entry and expansion, the case studies above suggest that barriers to entry/expansion are not significant, as discussed further below.

The role of advertising by incumbents or other costs associated with gaining customers, such as acquiring leads from third parties

4.44 The examples provided above show that Wonga's advertising (and advertising by others such as Enova/QuickQuid) has not prevented the expansion of rivals (for example, by making consumer acquisition difficult without comparable campaigns by new entrants). The growth outlined above indicates that customers are prepared to use new entrants (and increasingly so) even though widely advertised brands are already present in the segment. Moreover, Wonga has been able to grow and attract customers, many of whom were previously using mainstream credit products such as bank overdrafts, despite the significant level of advertising undertaken by the large incumbent banks.

4.45 Moreover, as indicated in Wonga's Initial Submission,[72] advertising costs are scalable to demand, which significantly reduces the risks facing a new entrant. In addition, it is likely that major advertising campaigns grow the overall market because they will tend to raise awareness of the product in general as well as specific brand awareness which will also benefit new entrants.

4.46 As regards lead generation, this provides an alternative model for acquiring business which (although not perfect) means that new entrants are not reliant on self generated business attracted solely through brand creation and advertising.

Whether regulation represents a barrier

4.47 As discussed in Wonga's Initial Submission, Wonga expects to see stricter enforcement of the current standards enshrined in consumer credit and consumer protection legislation when the FCA assumes responsibility for consumer credit regulation. The FCA regime will place more stringent requirements on firms in terms of compliance, systems and controls and Wonga anticipates that the FCA will take a more pro-active role than the OFT in monitoring the activities of regulated firms.[73]

4.48 As regards the implications of this for entry, the cases above indicate that successful entry has been achieved by entities which seek, like Wonga, to couple strong consumer protection policies with competitive success.[74] More generally, Wonga considers that financial technology companies with international growth plans are accustomed to addressing regulatory risk and successfully managing this as part of their growth strategy. A recent report by the Center for Financial Services Innovation entitled "*Financial Technology Trends in the Underbanked Market*" (see Annex 8) highlights the need to design products which are both compliant and consumer-focused in order to deliver commercial success:

> "*Entrepreneurs exploring social network and big data solutions for the under-banked market, in particular, will enjoy a comparative advantage if they can structure products to successfully navigate the regulatory landscape, tolerate the*

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72 Wonga's Initial Submission, paragraph 4.48(b).

73 Wonga's Initial Submission, paragraph 2.15.

74 QuickQuid, for example, describes in its Initial Submission how it has adopted consumer protection policies which go beyond the recommended best practise of the Consumer Finance Association (see page 7).

risks associated with still-pending regulations, and stay ahead of the regulatory curve by designing high-quality products with a consumer-focused orientation."[75]

4.49 Wonga considers that, going forward, more firms (including new entrants) will seek to emulate Wonga's successful pro-consumer business model such that dynamic competition will deliver better outcomes for consumers. More consistent compliance with the regulatory framework is needed to provide a stronger platform for competition and innovation by Wonga and others by levelling the playing field.

The technology investment required

4.50 As is clear from the descriptions above, technology is central to the business models of Wonga, Enova/QuickQuid, DFC Global Corp, Think Finance and others. These technology based entities have successfully entered and expanded and several make specific reference to the flexibility and scalability of their technology platforms. For example Enova/QuickQuid has stated:

> "*Our proprietary and custom-designed technology platform is built for scalability and flexibility and is based on proven open software. The technology platform was designed to be powerful enough to handle the large volume of data required to evaluate customer applications and flexible enough to capitalize on changing customer preferences, market trends and regulatory changes. The scalability and flexibility of our technology platform allows us to enter new markets and launch new products quickly, often within three to six months from conception to launch.*"[76] (emphasis added)

4.51 The ability to leverage investments in technology across a variety of products and geographic markets reduces significantly the risk associated with upfront investment. Wonga is adopting precisely this approach – the recent expansion within the UK (for example PayLater and Wonga for Business) and overseas has been powered by Wonga's real-time data-driven technology.

4.52 Smaller players who do not have a strategy of product or geographic diversification can reduce the risks associated with technology investment by acquiring third party solutions instead of undertaking the development themselves. Indeed, Wonga considers that certain third party systems are very advanced, for example, new providers in the US such as Sociagramics.

Summary

4.53 The CC indicates that it will collect and analyse information about the main characteristics of the market.[77] It will be important to capture as part of this investigation the dynamic aspects of the short-term credit market. In particular, the rapid growth of the payday segment, the evidence of market share volatility, the successful entry and expansion of new players who have grown more rapidly than existing players, and the dynamic incentives to invest and innovate.

4.54 The evidence outlined above points strongly to vigorous competition through product innovation and low barriers to entry. Technology is key to both, as it can be leveraged across products and across markets. Players with a real-time data-driven technology platform can be nimble and challenge incumbents (for example banks, credit card companies, and traditional payday lenders) where they see an opportunity to offer a

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75 "*Financial Technology Trends in the Underbanked market*", Center for Financial Services Innovation, May 2013, page 6.

76 www.nasdaq.com/markets/ipos/filing.ashx?filingid=7785977#D228493DS1_HTM_ROM228493_4, pages 92 to 93.

77 Statement of Issues, paragraph 25.

flexible, customer-focused product. This is what Wonga has done and many of its key rivals have a similar diversified growth strategy.

4.55 As indicated in Wonga's Initial Submission, these will be important aspects of the CC's investigation for the following reasons:

(a) in markets such as short-term credit which have seen rapid developments and innovation in recent years, current market features and firm performance may be a poor indicator of the likely outcomes going forward;

(b) innovation is more likely where there is a level regulatory compliance playing field across all forms of short-term credit; and

(c) the evaluation of any further consumer protection initiatives must be undertaken holistically taking into account all consumer welfare impacts including those relating to innovation.

5. ANALYSIS OF COMPETITION AND THEORIES OF HARM

5.1 The CC outlines in the Statement of Issues two potential theories of harm that it proposes to consider:

(a) Theory of harm 1: impediments to customers' ability to search and identify the best value product, and switch supplier; and

(b) Theory of harm 2: market power and barriers to entry.

5.2 The second theory of harm has been considered above. It is clear from the evidence that the short tem credit market is dynamic and innovative, with significant recent market entry and expansion.

5.3 With regard to theory of harm 1, the CC indicates that it will examine barriers to the following:

(a) accessing information;

(b) identifying best value offers; and

(c) switching suppliers.

Accessing information

5.4 The CC indicates that it will examine the extent of any barriers to customers accessing the information needed to make informed choices about payday lending products.[78] In this regard, Wonga makes the following preliminary observations.

<u>Transparency, flexibility and ease of use are central to Wonga's proposition, as reflected in its code of practice</u>

5.5 Wonga considers that being able to compare and contrast different forms of credit is vital for consumer choice and facilitates competition. It is for this reason that Wonga provides easy access to product information and associated costs (as outlined in paragraphs 5.9 *et seq.* below) in a clear and transparent manner to all current and potential customers.

5.6 Transparency, flexibility and ease of use are central to Wonga's proposition and Wonga is consistently told by its customers that its service is easy to use and that information is communicated well. Wonga's aim to transform financial services is focused on offering

[78] Statement of Issues, paragraph 56.

services which are clear and simple to understand, where charges are not hidden and which are delivered without significant delay (by virtue of the underlying technology described in Section 4 above).

5.7 In this regard, Wonga's code of practice (at Annex 4 of this memorandum) states the following on transparency:

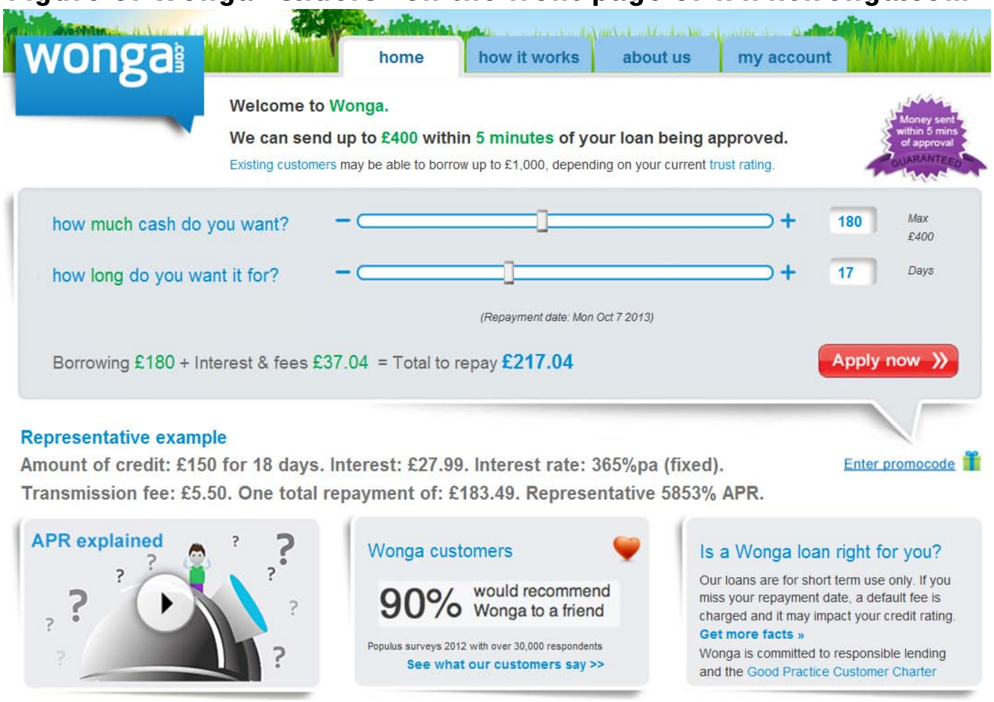
- "*In addition to any regulatory requirements, we will always show you the total cost of repayment very clearly and prominently before you apply*
- *This calculation includes all potential costs involved, with no carve-outs, hidden fees or catches*
- *We also clearly explain the potential costs and consequences of late or non-payment*
- *We won't ever change the rate of interest or charge during the short life of your loan*"

5.8 Wonga considers that the industry in general should aim to meet Wonga's level of transparency.

<u>It is straightforward to get a clear idea of the full costs of a Wonga loan (including for cases where circumstances change post loan approval) before making an application</u>

5.9 The most prominent features of Wonga's website (which are found on the front page) are the "sliders" which enable customers to choose the amount that they want to borrow for the amount of time that they need it (see Figure 5). For any combination of loan amount and loan duration selected using the sliders, customers are informed (on the front page of the website) of the total cost of the loan (including interest and fees). It could not be more transparent. The cost of borrowing remains unchanged once the application process has commenced. A representative example is also included on the front page of Wonga's website directly beneath the sliders which illustrates the cost of a representative loan (showing, separately, the amount of credit, interest cost, transmission fee, total repayment amount and representative APR).

Figure 5: Wonga "sliders" on the front page of www.wonga.com



5.10 One click from the main page (by clicking the "*how it works*" tab) information is provided on:[79]

(a) what happens in the event that a customer does not repay on time including a missed payment charge and the potential impact on credit ratings;

(b) the opportunity to discuss a solution with Wonga or use the automated online solution to create an appropriate repayment plan; and

(c) the way in which Wonga's continuous payment authority works and the accrual of interest on the outstanding balance (via a link).

5.11 Wonga does not provide information on its home page on the costs associated with extensions as it does not wish to promote the availability of extensions but rather provides comprehensive information in the event that a customer applies for an extension. The website does, however, provide information on extension fees in the section "*What does it cost*" (see Figure 6 below).

Figure 6: Wonga "What does it cost" information, one click away from the front page

What does it cost?

	Costs	Description
Interest Rate	1% per day (simple interest)	Calculated at the end of every day, calculated on your interest bearing balance that day
Transmission Fee	£5.50	Added to loan amount requested so will accrue interest. This fee also applies to new loan top ups
Extension Fee	£10.00	Charged if we accept your application to change your promise date
Late Payment Fee	£30	Charged at 5pm on your promise date if you miss your payment and added to your outstanding balance

Representative example:

Amount of credit: £150 for 18 days.
Interest: £27.99.
Interest rate: 365%pa (fixed).
Transmission fee: £5.50.
One total repayment of: £183.49.

Representative 5853% APR.

