COMPETITION COMMISSION

PAYDAY LENDING MARKET INVESTIGATION

Competition between payday lenders and other credit providers

Introduction

1. In this working paper we discuss the competition payday loans face from other forms of credit products such as credit cards, overdrafts and pawnbroking. This material will inform our views on the following areas.

   (a) The relevant market(s) payday loans compete in (and whether other types of credit are sufficiently substitutable for payday loans to be included in the relevant market(s)).

   (b) The extent to which the behaviour of payday lenders is likely to be constrained by competition from non-payday lenders.

2. The remainder of this paper is structured as follows.

   (a) Product characteristics—we present evidence on whether other credit products have similar characteristics to payday loans. The more similar the products, the more likely that customers will be willing to switch to these alternatives if payday lenders were to worsen their offering, and so the greater the competitive constraint.

   (b) Access to other credit products—we present evidence on whether payday loan customers can access other credit products. The more payday loan customers can access other credit products, the greater the competitive constraint they will exert on payday lenders.

   (c) Competition—we present evidence on the extent of competition between payday lenders and providers of other credit products. We consider the extent to which direct evidence exists showing payday lenders competing with non-payday lenders.

3. We make the following observations on the basis of the evidence that we have seen to date (while bearing in mind that analyses of some issues relevant to our assessment are ongoing).

4. First, the evidence on functional substitutability suggests that credit cards and overdrafts share characteristics with payday loans. For example, customers with an overdraft or credit card can obtain quick access to credit and can use these to borrow small amounts. Other credit alternatives generally differ more significantly in that they do not allow customers to access funds as quickly as when using a payday loan, require securitization, or do not allow small amounts to be borrowed. This would suggest that these two credit products are likely to be the closest non-payday commercial substitutes to payday loans for most customers.

5. Second, in our survey only 6 per cent of respondents said that if payday loans were not available they would have used other credit products. Our survey suggests that an important influence on this is payday loan customers' reduced access to mainstream credit, for example credit cards and bank loans.

6. Third, although some payday lenders report competing with non-payday credit providers, we have seen very little evidence of these providers adjusting their product offering in response to the actions of non-payday lenders. Most non-payday lenders do not consider themselves to compete with payday lenders—or take the actions of payday lenders into account in setting their own offering—although there are exceptions.

Product characteristics

7. In this section we discuss whether other credit products have characteristics which are similar to payday loans. If other credit products have similar characteristics to

payday loans then this could suggest that customers see them as functional substitutes and are therefore more likely to see other credit products as valid alternatives to payday loans. For example, payday loan customers have stated that speed of access is an important aspect in their decision to use payday loans.[1] Therefore credit products which do not offer quick access to the funds are less likely to be seen by customers as a valid alternative to payday loans. Below we first describe the characteristics of payday loans and then compare and contrast these with the characteristics of other credit products.

Characteristics of payday loans

8. As described in our working paper 'Payday loan products', we have defined payday loans as short-term, unsecured credit products which are generally taken out for 12 months or less, and where the amount borrowed is generally £1,000 or less. Some of the key defining characteristics of payday loans are:[2]

   (a) Amount of loan—this is typically less than £1,000.

   (b) Loan duration—this is typically a month or less, but can be up to a year for some products.[3]

   (c) Payment and repayment method—when customers take out a payday loan online the loan amount is deposited in their bank account, making the money available for paying bills and withdrawing as cash. With high street payday loans customers can receive the funds in cash or as a credit to their bank account. Loans are often repaid through the use of continuous payment authorities. Customers of The Money Shop can repay loans in cash in-store.[4]

   (d) Price—payday loans have high annual percentage rates.

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[1] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, p90.
[2] A full explanation of the characteristics of payday loans available is given in the Payday loan products working paper.
[3] Rollovers and refinancing may also result in the extension of the loan period.
[4] www.moneyshop.tv/short-term-loan-FAQ/.

(e) Rollovers—Another characteristic of many payday loan products is the existence of rollover facilities. The exact terms on which these facilities are offered, and the terms used to describe them, vary, but the common effect is to allow the customer to extend the duration of their loan beyond the originally agreed repayment date.

(f) Payday loans are unsecured loans.

(g) Speed of application, approval and transfer—successful applicants generally receive the funds on the same day, often within an hour (or less) of their application. Customers using high street payday lenders can receive the cash immediately after approval.