5.12 Further, guidance on whether an extension is appropriate and the costs involved is provided in the section "*How do I manage my loan*" (see Figure 7 below). This includes the warning: "*If your circumstances have changed and you can't repay your original loan, please don't apply for an extension. We urge you to contact us instead. If you can repay but would prefer to repay later, a loan extension could be right for you. This will be a new application and we can't guarantee it'll be approved*."[80]

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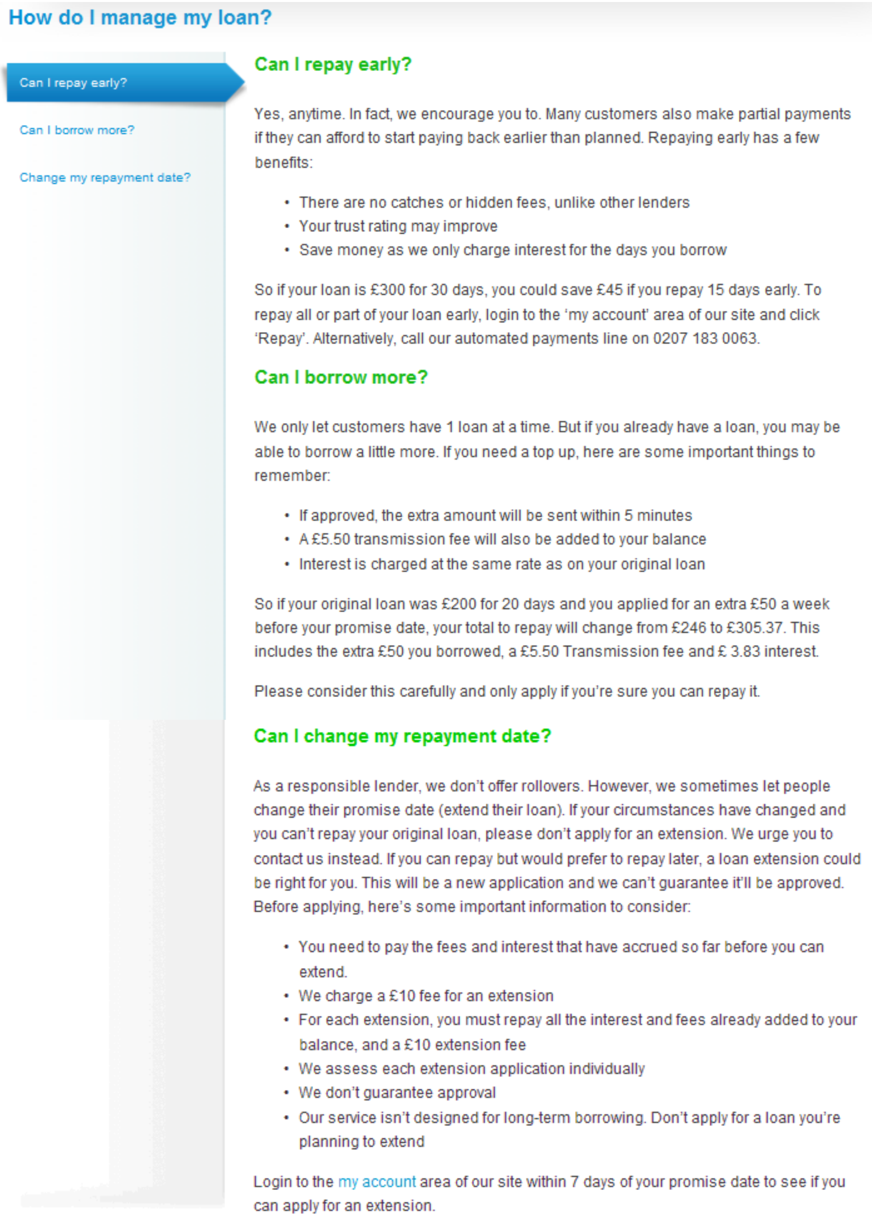
[79] See www.wonga.com/money/how-to-wonga/.

[80] As set out below, Wonga does not offer a traditional roll-over where the loan is re-financed (i.e. where the balance is capitalised and interest is then charged). Instead, Wonga allows customers to extend the pay-back date of their original loan (in which case the original loan is not refinanced and therefore the loan is not, in the traditional sense, subject to a "roll-over").

Figure 7: Wonga "How do I manage my loan" information, one click away from the front page



How do I manage my loan?

Can I repay early?

Can I borrow more?

Change my repayment date?

Can I repay early?

Yes, anytime. In fact, we encourage you to. Many customers also make partial payments if they can afford to start paying back earlier than planned. Repaying early has a few benefits:

- There are no catches or hidden fees, unlike other lenders
- Your trust rating may improve
- Save money as we only charge interest for the days you borrow

So if your loan is £300 for 30 days, you could save £45 if you repay 15 days early. To repay all or part of your loan early, login to the 'my account' area of our site and click 'Repay'. Alternatively, call our automated payments line on 0207 183 0063.

Can I borrow more?

We only let customers have 1 loan at a time. But if you already have a loan, you may be able to borrow a little more. If you need a top up, here are some important things to remember:

- If approved, the extra amount will be sent within 5 minutes
- A £5.50 transmission fee will also be added to your balance
- Interest is charged at the same rate as on your original loan

So if your original loan was £200 for 20 days and you applied for an extra £50 a week before your promise date, your total to repay will change from £246 to £305.37. This includes the extra £50 you borrowed, a £5.50 Transmission fee and £ 3.83 interest.

Please consider this carefully and only apply if you're sure you can repay it.

Can I change my repayment date?

As a responsible lender, we don't offer rollovers. However, we sometimes let people change their promise date (extend their loan). If your circumstances have changed and you can't repay your original loan, please don't apply for an extension. We urge you to contact us instead. If you can repay but would prefer to repay later, a loan extension could be right for you. This will be a new application and we can't guarantee it'll be approved. Before applying, here's some important information to consider:

- You need to pay the fees and interest that have accrued so far before you can extend.
- We charge a £10 fee for an extension
- For each extension, you must repay all the interest and fees already added to your balance, and a £10 extension fee
- We assess each extension application individually
- We don't guarantee approval
- Our service isn't designed for long-term borrowing. Don't apply for a loan you're planning to extend

Login to the my account area of our site within 7 days of your promise date to see if you can apply for an extension.

5.13 All the above information, and more, is available to every current and potential Wonga customer who has access to the internet. Moreover, the information may be accessed 24 hours a day, seven days a week, and is accessible via a range of devices (e.g. PCs, smartphones, tablets, etc).

<u>Wonga's customer research confirms that the service is easy to use and communicated well</u>

5.14 Wonga's customer research indicates that customers find the Wonga service to be easy to use, and a very high proportion ([✂] per cent) consider that information is communicated "well" or "very well" (see Populus Customer Survey, March 2013, slides 10 and 13 at Annex 1).[81]

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81 See Annex 3 of Wonga's Initial Submission for the Populus Customer Survey results in their entirety.

Identifying best value offers

5.15 With regard to the CC's intention to examine how customers identify best value offers and whether there is any evidence of customers struggling to establish which product is best for them, Wonga makes the following preliminary observations:

(a) customers are able to make meaningful comparisons, in particular:

(i) Wonga's product, user experience and application process are structured to facilitate customers undertaking comparisons, and reduce the hassle involved in doing so;

(ii) there are numerous free online sources of information on payday loans and alternative short-term credit options which enable comparisons of products; and

(iii) third party research indicates that many customers consider loan terms and understand the information provided; and

(b) Wonga takes steps to minimise the risks associated with customers overestimating their ability to repay a loan.

5.16 These points are considered in turn below.

Customers are able to make meaningful comparisons

5.17 The CC has stated that its "*initial observations suggest that differences between lenders in products offered and in the presentation of those products may mean it is not straightforward to compare products between lenders, even when the necessary information is available*".[82] For the reasons outlined below, customers are clearly able to make meaningful comparisons.

Wonga's website facilitates customers conducting comparisons

5.18 As noted above, Wonga's sliders provide an instant indication of the cost of borrowing without requiring the customer to click through to any other pages. It is very easy, therefore, for online customers to take this quote and click to another website to compare the quotes of other providers many of whom, for example Pocket Money Pay Day Loans,[83] also use a "slider" approach.

5.19 The way in which Wonga's website and application process is structured means that customers can compare Wonga's product offering with those of its competitors prior to submission of an application, after submission of an application and/or prior to the repayment date.

5.20 Comparing prior to submission of an application: If a customer leaves the online Wonga application form before receiving a decision as to whether the application has been successful, their application details are saved in Wonga's database as a partial application. The process for the returning customer is as follows:

(a) If the customer returns to the website and clicks "Apply now" on the homepage, and enters the same email address on the first page of the application form as initially used, the customer's partially completed application form will reappear.

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82 Statement of Issues, paragraph 63.

83 www.pocketmoneypaydayloans.co.uk/. Other lenders such as PaydayUK and Dosh Express also use a "slider" approach, albeit with only one slider for loan amount because these traditional payday lenders do not permit flexibility in the duration of the loan term but instead offer loans with a single payment typically due on a customer's payday.

(b) The application form is pre-filled with the information they entered previously up to the point where they left the application. This pre-filled information is saved for 30 days.

5.21 This facility, therefore, provides the customer with ample opportunity to compare Wonga's offer with other providers before committing to making a formal application, while avoiding having to redraft an additional Wonga application from scratch (thereby reducing any "hassle factor" which might deter searching).

5.22 In addition (as outlined above), Wonga's slider technology can be utilised by customers prior to the start of an application and therefore allows a customer to fully contemplate the total cost of credit for comparison at the outset, before any application data is entered.

5.23 <u>Comparing after submission of an application</u>: Once the Wonga application form has been completed online, the application data is sent to the Wonga risk management platform for a decision. If the loan is approved, the customer is still free to consider alternatives, and the loan will only be drawn down once the customer electronically signs the application to complete the agreement.

5.24 If the customer leaves the application without electronically signing the agreement, they have up to seven days to sign in with their email and password and accept. As soon as they sign in, they will be taken directly to a page where they can sign the agreement. If they do not sign the application, it is determined to have been "not taken up".

5.25 Wonga's key competitors have application forms of similar length to Wonga's, so the time period for comparing its offering with those of its competitors is likely to be comparable (thus offering a level playing field in terms in this regard).[84]

5.26 <u>Comparing prior to repayment date</u>: Wonga's loan model also allows for a customer to search for a new loan from a rival provider prior to the repayment date and use this loan to pay off an existing loan with Wonga (as an alternative to seeking an extension with Wonga).

5.27 In this context, an extension to the term of a Wonga loan is initiated by the customer through the "MyAccount" area of the Wonga website.[85] If a customer wishes to change their repayment date, they can sign into their account and, if the option is available, they will see a link in their account to change their repayment date. On clicking this link, they will be presented with sliders, allowing them to consider the costs of extending their loan over a duration specified by the customer.

5.28 The costs are updated in real time as they move the sliders, in a similar manner to the sliders on the Wonga homepage and can therefore easily be compared with the cost of applying for a new loan from a rival provider as an alternative to extending the Wonga loan.[86]

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84 Whether a customer would be equally likely to be accepted by Wonga and a competitor would be down to the lending criteria of the relevant lenders.

85 For more information go to www.wonga.com/money/how-to-wonga/, click "Managing your loan" and scroll to "Can I change my repayment date?".

86 If a customer wishes to change their repayment date, they will be charged an extension fee of £10, and will make a payment comprising of the interest and fees accrued to date. This will be treated as a payment towards their current balance, and will be deducted from the total they owe on their new promise date. As explained in paragraph 5.38(a)(ii), customers can only extend their loan up to three times, and the option only becomes available seven days before the loan is due to be repaid. There are no fees to repay a loan in full or in part before the promised repayment date ([✂] per cent of Wonga's loans are repaid early).

Numerous online sources of information

5.29 There are many free online sources of information on payday loans and alternative short-term credit options, and customers using the internet are directed to these information sites by search engines. For example, of the top 10 Google search results for "payday loan", only four lead to payday lenders. The remainder are online payday comparison websites and advice on payday loans as shown in the screen shot at Annex 9.