(h) Top-up facilities—some payday loan products allow the borrower to increase or top up their loan before the end of the loan term.

Characteristics of other credit products

9. In this section we discuss whether other credit products have similar characteristics to payday loans. First, we compare payday loans' non-price characteristics with those of credit cards and overdrafts. Second, we compare the characteristics of payday loans with credit products other than credit cards and overdrafts. Third, we compare the characteristics of payday loans with other, non-commercial, credit products. We will also publish at a later date our comparison of the price of borrowing using a payday loan with the price of borrowing using other credit products.

Comparison of credit cards with payday loans

10. Credit cards allow cardholders to pay for goods and services on credit, up to an agreed limit. The credit facility allows the cardholder to have a revolving balance, which can be paid off over time. If balances are not repaid in full, the cardholder will be required to make a minimum monthly payment. Gross credit card lending was

estimated to be £139 billion in 2012[5] and there were an estimated 31 million credit card holders and around 61 million cards in issue, meaning that the average credit card customer had two cards.[6] On a group basis, in 2012 the five largest credit card issuers were Barclays, Lloyds Banking Group (LBG), HSBC, MBNA and RBS Group. Together, they were estimated to have around three-fifths of the market, by share of customers. Other notable suppliers included Tesco, Capital One and American Express.[7]

11. Credit cards share many of the characteristics of payday loans:

(a) Amount of loan—customers can borrow sums less than £1,000 by purchasing items on their existing credit cards or can apply for credit cards with limits of less than £1,000. Barclays said that Barclaycard offered a revolving credit facility of £250 to £10,000. Capital One said that its minimum was £200 and maximum £12,000. MBNA told us that its minimum was £500 and its maximum was £20,000.[8] SAV[9] told us for new customers its minimum was £100 and £1,600 was the maximum.

(b) Payment and repayment method—unlike a payday loan, money borrowed on a credit card is not credited to the customer's bank account. However, customers are able to make purchases with their credit card.[10] Many credit cards also allow cash withdrawals. Repayment is typically from the customer's bank account, similar to payday loans.

(c) Credit cards do not offer rollovers in the same way as payday lenders. However, the ability to revolve credit gives customers flexibility over when they repay, implying credit cards share this characteristic with payday loans. Evidence from

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[5] Mintel, *Credit Cards – UK – July 2012*, p11.
[6] ibid, p21.
[7] ibid, July 2012, p14.
[8] This is the outlying range based on policy parameters. It is possible, by exception, to establish a credit limit beyond these parameters.
[9] SAV Credit operates the Aqua, Marbles and Opus credit card brands in the UK (www.savcredit.co.uk/).
[10] Barclays told us that Barclaycard had launched a facility for customers to transfer money from their credit card to their bank account.

our survey showed that some customers dislike credit cards precisely because of the perceived risks of being able to revolve their debts.[11]

(d) Like payday loans, credit cards are unsecured loans.

(e) Speed—like payday loans, customers who already have an existing credit card with available credit can use the funds on the same day. Customers who apply for a credit card typically will not be able to access the funds on the day of application and the time period between application and card delivery varies. Barclays told us the minimum was [✂] days; Capital One told us it was [✂] days; LBG told us it was [✂] days; RBS/Natwest told us it was [✂] days; and HSBC said it was a minimum of [✂] days. MBNA told us that for its Amazon-branded cards customers could spend immediately after approval, but only on Amazon's site.

(f) Top-up facilities—like payday loans, customers can spend additional amounts if they have not reached their existing credit limit.

12. However, credit cards do differ from payday loans on the payback period. Credit card customers are only required to pay a pre-specified minimum amount every month and can revolve the debt, extending the payback period.

Comparison of overdrafts with payday loans

13. Overdraft services can be applied for by customers who do not have a basic bank account. There are two kinds of overdraft: authorized and unauthorized.[12] Authorized overdrafts are agreed between the customer and the bank and allow the customer to continue spending up to this agreed limit. According to the British Bankers' Association in September 2013 £7.8 billion was being borrowed on authorized

[11] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, p85.

[12] The terms arranged and unarranged, and planned and unplanned are also used.

overdrafts from the major high street banks.[13] Unauthorized overdrafts are not pre-agreed between the customer and the banks and banks will typically charge additional fees for this service.