5.30 Sources of information include:

(a) money.co.uk: This website provides information to enable comparison across a range of financial products including credit cards, current accounts, personal loans, prepaid cards and mortgages;[87]

(b) paydayloanchecker.co.uk: This website uses sliders like those used by Wonga enabling customers to choose a loan amount and a loan duration;[88]

(c) moneysavingsexpert.com: Customers who need short-term credit but have no time or facility to arrange an overdraft extension, can compare the costs of a Wonga loan (using the Wonga sliders) against the likely costs of an unauthorised bank overdraft using a tool created by Moneysavingsexpert.com, which compares unauthorised bank overdraft charges;[89] and

(d) allthelenders.co.uk: Allthelenders, along with its "sister sites" (Everything-Payday, Online Loan Lenders and Pure Payday Loans), claims to have grown to become one of the "internet's biggest payday loan lender websites", comparing payday loans offered from over 30 lenders. Allthelenders estimates that over 30,000 customers compare loans on its site every month. This single comparison site alone, therefore, receives more hits per month than the LendersCompared comparison site (established as part of the remedies package to the CC's *Home Credit* market investigation) which received at its peak c.10,000 hits per month in 2009.[90]

5.31 The OFT suggests that comparisons may be problematic (particularly amongst online lenders) because of differing calculation methodologies (for example between loans where interest is charged per day and those where fixed interest charges are levied irrespective of the duration of the loan).[91] Whilst there is some product differentiation as highlighted by the OFT, the products identified are still relatively simple and transparent compared to many other products (for example utility products where customers may be faced with multiple tariff structures and uncertainty as to their consumption profile).

5.32 Moreover, product innovation by lenders such as Wonga and others to offer more flexible, short-term credit products which allow customers greater control (for example, by charging daily fees rather than fixed charges and allowing fee-free early repayment) is pro-consumer and pro-competitive. The ability of customers to compare prices is also pro-competitive and should be encouraged, but this should not come at the expense of innovation.

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87 See paydayloans.money.co.uk/. Another website (www.whichpaydaylender.co.uk/) also provides price comparisons for various lenders by showing the total cost repayable for £100 over 30 days. Users are also provided with "reviews" for a number of lenders which highlights and explains any product differentiation so that customers can weigh this up in relation to the price information provided.

88 www.paydayloanchecker.co.uk.

89 www.moneysavingexpert.com/banking/bank-charges-compared.

90 "Understanding past market investigation remedies - Home credit", February 2013, Figure 2, page 29, paragraph 132.

91 OFT's decision document, paragraph 3.48.

Third party research indicates that many customers consider loan terms and understand the information provided

5.33 The Bristol University Research indicates that a significant proportion of customers do consider the total repayment amount when taking out a loan, and do make comparisons before taking out the loan. Further, the Citizens Advice survey (cited in the OFT's reference decision) suggests that this information is understood. More specifically:

(a) the Bristol University Research indicates that 89 per cent of online payday lending customers considered the total repayment amount (i.e. the original loan amount plus interest) before they took out their loan, and 75 per cent considered the total amount of interest that would be charged;[92]

(b) the research also suggests that around half (46 per cent) of online payday customers compared the cost of their loan with similar or other types of lenders before taking out their loan.[93] This is consistent with Wonga's customer research which indicates that a significant proportion ([✂] per cent) of its first-time customers considered at least one other cash advance website before choosing Wonga and that an increasing proportion of these are looking at "lots" of cash advance websites (see Populus Customer Survey, March 2013, slide 16 at Annex 1)[94];

(c) the OFT reports evidence from the Citizens Advice survey that 79 per cent of respondents felt that they were "clear" on the total repayment cost of their individual loan(s);[95] and

(d) Wonga's customers have indicated that the most useful information when considering a loan from Wonga or elsewhere is the total cost of borrowing. Knowing the total cost of borrowing was considered the most useful piece of information by [✂] per cent of customers, compared to only [✂] per cent who considered APRs to be the most useful information. In fact, the APR was stated as the least useful piece of information (compared with total cost of repayment and knowing payment/repayment dates) by [✂] per cent of customers.

Wonga takes steps to minimise the risks associated with customers overestimating their ability to repay a loan

5.34 The Statement of Issues states that the CC intends to examine the extent to which other factors may affects borrowers' abilities to identify best value offers, namely:

(a) when assessing the value of a payday loan, some customers may not fully take account of the cost of future repayments, thus underestimating the full value of the loan; and

(b) that some customers may overestimate their ability to meet repayment obligations.[96]

5.35 With regard to (a) (assessing the value of a payday loan), as outlined in paragraphs 5.9 *et seq.* above, Wonga already provides easy access to the loan-related information (and

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92 Bristol University Research, page 31, Table 5.3.

93 Bristol University Research, page 30, Table 5.1.

94 See Annex 3 of Wonga's Initial Submission for the Populus Customer Survey results in their entirety.

95 OFT's decision document, paragraph 3.51. Figure 1 of the OFT's reference decision also suggests that a high proportion of survey respondents were clear on the "repayment method".

96 Statement of Issues, paragraph 64.

associated costs) in a clear and transparent manner to all current and potential customers.

5.36 With regard to (b), it is important for the CC to appreciate that Wonga does not rely on customers to determine their own ability to repay a loan in making a decision whether to approve a loan (although Wonga does ask applicants to ensure they have considered their ability to repay the total cost of credit on the due date). This is because Wonga has strong commercial incentives to undertake its own rigorous upfront and ongoing checks which aim to identify and accept only those individuals who Wonga believes (with a reasonable degree of certainty) will be able to repay the loan on the due date given their financial circumstances (including their level of indebtedness).

5.37 Wonga has no interest in offering loans or providing extensions in circumstances which are likely to result in a customer experiencing financial difficulties, and Wonga rejects over 60 per cent of first loan applications on this basis. As a consequence, Wonga (and its customers) benefit from low default rates. If over-optimism is a behavioural bias displayed by short-term credit customers, Wonga does not exploit this, but rather seeks to make a lending decision which is not influenced by customer perception and bias.

5.38 This position is also reflected in:

(a) Wonga's policies, for example:

(i) credit caps – first time borrowers are never allowed to borrow in excess of £400, while existing customers are eventually limited to a maximum of £1,000. The average first-time customer borrows £180 and the average across all loans is £257, with average length of loan being 17 days; and

(ii) limits on extensions to a maximum of three (in accordance with the FLA Lending Code 2012) as well as a requirement that the customer must pay off all outstanding fees and charges prior to any extension; and

(b) key performance indicators, in particular, the very low proportion of loans which are extended (8.5 per cent in 2012), and low default rates at around [✂] per cent of principal lent in 2012 which is significantly lower than the level of approximately [✂] per cent which applied in 2008 due, in large part, to Wonga's continuing investment in data and affordability assessment models.

5.39 In addition, Wonga seeks to address any behavioural bias towards over estimation of the ability to repay by making clear on its website the consequences in the event a customer is unable to repay on the due date (as described at paragraph 5.10 above).

Switching suppliers

5.40 With regard to the CC's intention to examine the extent to which customers are able to switch suppliers, particularly at the point of rollover, Wonga would make the following preliminary observations.

<u>Wonga is continually evolving its product in order to remain competitive (due, in part to the risk of customer switching)</u>

5.41 As outlined in Section 4 above, since start-up Wonga has made numerous changes to its product, systems and website to improve the user experience, and a significant proportion of Wonga's staff of 500 are devoted to developing new products. Many of these innovations and improvements have been developed in order to provide the customer with sufficient information to make an informed decision about affordability, but also to convert Wonga website visitors into customers and to attract switching customers – all in competition with other short-term credit providers.

Barriers to switching at the point of extension are overstated

5.42 The OFT acknowledged that "*switching to alternative providers may be a realistic possibility for some borrowers*"[97] but still considered there to be substantial barriers at the point of rollover. Wonga considers that these barriers have been overstated:

(a) As explained in more detail in paragraph 5.26 above, at the point a loan is due, customers may apply for loans from alternative suppliers (whether payday loans, or alternative sources of credit), comparing the costs of credit from each and, in the event of a successful application, they may use the proceeds to settle their initial loan. In this regard, Wonga does not proactively encourage extensions and Wonga will only ever extend the length of a loan when requested to do so by a customer.

(b) Customers would face very low switching costs:

(i) the time and effort involved in applying for a short-term credit product compares favourably with other credit products such as credit cards because of innovations such as real-time automated affordability checking;

(ii) Wonga customers who wish to switch before the end of their loan term because they have identified a better deal elsewhere can do so without a redemption penalty ([✂] per cent of Wonga's loans are repaid early). This feature is typical of other short-term credit providers and the industry in general. QuickQuid, for example, similarly does not charge any switching fees for customers wishing to take their business elsewhere;[98] and

(iii) customers would not risk losing out on any promotional benefits ([✂]) offered to repeat customers by Wonga if they applied for a loan elsewhere rather than extend an existing loan with Wonga. This is because [✂].

Summary

5.43 As regards the ability of customers to access the information needed to make informed choices about payday lending products, Wonga considers that transparency, flexibility and ease of use are central to it's proposition. Moreover, it is straightforward for customers to get a clear idea of the full costs of a Wonga loan (including those cases where circumstances change post loan approval) before making an application.

5.44 There is evidence indicating that customers are able to identify best value offers by making meaningful comparisons. For example, Wonga's product, user experience and application process are structured to facilitate customers undertaking comparisons, and to reduce the hassle involved in doing so. In addition, there are numerous free online sources of information on payday loans and alternative short-term credit options which enable comparisons of products, and third party research indicates that many customers consider loan terms and understand the information provided. As regards concerns relating to consumer bias, Wonga takes steps to minimise the risks associated with customers overestimating their ability to repay a loan.

5.45 Finally, the evidence of continual product innovation outlined in Section 4 is consistent with a market where the risk of switching compels lenders to invest and evolve to remain competitive. Finally, Wonga considers that barriers to switching at the point of extension have been overstated.

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97 OFT's decision document, paragraph 3.98.

98 "QuickQuid submission to the Competition Commission 12 July 2013", page 14.

Annex 1: Extracts from the Populus Customer Survey, March 2013

Slide 8
[✂]

Slide 10
[✂]

Slide 13
[✂]

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Slide 16
[✂]

Slide 16
[✂]

Slide 21
[✂]

Annex 2: Chartered Institute for Securities & Investment research comparing the cost of unauthorised short-term overdrafts with payday lenders

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4 February 2013

It's as cheap or cheaper to borrow via a payday lender rather than a bank, CISI research shows

New research* undertaken by the Chartered Institute for Securities & Investment (CISI) has shown that customers looking to borrow money on a short-term basis might be better off going to a "pay day lender" rather than a high street bank.

The CISI, the 40,000 strong professional membership organisation for those working in the securities and investment industry, in the February edition of its magazine Securities & Investment Review, compares the cost of taking out a £200 unauthorised short-term overdraft from a typical payday lender, Lloyds Bank and Nat West.

The cost of borrowing £200 from the payday lender was £66.

However, from Lloyds Bank the charge for borrowing the same amount was £84.22, an APR of over 2,200%, and at Nat West the charge was £110, an APR in excess of 4,000%.

Simon Culhane, Chartered FCSI and CISI CEO said: "Late last December the Government, as part of the Financial Markets Act, undertook to introduce a cap on the amount of interest that can be charged on a loan. However, this legislation was aimed at payday lenders.

"The scandal isn't the rates charged by payday lenders but the rates charged by banks. The complete silence on rates being charged by banks for unauthorised borrowing is mystifying.

If the Government does legislate for a cap on interest we can expect to see the payday lenders focusing on charging fees, rather than interest, which will then allow some real comparison."

Ends

*Research document - **Example of APR rates**

See www.cisi.org/bookmark/genericform.aspx?form=29848780&URL=87925819 for a link to the underlying research data.

Annex 3: [✂]

[✂]

Annex 4: Wonga Code of practice

Available at www.wonga.com/money/downloads/code-of-practice.pdf

Code of practice

About Us

Wonga is a leading short-term lender. We provide credit to UK consumers via the internet and mobile. We launched our first website in October 2007 and offer flexible loans of £1 to £1,000, for between one and 31 days.

We have a consumer credit licence from the Office of Fair Trade (OFT) and are regulated by Consumer Credit Act 2006. We are also a member of the Finance and Leasing Association (FLA) and abide by its Lending Code.

Our Mission

Our mission is to solve consumers' occasional, urgent and short-term cash flow problems with an equally short-term solution. We base our commitment to responsible lending to **transparency**, **flexibility** and extreme **selectivity** – believing it's possible to provide credit in a way that suits consumers, not lenders.

We feel that for too long traditional lenders have been devising and marketing products with low headline rates, whilst generating most of their revenue by keeping consumers in long-term debt, or through charges hidden in the small print. Such is the lack of transparency that many financial products, including free bank accounts, would not be commercially viable without a significant portion of customers making mistakes, misunderstanding terms or using them irresponsibly.

We are taking a fresh approach to short-term credit and this is a relatively a new market in the UK. Not everyone operating in this space is doing scrupulously, so here we spell out exactly what consumers can expect when using our service. These principles are in addition to our strict adherence to UK law, regulatory requirements and the FLA's Lending Code.

Our operating principles

1) FLEXIBLE

- You will never be forced to borrow more credit than required
- We will let you control exactly how much you want to borrow, down to the last pound, and then determine the cost by deciding how many days you need it for (within defined parameters)
- If you haven't used Wonga before, we won't let you apply for more than £400
- We will determine your immediate and future credit limit based on in-depth credit and status checks, including how responsibly you have used our service in the past
- We deliver on our promises and describe our service honestly and accurately at all times - we will never make any misleading claims or hard-sell you credit

2) TRANSPARENT

- In addition to any regulatory requirements, we will always show you the total cost of repayment very clearly and prominently before you apply
- This calculations includes all potential costs involved, with no carve-outs, hidden fees or catches
- We also clearly explain the potential costs and consequences of late or non-payment
- We won't ever change the rate of interest or charge during the short term life of your loan.

3) SELECTIVE

- We use Credit Report Agencies and all the publicly-available data at our disposal to guard against fraud and make the best possible lending decisions based on your circumstances at the point of application. This includes evidence of your disposable income and financial commitments
- You will receive an online decision
- If you are declines, we will give you as much information as possible about the reasons why, along with any relevant advice we can offer
- We recognise you circumstance can change so, if you return to our service again, we will base every decision on a fresh review of your credit-worthiness, reserving the right to decline future applications even if you have repaid a previous loan on time
- Regardless of whether you apply via the website or an iPhone, our checks will be just rigorous

4) SHORT-TERM

- You will always be encouraged to settle your debt quickly – either on time or early
- You will be able to compare interest accrued at any stage with the total cost of credit on the agreed repayment date – at any time. We will clearly show you how much you could save
- You can repay a loan at any time and save money, paying only the interest accrued up to that point. We do not charge early repayment fees and there are no catches
- We will remind you of your responsibilities, the amount owed and the repayment date agreed during the short term course of your loan
- We will automatically collect full repayment on the date agreed and never encourage you to roll your balance over for another term

5) FAIR

- We always provide clear warning about the serious nature of credit and explain the potential consequences of no-payment or late repayment
- If your circumstances change for the worse, you will treated fairly and respectfully
- We abide by both the spirit and the world of the OFT's guidance on Debt Collection (OFT664) and subsequent associated guidance
- We ensure that any third parties we instruct on an agency basis maintain membership of the Credit Services Association (CSA) and comply with its Code of Practice
- We only recruit and employ experienced collections professionals whose objective is to reach a practical and positive solution for both you and Wonga
- We will only ever extend the length of your loan term when requested to do so by you – and if will believe it to be in your best interests. We will clearly explain the additional cost of extending your loan, require you to significantly reduce the outstanding balance to do so and limit the number of times you can move your repayment date
- We will never extend the term of you loan without your request, i.e. by 'default rollover'
- We charge reasonable default fees (a one off charge of £15 for a failed collection). This helps us cover some costs and dissuades people from let repayment, but nothing more
- We will freeze interest at the earliest possible stage – if a reasonable repayment plan can be commenced or after **a maximum of 60 days** failing that

6) RESPONSIVE

- We make it easy to conduct us during office hours: via the website, email, phone or instant chat
- If you have a complaint or a concern you will receive a satisfactory response
- We will respond to your complaint and endeavour to resolve it within 7 days. If your complaint is particularly complex it may take longer to investigate but, in these cases, we will explain why there is a delay and tell you when we will contact you again
- If you are not satisfied with our response you can appeal the decision by writing to us again, stating your abjections and providing any new information to be considered
- We are a member of the Finance and Leasing Association, so you can register a complaint via them if you have already contacted us and fell we have not responded to your concerns or resolved the matter fairly: www.fla.org.uk

Annex 5: Top 20 from the 2013 Tech Track 100 league table

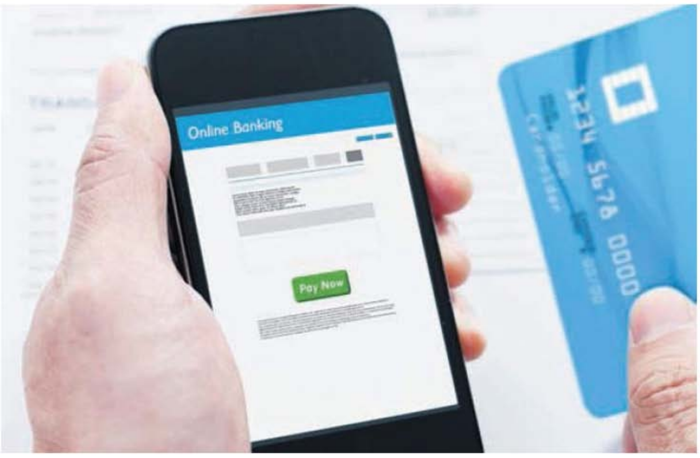
For the full table, see:
www.fasttrack.co.uk/fasttrack/leagues/tech100leaguetable.asp?siteID=3&searchName=&yr=2013&sort=num&area1=99

Rank	Company Activity	Sales growth % pa	12/13 sales (£m)	09/10 sales (£m)	Comment
1	MVF Digital marketing services	277.88	‡13.9	0.3	Its marketing platform helps its clients reach new customers in more than 50 countries
2	Switch Concepts Advertising software developer	268.56	‡14.5	0.3	Places over 1 billion adverts each day for customers in more than 20 countries
3	Quintessential Finance Group Financial technology services	259.76	‡34.4	0.7	Plans to launch a price comparison site for life insurance customers this year
4	SPEX Group Oil & gas technology developer	259.41	13.9	*0.3	Recently won a multi-million pound contract with Shell to design an innovative subsea tool
5	MobileWebAdz Mobile advertising provider	220.19	‡20.4	0.6	Targeting growing numbers of mobile phone users in emerging markets has boosted revenues
6	Zoopla Property Group Property websites operator	213.64	*35.8	1.2	Is reported to be looking at a stock market flotation for more than £1bn
7	PaymentSense Payment processing services	197.70	‡12.4	*0.5	30,000 small businesses in the UK use this firm's credit card processing service
8	Equal Experts Software developer	195.09	‡13.5	0.5	Is using its private sector experience to help the UK government roll out its digital strategy
9	Active Securities Online finance provider	194.56	‡8.9	0.4	Is expanding into Canada, New Zealand, Spain and Poland
10	Mind Candy Children's games developer	190.05	‡46.9	1.9	Has over 80m registered players and plans to launch an animated Moshi Monsters series
11	We Are Social Social media marketing agency	185.97	10.1	0.4	In five years it has grown headcount from 2 to 350, and it has staff in 8 countries
12	E-Leather Eco-friendly materials developer	180.77	7.0	0.3	Saving weight, airlines use less fuel and recover the cost of using E-Leather
13	AlertMe Smart home monitoring provider	169.52	‡13.6	0.7	Has raised over £23m in venture capital since it was founded in 2006
14	Mansion House Consulting IT consultancy	160.43	12.0	0.7	Has offices in Frankfurt, New York and Singapore
15	LMAX Exchange e-FX trading technology	160.27	‡*5.6	0.3	Captured a 1% share in one of the fastest growing segments of the $5tn daily global FX market
16	Wonga.com Online money lender	155.15	‡309.3	18.6	Has made over 7m loans in six years
17	Infectious Media Digital advertising software developer	151.32	13.4	0.8	Buys more than 2 billion ad spaces each month
18	Tech21 Device impact protection developer	147.12	‡16.9	*1.1	Uses specialised materials, including a polymer used in bullet proof glass
19	R-Com Consulting IT consultancy	130.00	‡5.1	0.4	Customers include Play.com, Cardiff University and The Royal Mint
20	APSU IT services provider	129.43	25.6	2.1	Customers include Aldi, Primark and IBM

Annex 6: City AM article, 10 September 2013

CITY A.M.
Tuesday 10 September 2013
BUSINESS WITH PERSONALITY

CNBC Comment: Banks face an IT Wonga challenge



by Catherine Boyle
September 10, 2013, 1:16am

The market may not be factoring in the cost of new technologies

THERE is a shadow looming over the world's retail banks, which many believe the market is not factoring in.

For much of the past few years, the focus has been on the fallout from the higher-stakes poker games played before the financial crisis. But now retail banks face the prospect of a significant shake-up across the board, particularly focused on their use of cutting-edge technology.

The need for "significant" renewal in banks' IT systems was recently highlighted in research by Deutsche Bank analysts. They have estimated that most of the big banks now need the kind of technological overhaul that would drive up costs by around 10 per cent initially.

Revamped systems should eventually lead to more efficiently run banks, with a smaller high street presence, fewer staff in branches and lower costs. But an initial outlay will have to be made.

Whether or not they can get ahead of the pack will be a key determinant for the relative success of individual banks. And getting an edge comes on top of traditional worries about security – banks have to be fanatically paranoid about the protection of their customers' details.

Payday loan company Wonga's results last week showed how digital strength can help profits. Three-quarters of a million people in the UK now have the company's app on their phone, and this ease of access has helped the lender gain market share – despite the controversy over the interest rates charged on some of its loans.

Larger, less nimble banks and credit card companies have yet to come up with an app which can establish market dominance. And the problem hasn't been helped by banks' wish for differentiation, making it difficult to develop a "one size fits all" app.

The Near Field Communication (NFC) system, used by digital wallet projects like Visa's V.me and Mastercard's Masterpass, doesn't seem to have taken off with consumers yet. Attendees at the recent IFA consumer electronics fair in Berlin whispered that Paypal still has the edge, despite the years poured into the NFC project. Perhaps tellingly, the executive in charge of the project within Visa recently moved to another role within the company.

It will be interesting to see whether any of the anticipated new iPhone designs launched later this month are NFC-compatible. Apple has been more reluctant than rival Samsung to embrace the technology. A secure, trusted and easy-to-use iPhone app might make all the difference to the market.

As those trying to spearhead change are aware, the consequences for industries which don't embrace the digital age quickly enough can be dire. Ask anyone working in the music or "old media" industries.

Catherine Boyle is a staff writer for CNBC.com and an on-air contributor for CNBC. Follow her on Twitter @cboylecnbc

Annex 7: BBC article, 4 May 2013

See www.bbc.co.uk/news/business-22401744

4 May 2013 Last updated at 00:54

Share

Peer-to-peer lending tempts hard-hit savers

By Ramzan Karmali
Business reporter, BBC News

Interest rates have been at a record low of 0.5% for more than four years and that has meant a paltry rate of return for many savers.

Nick Hallwood says that it has not all been plain sailing

So instead of putting their money into a bank or building society, some have turned to an alternative way of investing their money, known as peer-to-peer lending.

Also called social lending, this allows savers to lend directly to individuals or businesses looking to borrow money. It often provides a better return than they would get with their bank, but there are greater risks involved and less protection for their investment.

At present, there are three big players in the market: Zopa, Funding Circle and RateSetter. These three companies have overseen about £458m of loans and many predict this figure will continue to rise.

Savings and Investment

How the Bank's policy affects you

UK Savers: Why do they still bother?

How can you pay for long-term care?

Financial action plan when moving abroad

'Testing the water'

Nick Hallwood is a project manager from Surrey. He inherited some money when his aunt died last year. He joined Funding Circle and has invested in more than 200 companies in the past year.

"With a small amount of money I decided to dip my toe in the water. I was quite interested in lending to small businesses and helping to support them at a time when perhaps banks were not," he says

His other motivation to invest in a peer-to-peer lending scheme was discovering how little interest he would receive from High Street bank and building society savings accounts.

The rate of return on easy access accounts has fallen by an average of 68% over the past two years, according to financial information service Moneyfacts. At the start of this month, the average rate on an easy access savings account with no bonus was only 0.76%.

Mr Hallwood says he has seen a much better return than this. Over the past tax year he has worked out that he has earned 4.9% interest on his investment, despite facing a few problems with his investments.

"I have received some bad debt. Some companies won't always be able to pay back the loans that you have given," he says.

"But even with that bad debt, I've probably got twice the return than I would have if I had put my money in a one-year bond with a bank."

“You need to be aware that your funds are not covered by the Financial Services Compensation Scheme and also there is the potential of bad debts”

David Black

Consumer Intelligence

Risks involved

Peer-to-peer lending is still dwarfed by traditional bank lending to small and medium-sized businesses, which in gross terms stands at about £3bn a month.

Unlike the more traditional forms of lending, there are some additional risks to be aware of with peer-to-peer lending. David Black, of the information firm Consumer Intelligence, points out that there is one major guarantee missing from these peer-to-peer lending schemes.

"You need to be aware that your funds are not covered by the Financial Services Compensation Scheme and also there is the potential of bad debts," he says.

This means that these schemes do not have the same protection as savers with UK-registered banks, building societies and credit unions. Under the FSCS, the first £85,000 of their funds per person per institution are protected if it goes bust.

Mr Black believes that the sector is trying to address this shortfall.

"Some of the schemes do have a safeguard provision fund to cover some of the bad debts. It is also worth bearing in mind that until next year they are not covered by the regulatory authorities," he said.

Christine Farnish believes the sector still has room to grow

'Phenomenal growth'

The peer-to-peer lending sector is growing fast. Christine Farnish, of the Peer 2 Peer Finance Association, believes there is still more growth to come.

"I think they are just scratching the surface of the potential market at the moment. They are growing at about 250% a year, which is pretty phenomenal," she says.

A recent study by innovation charity Nesta suggests the sector has the potential to account for £12.3bn of loans a year.

But Mr Black warns that this does not mean every scheme will be a success.

"There are a number of smaller players that have ceased training. So it is a competitive business and not all of them will make it," he says.

So, for those tempted to invest in a peer-to-peer lending scheme, how good an investor do you need to be?

The Nesta study concludes that the typical saver who put money into these schemes was "highly educated and relatively wealthy" but Mr Hallwood believes anyone can do it and it will not take up all their time.

"It is actually quite fun looking at these businesses and investing in them. If I look at the time I'm spending on this a week, it is probably an hour, perhaps two hours at most," he says.

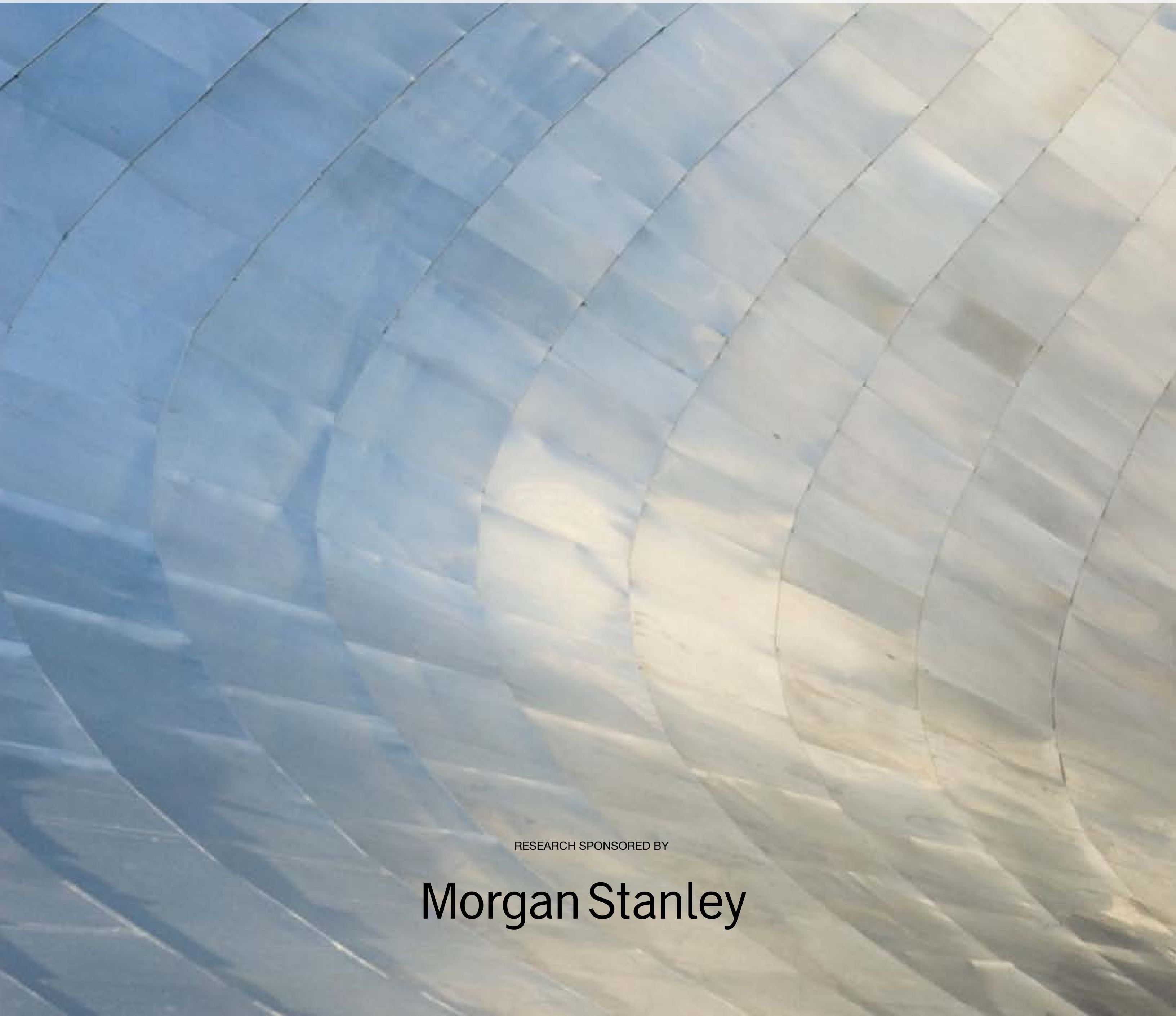
Annex 8: Financial Technology Trends in the Underbanked Market, 2013

Financial Technology Trends in the Underbanked Market

May 2013

CFSI Center for Financial Services Innovation

CORE INNOVATION CAPITAL



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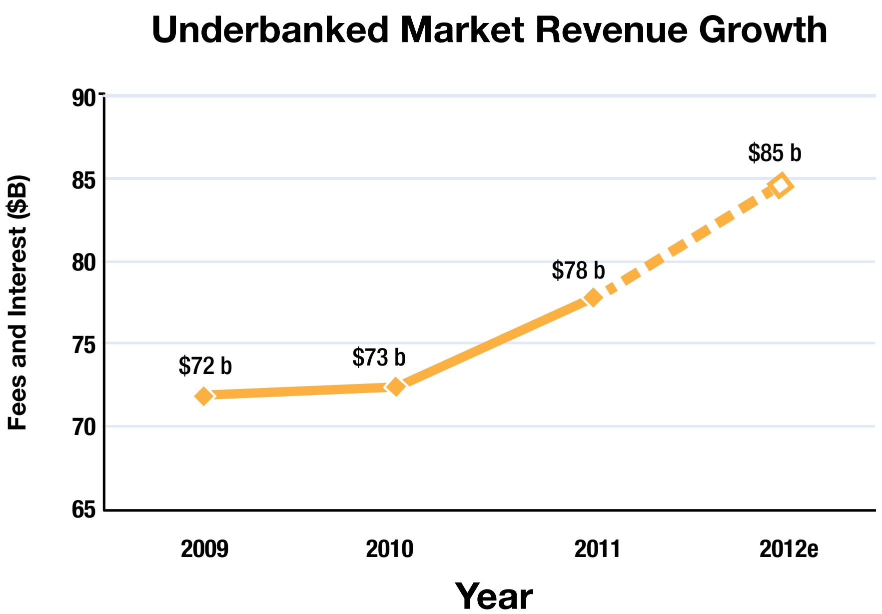
Introduction

The emerging industry of technology startups providing financial services, known as FinTech, has typically targeted a relatively affluent customer base. Yet beneath the surface, a groundswell of hundreds of FinTech companies are developing innovations to serve a consumer segment in even greater need of new ways to access and manage their money.

Financially underserved consumers – those who are financially challenged due to a lack of access to traditional financial services, low or absent credit scores, or simply low incomes – represent over a quarter of American households and $78 billion in annual spending on financial services.[1,2] Emerging companies are recognizing the profit opportunity to apply financial technology innovations towards the development of products that better serve this market of more than 68 million U.S. consumers.[3]

The market for products used by underserved consumers grew by 7% in 2011 alone, but many of the credit, payment, deposit, and other financial services in this marketplace fail to integrate available technology, leaving tremendous opportunity for disruption through digitization of offerings and democratization of consumer access.[4] Paper-based transactions, inaccessible data, high acquisition costs, and risk models unsuited to identifying attractive borrowers have historically passed high costs on to underserved consumers and kept entrepreneurs at bay.



Source: 2011 Underbanked Market Sizing Study, CFSI/Core Innovation Capital, November 2012

However, the same technologies that are driving the growth of startups from Silicon Valley to Atlanta are reinventing the marketplace of financial services for underserved consumers. Emerging companies are capitalizing on increasingly robust and inexpensive computing power, ubiquitous consumer Internet and mobile access, and growing demand for comprehensive digital networks. These companies are improving access to effective, high-quality products for underserved consumers while developing technology with broad applications beyond the underbanked market.

This report examines four key trends in emerging financial technologies impacting the underbanked marketplace today and highlights a selection of noteworthy companies capitalizing on these trends to improve consumer financial health and their own bottom line. The trends include:

- **Harnessing Social Networks**: The power of the crowd – online communities easily linked and self-sorted for mass communication and organization – can influence personal financial management, enable opportunities for peer-to-peer lending, and improve the quality and depth of data used to identify credit risk.

- **Solving the Cash In/Out Problem**: Digital payment networks can smoothly transition funds to cash and back again through secure loading, single-click purchasing, and other real-time touch points for the many consumers who continue to prefer cash in an increasingly electronic financial world.

- **Leveraging Big Data for Better Risk Management**: Advanced analytic tools for credit evaluation, account monitoring, and risk management are unlocking access to new sources of available capital and a wider field of qualified borrowers with greater accuracy.

- **Scaling Up by Going B2B2C**: Startup companies are exploiting B2B distribution channels to rapidly reach their target underserved consumer base through white label products and innovative partnerships between new and established industry players.

Methodology

As the leading nonprofit expert and the leading venture capital fund focused on the underbanked market, the Center for Financial Services Innovation (CFSI) and Core Innovation Capital (Core), respectively, are in a unique position to identify and observe the key financial technology trends driving market growth and innovation today. Following a thorough analysis of over two hundred FinTech companies, drawn primarily from Core's investment pipeline, the trends in this report were identified based on their applicability to a range of financial products across multiple sectors and their positive implications for profitability and near-term scalability.

While the trends and companies outlined in this paper have already attracted significant investment capital, the underbanked market for FinTech products is still at a relatively early stage in its development. Questions regarding profitability, revenue models, customer retention, growth rates, exit opportunities, and intensity of capital investment needed to succeed have yet to be fully resolved. Furthermore, the underbanked market encompasses a heterogeneous collection of financial products drawing from several sectors including credit, payments, deposits, alternative data, and personal financial management tools, each with its own characteristics, challenges, and angles for successful entry. This report is an invitation to examine the nuances of an emerging industry that is still a work in progress, populated by new ideas and open to changing dynamics.

Featured Companies

The selection of companies featured in this report illustrates the broad range of startups and innovations in various stages of development that target underserved consumers, either exclusively or as part of a broader market strategy. Many companies are capitalizing on several of the trends and FinTech industry factors outlined below by building out existing products or developing new frameworks to connect people, process data, and enhance consumer choice through technological innovation.

For brief profiles of the companies mentioned in this report - including sector and trend alignment, business stage, location, and website information - please refer to the appendix.

Please note that all companies and financial products included in this report are solely intended to demonstrate financial technology trends and innovations impacting the underbanked marketplace. Characterizations of companies mentioned are solely the opinion of CFSI and Core and may describe only some aspects of their business models, product offerings, and activities. Their inclusion does not constitute specific market predictions, investment recommendations, product endorsement, or commentary on the appropriateness, safety, or quality of these products for consumers by the authors or sponsors of this report.

Key Underbanked FinTech Industry Factors

Each trend is analyzed in light of five key industry factors, highlighted below, that will shape the growth and profit potential of FinTech companies targeting the underbanked market. Icons designating the relevance of these industry factors to the identified trends are deployed throughout this report.

Macro Ecosystem

FinTech companies that capitalize on broad economic trends impacting the underserved population will improve their market potential. Key aspects of the macro landscape in this space include the increasing migration of finance to digital formats backed by muscular computing power, the slow and uneven decline of cash usage in the American economy, and the impact of the financial crisis on credit scores, interest rates, and the availability of credit. Shifts in the financial needs of underserved consumer segments – such as recent immigrants, recipients of Social Security and other government benefits, and baby boomers with insufficient retirement savings – are also stimulating product innovation. These macro forces will influence the fortunes of new FinTech entrants that exemplify the trends toward social media and big data usage to extend credit and other services to underserved consumers or the trend toward developing solutions that address consumer need to use cash and electronic funds in tandem.

Regulatory Environment

The advent of the Consumer Financial Protection Bureau (CFPB) and the results of other legislation, rulemaking, and guidance impacting financial services markets have induced greater regulatory complexity and uncertainty at the federal level. These developments create potential barriers to entry that are particularly relevant for companies innovating in lending and personal data use practices. Entrepreneurs exploring social network and big data solutions for the underbanked market, in particular, will enjoy a comparative advantage if they can structure products to successfully navigate the regulatory landscape, tolerate the risks associated with still-pending regulations, and stay ahead of the regulatory curve by designing high-quality products with a consumer-focused orientation.

Industry Dynamics

FinTech startups developing new transaction networks or alternative approaches to credit may prove able to disrupt dominant incumbents in the underbanked market, particularly where the institutional infrastructure of entrenched players hampers their own ability to innovate. Some startups are also finding that the best prospects for surmounting barriers to entry and scaling up quickly at low cost involve partnering with, rather than challenging, leading players in their respective field.

Look for these icons where trends exhibit key FinTech industry factors throughout this report.

Supply Chain Position

The financial services industry features a complex supply chain involving banks, payments networks, clearing systems, processors, distribution partners, and end consumers, among other players. The ability of FinTech companies targeting the underbanked market to exploit a particular position in the supply chain for maximum value creation, especially with respect to electronic transaction networks that incorporate cash usage and when B2B2C strategies are involved, can be critical to driving consumer access to high-quality products and profits for investors.

Consumer Behavior

Successful products in the underbanked market not only fulfill current financial needs but also closely track underserved consumers' evolving tastes, habits, demographics, and social relationships. Financial technology companies that attract significant business will be those that capitalize on the increasingly digital lifestyles of underserved U.S. consumers with weak attachment to traditional financial institutions but strong affinities to social networks, as well as those who continue to prefer cash for daily transactions but also require electronic payment options.

Financial Technology Trends in the Underbanked Market

TREND #1: Harnessing Social Networks

The advent of social media is changing the way an increasing number of consumers approach their finances. Banks and financial service companies are quickly recognizing the potential to tap into the existing networks and habits of the two out of three adult Internet users who already use social media.[5] Financial products integrated with social media can be tailored to consumer behavior, addressing unique needs and usage patterns by offering the potential for a responsive, customizable user experience that traditional providers have struggled to offer.

The underserved are increasingly present online and on mobile devices, outnumbering the mass market in use of smartphone technology 52% to 38%.[6] Social media in particular is disproportionately popular among demographic groups who are likely to be underserved, including young adult consumers (83%), low income consumers (72%), and minority consumers (68% and 72%, respectively, for black and Hispanic users), compared to the national average for social media usage of 67%.[7] Many are tackling savings and financial planning goals amid job instability or impending retirement, while others are struggling to gain access to credit after seeing scores decline during the recent recession. Online accounts, payment portals, and web-based credit applications can connect individuals who share financial commonalities or symbiotic goals, predict consumer behavior for creditors, match borrowers with lenders, aid accountability, and convert personal networks into financial assets for both providers and consumers.

Several emerging social media innovations, such as the use of online activity to influence lending decisions, remain under scrutiny as federal regulators weigh aspects of information privacy, fair lending laws, and Fair Credit Reporting Act (FCRA) compliance. Innovators and investors operating in this area will build the greatest amount of trust with their consumers and regulators when they employ best practices to protect consumer information, prevent discriminatory lending practices, and minimize risk from changes driven by impending regulations. Promisingly, the concepts inherent in one area of social networks, peer-to-peer (P2P) lending, are becoming increasingly recognized and standardized in rulemaking. A higher degree of certainty has allowed established online P2P lenders, such as Prosper and Lending Club, to adjust their business models accordingly and gain traction with retooled offerings that reflect updated SEC compliance.

As alternative lenders and credit scorers navigate evolving regulations, they are beginning to utilize social networks to expand access to credit for reliable consumers overlooked by traditional credit scoring models. Companies such as ***Sociogramics*** and ***Kabbage*** are developing methods to mine the data in social media profiles and online interactions to evaluate creditworthiness during the verification and underwriting process. Others are building on the P2P model by enabling the crowdsourcing of loan funds to small business borrowers. ***SoMoLend*** connects small entrepreneurs with individual lenders, municipal governments and local financial institutions to facilitate online community lending within existing networks or by matching loan requests based on regional and business sector affinities.

Recalling the values of savings and personal financial management represented by the old-fashioned piggybank, emerging companies ***SmartyPig*** and ***Piggymojo***, a CFSI grantee[8], both offer unique packages that leverage mobile tools and online networks to promote savings behavior. Their online dashboard tools, savings pockets, and reward incentives encourage users to share savings goals and progress through social media to garner the benefits of positive reinforcement, social commitments, and even contributions from the people in their networks. In a similar fashion, ***Motozuma's*** online savings accounts let first-time and low-income car buyers connect through their social networks to gain financial and social support for a down payment while earning matching funds from vehicle merchants.

SOCIAL NETWORKS...

- **Tap into consumer technology usage patterns**

  Adult internet users with social media accounts: 67%

  Underbanked consumers who have smartphones: 52%

- **Are popular in demographics hardest hit by the Great Recession**

  Social media use among young consumers (ages 18-29): 83%

  Among minority consumers: black 68%; hispanic 72%

  Among low income consumers (< $30,000 annual income): 72%

- **Benefit from increasing legal recognition and growing regulatory clarity, while some uncertainty remains in the short term**

  JOBS Act defines a legal mechanism for crowdfunding to encourage peer-to-peer lending through social media: 2012

  CFPB continues to review fair lending practices: 2013

- **Innovate financial technology for the underbanked in multiple sectors**

  Alternative Underwriting • Credit • Savings • Personal Financial Management

See text for full citations.

Social Networks Case Study: Kabbage

Recognizing the important role of small business in the economy, Atlanta-based Kabbage, Inc. provides online retailers with fast access to working capital, in part by utilizing social media history to assess their customers' vendor relationship histories. Kabbage mines the data generated as sellers interact with online merchants, rack up customer satisfaction ratings, and demonstrate cash flow and shipping activity. The company then analyzes this information to create a Kabbage Skore based on its Social Klimbing underwriting formula for businesses generating at least $1,000 in monthly sales.

Kabbage collects and reviews sales data gathered from Amazon, Ebay, Etsy, and other supported providers for merchants seeking to borrow funds. It then makes underwriting decisions based in part on its ability to verify healthy sales volume, reliable e-payment activity, and positive reviews made by an applicant's business partners and customers on social media sites including Facebook and Twitter. Most recently, Kabbage has teamed up with UPS, adding an additional layer of measurement to the underwriting process that may increase access to capital at lower rates by reviewing users' shipping history on products sold.

Since launching its lending platform in 2009, Kabbage has supplied more than 50,000 advances to small companies that collectively generate over $800 billion in annual sales. For many of these borrowers, who drive Kabbage's revenue model through spending on loan interest and fees, Kabbage offers capital when traditional lenders would most likely turn them down. Kabbage reports that 60% of the small business owners it lends to have a FICO score below 650 and that its typical customer returns to borrow short-term credit 10 times each year. Total demand for its loans has reached an annualized volume of $200 million, increasing 1000% in 2012.

The incorporation of social media exemplified by Kabbage holds potential for consumer lending too, as social media usage at the individual level may eventually facilitate greater access to consumer credit. Social media provides a trove of alternative data for lending decisions that is increasingly inexpensive, instantaneous, and up-to-date. Application to individual borrower networks, however, will be more complex due to ongoing regulatory review and the need to build consumer protections into this evolving practice. Safeguarding personal data from identity theft, fraud, or unauthorized resale and other misuse will be vital to developing high-quality credit products that serve consumers well and manage regulatory and reputational risk for innovators and investors in this space.

TREND #2: Solving the Cash In/Out Problem

Despite the growth of electronic accounts and the steady media drumbeat regarding the "end of cash," cash remains a key component of the American wallet, especially for underserved consumers. Swiping plastic or keying in an online transaction may have become standard, but more than a quarter of all US retail transactions are still conducted in cash.[9] Even the electronic payment service Square, a FinTech darling, includes a receipt printer in its merchant kits to address the high volume of consumers who pay with cash and require a paper record of their transaction.

As consumers increasingly depend on a variety of payment options in this shifting landscape, savvy providers are expanding consumer access to electronic accounts by facilitating near-frictionless conversions to and from cash. Products that easily convert digital money to cash and back are particularly vital for underserved consumers because 47% report that they prefer to pay with cash, receive their income in cash, or otherwise consider paper money their primary mode of transaction.[10] While 30% of consumers have been reducing cash usage in recent years, 20% have increased their use of cash.[11] The instant accessibility and liquidity of cash, its inherent lack of monthly service fees, and its pervasive use for informal transactions also make it attractive to underserved consumers. Yet as many financial service providers move away from the added risks and expenses associated with handling cash, the underserved must increasingly rely on electronic channels for transactions including larger purchases, online purchases, the receipt of salaries and government payments, and the transmission of remittances.

Companies that address the simultaneous need for cash and electronic funds can capitalize on the opportunity presented by a consumer segment that otherwise accesses cash primarily at supermarkets, banks, credit unions and check cashers for services that can be offered more cheaply and conveniently through financial technology innovation. The growing consumer market for such products is evident in the $77 billion that was transacted through general-purpose reloadable (GPR) cards in 2012.[12] In that year, open-loop GPR cards alone attracted more than 10 million consumers who conducted 1.3 billion transactions.[13, 14] Digital payment networks that allow easy access to cash while also encouraging long-term use of GPR cards for fund storage and transfer are increasingly vital for underserved consumers who prefer cash but are finding themselves drawn into digital payment structures by employers and government benefit offices. GPR prepaid usage volume is expected to grow to $168 billion by 2015.[15] New rules now require all federal benefits to be distributed electronically to prepaid cards when direct deposit is unavailable, and private employers are also gravitating toward checkless paychecks, having loaded $31 billion in wages onto payroll cards in 2011.[16]

Financial technology is swiftly dismantling cumbersome routines that had previously slowed the flow of transactions and forced underserved consumers to accept inconvenient and badly matched services. ***Tio Networks***, a CFSI Catalyst Fund portfolio company, enables cash conversion for the underserved by drawing on mobile technology, self-serve kiosks, and point-of-sale bill payment. ***Plastyc***, a Core portfolio company, offers debit cards with broad functionality that allow customers to load cash at any of 50,000 locations, deposit checks remotely, buy mobile phone minutes, or even access prescription drug discounts. ***Wipit's*** international mobile payment network creates a seamless, one-click format for purchases, payments, cash loading, and mobile remittance.

Several other startups focused on remittances also utilize financial technology features to address the needs of immigrant populations, which often receive wages in cash but want to send funds abroad directly and securely. Electronic transfer services include ***iSend***, a former CFSI Catalyst Fund portfolio company, which allows users to digitally pay retailers or billers on the receiving end with cash on the front end; ***Nexxo***, which provides stand-alone kiosks to load remittances, pay bills, and convert cash for other uses; and ***Boom Financial***, which enables customers to send funds, loaded at thousands of retail partners, by text message or mobile app. These services allow consumers to instantaneously move money to friends and family through mobile wallet features that reduce the time, expense, and insecurity of sending cash or wiring money.

PayNearMe and ***ZipZap*** provide access to online transactions for cash-preferred shoppers by enabling customers to purchase products online or by phone and then pay in cash at local convenience stores like 7-Eleven. These startups are entering an arena also courted by incumbents such as PayPal, which recently joined the cash-to-card migration space by partnering with Coinstar and MoneyGram to provide account holders with offline loading venues that make cash resources available for online purchases.

The ability to load funds from a paper check directly into an electronic prepaid account or mobile wallet system is also being solved for underserved consumers without the expense and inconvenience of cashing a check. The infrastructure for remote deposit capture developed by ***Chexar*** and others enables account holders to instantly access good funds by taking a picture of a check with a mobile phone. This feature is particularly valuable for underserved consumers, who tend to hold low account balances and are otherwise beholden to the timing vagaries of cleared checks to stay current on their bills.

While some companies are developing networks to facilitate the smooth transfer of cash in and out of consumer payments, others are exploring ways to incentivize consumers to change their behaviors altogether with regards to cash. ***PayPerks*** provides a platform for prepaid customers that encourages point-of-sale purchases using plastic through educational modules and rewards while discouraging ATM withdrawals. The company's push to instill digital payments habits in consumers anticipates a future where paycheck or benefit deposits via check are increasingly obsolete.

CASH IN / OUT…

- **Opens the door to digital finance for underbanked consumers**

  Underbanked consumers who are cash-preferred: 47%

- **Addresses the continued use of cash for small and medium purchases**

  US retail transactions conducted in cash: 25%

- **Enables consumers to interact with an increasingly digital world, especially as prepaid card growth continues**

  Amount loaded on to GPR prepaid (2012): $77b

  Expected amount loaded on to GPR prepaid in 2015: $168b

  Amount loaded on to payroll cards (2011): $31b

- **Innovates financial technology for the underbanked in multiple sectors**

  Payments & Transactions • Personal Financial Management

See text for full citations.

Cash In/Out Case Study: PayNearMe

Purchasing a bus ticket, ordering a book, or making a secure, online utility bill payment can be impractical for consumers without a credit, debit, or prepaid card. PayNearMe unlocks access to web commerce and other remote transactions by bridging the gap between online payments and accessible brick and mortar storefronts. For vendors, who pay interchange fees that drive PayNearMe's revenue model, the system provides a chance to convert expensive customers who would otherwise pay with cash or checks to a cheaper digital format, plus incorporate new customers previously cut off from digital payment options.

Merchants who contract with PayNearMe accept cash from customers along with credit card payments and other items on their electronic or phone menu. Cash-preferred consumers who choose PayNearMe receive a barcode to be printed or displayed on a smartphone, or use a vendor provided card, which they present with cash at a nearby payment location. The service instantly transfers remote cash payments to billers and provides an electronic record of receipt that documents the payment for both parties.

PayNearMe's growing network of payment locations encompasses more than 8,000 7-Eleven and ACE Cash Express stores nationwide – and will soon incorporate tens of thousands more through a recently inked deal with InComm – where customers can scan their barcode and hand cash over the counter, expanding opportunities for safe and accountable commerce.

Launched in 2009, the company has recently added PayNearMe Express, a new feature that incorporates additional services for smaller merchants, such as landlords, who can now offer the service through PayNearMe's IT infrastructure if they lack their own. The company's transaction volume grew by 325% in 2012.

TREND #3: Leveraging Big Data for Better Risk Management

Big Data – that immense plethora of worldwide digital information that is now easily tracked, stored, and analyzed through increasingly powerful technology – is redefining the study of consumer behavior across the economy and raising critical questions about consumer privacy and security in its wake. The availability of digital consumer information continues to expand. The volume of the digital universe is projected to multiply 50 times between 2010 and 2020 to 40 zettabytes (ZB) of usable data.[17] Mobile data traffic alone is currently estimated to be expanding at a compound annual growth rate of 78% through 2016.[18]

For the underbanked financial services market in particular, Big Data's most profound impact lies in unlocking access to credit. It enables innovators to identify and engage with information about underserved consumers who lack conventional financial histories and often find themselves with few options outside the high-priced, low-quality world of payday loans and other subprime credit options. Indeed, the quarter of Americans who have thin or nonexistent credit files are often invisible to traditional lenders and marketers although research shows that 46% of these 70 million consumers are reasonable loan candidates.[19] In the aftermath of the financial crisis, during which 21% of American consumers saw their credit scores fall by 21 points or more, many are seeking to rebuild credit by demonstrating ability to repay through a more widely conceived consumer profile.[20]

Utilizing digital records and online activity to assess creditworthiness, alternative credit risk scoring enables lenders to bypass the narrow methods and often calcified assumptions of traditional underwriting. Despite new forms of risk scoring on the market, the vast majority of credit decisions still rely on the limited trade lines traditionally used by the leading credit bureaus. As incumbents in the credit scoring space are awakening to the need to incorporate broader risk analysis models, new entrants and small, nimble innovators will continue to play an outsized role in driving competition and providing partnerships to reach underserved consumers. RentBureau, a former CFSI Catalyst Fund portfolio company, which tracks rent payments to identify strong loan candidates among young and underserved adults with paltry credit data, was acquired by Experian in 2010 in an effort to expand its analytical competencies into the underbanked market. Similarly, TransUnion has employed the Thin File Model developed by its partner ***L2C, Inc.***, a Core portfolio company, since 2007 to reach borrowers with limited credit histories. Dominant credit scorer FICO recently announced a partnership with relative newcomer ***FactorTrust***, a purveyor of modern predictive analytics for alternative credit performance, to expand its capabilities in this area.

Storing and accessing troves of consumer data also carries genuine risk regarding data privacy, security, and fair lending. Innovators and investors leveraging big data will be most successful if they vigilantly avoid potential data breaches, actively monitor shifts in regulation, and consistently ensure that the end consumer and their data are treated fairly. To comply with federal fair lending standards, banks and non-bank financial service entities now under the supervision of the CFPB should take particular care to ensure that models incorporating big data do not skew lending decisions in ways that discriminate or otherwise result in disparate impacts on specific demographic groups.

While the business risks of using big data for risk management should be noted, the recognition of additional ranks of credit-worthy consumers also presents a significant opportunity to reach underserved consumers. Their lack of strong traditional credit scores results in poorly met demand for quality credit, contributing to a $62 billion domestic market for short-term and very short-term loans that are often characterized by inordinately high interest rates and fees.[21] CFSI research shows that underserved consumers who turn to alternative small-dollar credit products are much less likely to have a credit card than other consumers and cite an inability to qualify as the most common barrier.[22]

Cutting edge data platforms that allow for massive distributed data sets, such as the programming framework Hadoop, are being deployed for financial risk management today. Innovators like ***L2C, Inc.*** are seizing the opportunity to create alternative underwriting platforms for clients looking to incorporate big data into their lending practices by developing customized data models resourced from a broad array of trade lines, consumer data, and public data, as well as information from the big three credit bureaus. ***Sociogramics*** and ***DemystData*** are developing new ways to identify promising borrowers through a broad set of online social media data, making these companies prime examples of multiple financial technology trends.

Their proprietary risk models provide a wealth of information for lenders to assess ability to repay while remaining efficient and cost-effective.

Other innovators are creating new sources of data or finding value in previously overlooked sources to enhance risk scoring accuracy. ***ZestFinance*** leverages its expertise in machine learning, not only using large and distributed datasets, but applying algorithms that evolve and improve insights over time. For ***FairLoan***, payroll data represents a hidden treasure of real-time consumer income and job stability metrics that drive loan risk assessment. ***Neo*** specializes in offering credit to underserved car buyers based, in part, on previously inaccessible income and transaction data.

Big data is also charting new courses for smart lending beyond personal loans. Companies such as ***On Deck*** and ***Kabbage*** use alternative data drawn from online merchants and retail channels to provide access to working capital for small businesses, especially those that operate online.

The credit sector is not the only one drawing on big data to fill gaps in the underbanked market. ***Yodlee*** gathers information after being granted access by consumers to their bank accounts, then synthesizes it to create aggregate portraits of consumer income and spending behavior. This allows the company to enable robust personal financial management tools and to provide financial institutions with valuable market research data.

In the public sector, government recognition of big data's potential led the U.S. Treasury Department to launch a "smart disclosure" initiative in 2009.[23] The project aims to increase access to consumer-level data collected by companies and government agencies in machine-readable formats, enabling developers to create offerings that promote sound decision-making based on actual consumer behavior. ***HelloWallet*** utilizes this newly accessible public and private sector data to identify healthy consumer financial management strategies. It then provides employers and their workforces with tools and incentives to guide employee management of salaries, benefits, and retirement accounts to build financial capability and security.

BIG DATA…

- **Utilizes the rapidly expanding universe of available data**

  Growth of digital universe during this decade: 50x larger to 40 ZB of data

  Compound annual growth rate of mobile data traffic: 78%

- **Disrupts inefficient risk scoring practices by dominant incumbents**

  American consumers with no traditional credit file or a thin file: 25%

  Poor credit file consumers projected to be a prime or superprime risk: 46%

- **Identifies alternative indicators of risk amid declining credit scores**

  American consumers whose credit scores dropped at least 21 points between 2008 and 2011: 21%

- **Faces opportunities and challenges to operation within enhanced identity, security and consumer protection concerns**

  The FTC's 2012 report on protecting consumer privacy provides a roadmap with a voluntary framework for data brokers

- **Innovates financial technology for the underbanked in multiple sectors**

  Alternative Underwriting • Credit • Personal Financial Management

See text for full citations.

Big Data Case Study: L2C, Inc.

Since its founding in 2000, L2C, Inc., a Core portfolio company, has focused on new ways of computing consumer risk. The company synthesizes vast troves of consumer data including utility payments, checking account information, public records, alternative financial service usage, and more to create proprietary data points and predictive repayment models. L2C has created over 200 million alternative credit scores for its clients, filling in the blanks on thin-file borrowers for companies ranging from credit unions to auto lenders to healthcare businesses.

L2C's heterogeneous data sources capture opportunities often missed by loan decisions that rely on the limited trade lines used by traditional credit scoring models. L2C's clients gain insights into their target markets when they purchase its scoring solution, either directly or through L2C's partner TransUnion, then integrate L2C's consumer profiling and predictive behavior models with standard risk measurements, increasing their ability to lend to previously overlooked consumers. L2C reports that its customers gained actionable risk data for nine out of ten consumers who could not be accurately sized up by the big three credit bureaus. L2C's big data modeling – based on Hadoop's data processing framework – also extends beyond credit scoring to include delinquency management, marketing strategies, and fraud detection, all of which can ultimately improve provider efficiency and decrease consumer costs.

TREND #4: Scaling Up by Going B2B2C

For financial startups applying tech-based solutions to the underbanked market, business-to-business partnerships are lowering the time and expense of marketing new products directly to underserved consumers. These consumers can be a hard-to-reach population with entrenched financial behaviors and long-standing relationships with their existing providers, even when those providers present higher costs and lower quality than available alternatives. Joining forces with a high-value brand or offering a white label product from behind the scenes can allow FinTech startups to gain access to broad and established distribution channels, decreasing the cost of acquisition and enhancing scalability.

In complement, leading financial institutions are beginning to identify the potential of underserved customer segments that demand more specific engagement strategies. Some have addressed the need for this new competency by incorporating the products of agile startup companies, which offer a way to differentiate and broaden incumbents' offerings without significant in-house investment.

These synergies make business-to-business partnerships attractive for startups and established players. Prepaid provider ***Plastyc***, a Core portfolio company, powers H&R Block's Emerald Card MasterCard platform for tax refund delivery. Plastyc adds value by transforming the tax refund prepaid card from a one-time payment vehicle to a year-round banking solution with mobile and direct deposit capability. Enhanced consumer retention aids H&R Block's bottom line, while providing a white label product for a prepaid card issuer with 3.4 million customers lets Plastyc expand its reach quickly through a known and trusted brand.

ReadyForZero partners with banks who steer at-risk customers to its debt management services, fostering healthier consumer financial behavior and deepening the relationship between consumers and their banks. ***BillFloat*** offers short-term credit through bill payment channels, providing value for consumers and billers by smoothing cash flows. Through partners like MetroPCS/T-Mobile, which has 43 million users, Comcast, which boasts 19 million subscribers, and GEICO, which has 11 million auto policy holders, BillFloat's credit option is made widely available. ***PayNearMe*** also works with a network of retailers and billers that offer its cash payment option to underserved consumers making remote purchases. Customers access ***iSend's*** remittance services at alternative financial product stores such as ACE Cash Express or Pay-O-Matic. For ***SaveUp*** and ***SavvyMoney***, a Core portfolio company, which offer online services to build savings and manage personal debt, cooperation with financial institutions – like SaveUp's partner Bank of the West and SavvyMoney's partner American Airlines Federal Credit Union – provides a wider customer base. Their financial capability services, in turn, provide a support system for bank and credit union consumers to manage basic banking products successfully.

B2B2C…

- **Expands available product offerings for established providers and increases scale for new entrants at low cost**

  Plastyc and H&R Block: Full-feature prepaid card for tax refund load and continued use now available to customer base of: 3.4 million

  BillFloat and 2,500 partners: Financing options for consumers at nationwide retailers including: Comcast 19 million users, GEICO 11 million auto policy holders MetroPCS/T-Mobile 43 million users

- **Enables startups to reach customers who have long-standing relationships with their preferred banks and credit unions**

  SaveUp and Bank of the West are piloting prize-linked savings. Bank of the West customer base: 1.6 million

  SavvyMoney and American Airlines FCU are offering online debt management tools. AAFCU membership: 232,000

- **Adds value by replacing high-cost lead-generation business models**

  Typical lead generation cost for small-dollar credit: $50 to $150 per lead

- **Is broadly applicable to multiple sectors in the underbanked marketplace**

See text for full citations.

B2B2C Case Study: BillFloat

Most short-term lending is expensive because customer acquisition costs are high even when leads are generated online, costing as much as $150 per loan.[24] Instead of marketing directly to consumers, BillFloat partners with over 2,500 institutions that already attract and cater to underbanked consumers. Its small-dollar loans are designed to solve short-term cash flow needs by providing credit up to $200 to cover bills and allowing borrowers a 30-day cushion for repayment. BillFloat reaches most of its consumers with zero customer acquisition costs by embedding its loan application in the billing payment options of partner companies, which range from utilities such as Reliant and Duke Energy, to wireless providers including Metro PCS and Sprint, to Cablevision, to insurance companies like GEICO and Allstate. BillFloat's partners also actively promote its credit option through online ads and insertions into customer payment reminders and text messages to encourage avoidance of late payments or decrease the time of outstanding bills.

As an option for online bill payment, or made available by merchants at points of sale for smartphone financing, BillFloat offers alternatives for consumers striving to stay current on their bills or purchase higher cost items with a monthly payment structure. The company, which launched in 2009, expects to lend $400 million this year to more than 830,000 registered users. BillFloat uses consumer data from partnered banks, past utility bill history, and other payments activity to assess credit risk. For consumers with near-prime credit scores, it offers the additional option of a standing line of credit up to $1,000 underwritten by partner banks.

Although BillFloat's interest rates and bill payment fees amount to a higher cost than loans offered by some traditional small-dollar credit products, such as credit cards, they are considerably lower than many alternatives – such as standard payday loans – that customers might otherwise use. BillFloat can afford to offer comparatively lower rates while still making a profit because its model slashes inefficiencies that normally plague small-dollar credit providers.

Given CFSI's research showing that over a third of small-dollar credit borrowers use small-dollar loans to pay off a utility bill, BillFloat's ability to distribute its service directly through bill payment sites adds value for all involved.[25] Its services also allow retailers, utilities, and insurance companies to differentiate and broaden their consumer offerings by providing a unique financing option.

Conclusion

Unmet demand for high-quality financial products that address the needs of financially underserved consumers presents a genuine opening for FinTech startups to disrupt an entrenched industry while improving the financial health of millions of Americans. The financial technology trends discussed in this paper – social networks, cash in/out, big data, and B2B2C scaling strategies – are a snapshot of forces currently driving innovation in this fluid market. At the same time, larger, established providers are reevaluating their own strategies and will increasingly act upon the growing awareness of this opportunity, in many cases by investing in, partnering with, or even acquiring the most promising new players.

The potential for FinTech companies to generate healthy profit margins while providing high-quality financial services to underserved consumers stands on the cusp of realization. Savvy entrepreneurs and investors should keep a close eye on this dynamic and emerging marketplace.

Appendix

Featured Companies

COMPANY	LOCATION	SECTOR	FINANCIAL TECHNOLOGY TREND	STAGE	WEBSITE
BillFloat, Inc.	San Francisco, CA	Credit	B2B2C	Early growth	www.billfloat.com
Boom Financial, Inc.	Palo Alto, CA	Payments	Cash In/Out	Early growth	www.useboom.com
Chexar Networks, Inc.	Roswell, GA	Payments	Cash In/Out	Growth	www.chexar.com
DemystData	New York, NY	Alt Data	Big Data	Startup	www.demystdata.com
FactorTrust, Inc.	Roswell, GA	Alt Data	Big Data	Early growth	ws.factortrust.com
FairLoan Financial, Inc.	San Francisco, CA	Credit	Big Data	Startup	www.fairloanfinancial.com
HelloWallet, LLC	Washington, D.C.	PFM*	Big Data	Early growth	www.hellowallet.com
iSend LLC	Middlebury, CT	Payments	Cash In/Out, B2B2C	Early growth	www.isendonline.com
Kabbage, Inc.	Atlanta, GA	Credit	Social Networks, Big Data	Growth	www.kabbage.com
L2C, Inc.	Atlanta, GA	Alt Data	Big Data	Growth	www.l2cinc.com
Motozuma LLC	Chicago, IL	Savings	Social Networks	Startup	www.motozuma.com
Neo Finance, Inc.	Palo Alto, CA	Credit	Big Data	Startup	www.myneoloan.com
Nexxo Financial Corp.	Burlingame, CA	Payments	Cash In/Out	Early growth	www.nexxofinancial.com
On Deck Capital, Inc.	New York, NY	Credit	Big Data	Growth	www.ondeckcapital.com
PayNearMe, Inc.	Sunnyvale, CA	Payments	Cash In/Out, B2B2C	Early growth	www.paynearme.com
PayPerks, Inc.	New York, NY	PFM	Cash In/Out	Startup	www.payperk.com
Piggymojo (SavingsHero, LLC)	Brooklyn, NY	Savings	Social Networks	Startup	www.piggymojo.com
Plastyc, Inc.	New York, NY	Payments	Cash In/Out, B2B2C	Early growth	www.plastyc.com
ReadyForZero, Inc.	San Francisco, CA	PFM	B2B2C	Startup	www.readyforzero.com
SaveUp, Inc.	San Francisco, CA	PFM	B2B2C	Startup	www.saveup.com
SavvyMoney, Inc.	San Francisco, CA	PFM	B2B2C	Startup	www.savvymoney.com
SmartyPig, LLC	Des Moines, IA	Savings	Social Networks	Early growth	www.smartypig.com
Sociogramics, Inc.	Mountain View, CA	Alt Data	Social Networks, Big Data	Startup	www.sociogramics.com
SoMoLend Holdings, LLC	Cincinnati, OH	Credit	Social Networks	Startup	www.somolend.com
Tio Networks Corp.	Vancouver, BC, Can.	Payments	Cash In/Out	Growth	www.tionetworks.com
Wipit, Inc.	Lake Forest, CA	Payments	Cash In/Out	Startup	www.mywipit.com
Yodlee, Inc.	Redwood City, CA	Alt Data, PFM	Big Data	Growth	www.yodlee.com
ZestFinance, Inc.	Los Angeles, CA	Alt Data	Big Data	Early growth	www.zestfinance.com
ZipZap, Inc.	San Francisco, CA	Payments	Cash In/Out	Startup	www.zipzapinc.com

* Personal Financial Management

Morgan Stanley

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CFSI Center for Financial Services Innovation

The Center for Financial Services Innovation (CFSI) is the nation's leading authority on financial services for underserved consumers. Through insights gained by producing original research; promoting cross-sector collaboration; advising organizations and companies by offering specialized consulting services; shaping public policy; and investing in nonprofit organizations and start-ups, CFSI delivers a deeply interconnected suite of services benefiting underserved consumers. Since 2004, CFSI has worked with leaders and innovators in the business, government and nonprofit sectors to transform the financial services landscape. For more on CFSI, visit our web site and join the conversation on Twitter @CFSInnovation.

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CORE INNOVATION CAPITAL

Core Innovation Capital is a leading investor in financial technologies serving the Emerging Middle Class, defined as the 80 million Americans that annually generate over $1 trillion in income and spend more than $78 billion in fees and interest on financial services. Core partners with proven entrepreneurs and invests in disruptive financial technologies that measurably improve the lives of the Emerging Middle Class. The Core Impact Alignment Investment Thesis leverages this social impact to create market disruption, positive change, and greater financial return. For more information about Core Innovation Capital, visit www.corevc.com.

Endnotes

1. "2011 Underbanked Market Sizing Study," CFSI/Core, November, 2012
2. "2011 FDIC National Survey of Unbanked and Underbanked Households," September, 2012 The FDIC defines underbanked consumers as those who conduct some or all of their basic financial transactions outside of the mainstream banking system. For the purposes of this report, we consider a somewhat broader array of consumers including those who face analogous financial barriers through lack of access to prime credit or challenges rooted in low incomes.
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7. Pew Research Center, Internet and American Life Project, Social Networking 2/14/13 http://pewinternet.org/Commentary/2012/March/Pew-Internet-Social-Networking-full-detail.aspx
8. CFSI supports promising nonprofit-led projects, selected through a competitive grant proposal process, which are designed to promote financial capability for underserved consumers by leveraging technology, applying behavioral economics concepts, and closely combining relevant, timely, actionable, and ongoing strategies with access to high-quality financial products and services.
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25. "A Complex Portrait: An Examination of Small-Dollar Credit Consumers," CFSI, August 2012

Annex 9: Top 10 Google search results for "payday loan" (20 September 2013)

Payday Loans - Wizzcash
https://www.wizzcash.com/payday-loans/
The 3 month payday loan – an exciting new breed. A 3 month loan is a normal loan repaid over 3 months. This option offers customers greater flexibility because ...

Top 10 Payday Loans UK - Compare Best Pay Day Loan Lenders
paydayloans.money.co.uk/
Compare payday loans from all the payday loan lenders offering cash loans in the UK at a glance, find the cheapest pay day loan company & apply online for an ...
Bad Credit - Instant Payday Loans - Direct Payday Loan Lenders - All Payday Loans

News for payday loan

Is one-year borrowing worse than a payday loan?
The Independent - 5 days ago
It would appear that warnings against the toxic nature of payday loans have had little success, after Wonga's recent announcement that it made ...

Use of APR 'skews view of payday loan deals'
Belfast Telegraph - 1 day ago

Alabama seeks to enforce payday loan limits
Businessweek - 17 hours ago

Payday loans from PaydayUK | Online Cash Loans
https://www.paydayuk.co.uk/
PaydayUK offers quick and hassle-free online payday loans between £100 and £ 1000. No fuss and repay on your payday. PaydayUK are a direct lender.
Contact details - Apply Now - Frequently asked questions - How payday loans work

Payday loans in the United Kingdom - Wikipedia, the free ...
en.wikipedia.org/wiki/Payday_loans_in_the_United_Kingdom
Payday loans in the United Kingdom are a rapidly growing industry, with four times as many people using such loans in 2009 compared to 2006—in 2009, 1.2 ...

List of Payday Loan Lenders Only
www.listofpaydayloanlenders.co.uk/
View our list of payday loan lenders only along with reviews of each to help you find the best payday loan lenders for a short term cash solution.

Payday Loans - Cash in Your Account in 15 Minutes
www.rapidpaydayloanadvances.co.uk/
Borrow up to £1000 Payday Loans in 15 Minutes. Apply Now for Cash and Get Paid Quick.

Payday loans - Step Change
www.stepchange.org/Paydayloans.aspx
Payday loans debt help? Free & instant online advice from StepChange Debt Charity (formerly CCCS), the leading UK debt help charity.

Payday loans: know your rights - Citizens Advice
www.citizensadvice.org.uk › ... › Current campaigns › Payday loans
Need help with your payday loan? Visit the payday loan pages on Adviceguide. Call our consumer helpline 08454 04 05 06. You can contact Citizens Advice ...

Payday Loans Online - Fast Payday Loan Providers in UK
https://www.peachy.co.uk/payday-loans
Searching for a Payday Loan? We have the answer. Peachy specialize in instant Payday Loans of up to £500 with same day Pay-out.

Citizens Advice - Payday loans - AdviceGuide
www.adviceguide.org.uk › ... › Loans › Payday loans
How payday loans work, including continuous payment authority, stopping payments, extending the loan and alternatives to payday loans.