14. Overdrafts share many of the characteristics of payday loans.

(a) Amount of loan—customers can borrow less than £1,000 or more through authorized overdrafts. For example, Barclays told us that customers could apply for authorized overdrafts of up to £5,000. Unauthorized overdrafts also allow customers to borrow for certain types of transactions, but the amounts depend on the creditworthiness of the customer. For example, RBS/Natwest told us [✂]. HSBC told us [✂]. Barclays told us it did not provide unarranged overdrafts, but instead offered a Personal Reserve service. This was a service that gave customers an extra agreed amount which could be used if they had occasional need to go overdrawn or exceed an arranged overdraft limit. Personal Reserves of between £150 and £2,500 were available to eligible current account customers.

(b) Payment and repayment method—both authorized and unauthorized overdrafts result in available credit being added to customers' bank accounts and are therefore similar to online payday loans. Cash withdrawals can be used to replicate the cash from high street payday lenders. Repayments are made by depositing funds in the account, effectively the same as payday loans.

(c) Rollovers—authorized overdrafts are typically open-ended credit arrangements, with customers having an overdraft facility until it is removed by the bank. Since there is no specific repayment date overdrafts cannot be rolled over in the same way as payday loans, but they allow customers to extend the duration of their borrowing and therefore can be seen as offering a similar service to rollovers.

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[13] www.bba.org.uk/statistics/article/september-2013-figures-for-the-high-street-banks. The BBA data covers Santander, Barclays, HSBC, Virgin Money, Lloyds and RBS.

Unauthorized overdrafts are typically shorter-term arrangements, with banks often honouring a few payments before rejecting others. Unauthorized overdrafts therefore do not allow customers to roll over a debt. For example, LBG told us that it tried to avoid customers staying in their unplanned overdraft for an extended period as that was not what the service was designed for. It would contact customers who went over their unplanned limit by £100 and discuss a possible repayment plan. More generally, a customer's unplanned overdraft could be removed as part of the monthly scoring/limit assignment process.

(d) Like payday loans, overdrafts are unsecured loans.

(e) Speed—like payday loans, customers with an existing authorized overdraft and available credit can use the funds on the same day. Similarly, unauthorized overdrafts allow funds to be used on the same day. When customers have to apply for an authorized overdraft the evidence from banks showed that the funds would be available quickly. Barclays, HSBC, LBG and Santander told us that the funds would be made available immediately. RBS/Natwest told us [✄].

(f) Top-up facilities—like payday loans, customers can spend additional amounts if they are below their authorized overdraft credit limit. Unauthorized overdraft limits cannot be increased in the same way.

15. However, overdrafts do differ from payday loans on the payback period. Authorized overdrafts typically run over an extended period and can extend indefinitely. Unauthorized overdrafts typically cover a shorter period. Santander told us that the average time a customer spent in unauthorized overdraft was three days. RBS/Natwest told us that in a typical month [✄] per cent of the accounts that entered unauthorized overdraft did so for [✄]. LBG told us that of those customers that used an unauthorized overdraft, [✄] per cent stayed in their overdraft for [✄].

Comparison of other credit products with payday loans

16. Table 1 summarizes our comparison of other credit products with payday loans.

TABLE 1 **Comparison of payday loan characteristics with those of other credit products**

Characteristic	*Are credit union loans similar?*	*Is home credit similar?*	*Are logbook loans similar?*	*Is pawnbroking similar?*	*Is peer-to-peer lending similar?*	*Are personal loans similar?*	*Is retailer credit similar?*
Amount	Yes—£100 to £7,500*	Yes—£50 to £2,500	Yes—£200 to £50,000	Yes—£5 to £100,000	No—minimum of £1,000	No—minimum typically £1,000†	Yes—£150 upwards
Payback period	Yes—some one-month loans‡	No—minimum 14 weeks	Yes—minimum six month	Yes—customers can repay at any time up to seven months	Yes—minimum six months, but typically longer§	No—typically one year¶	No—revolving credit
Payment and repayment method	Yes—paid and repaid through bank account	No—cash sum lent is paid back in cash	Yes—paid and repaid through bank account	No—cash sum lent is paid back in cash	Yes—paid and repaid through bank account#	Yes—paid and repaid through bank account	No—credit only for purchases from retailer
Rollovers	No—new loan required	No—customers can miss payments at no extra cost	No—new loan required.	Yes—customers can rollover their loan at any time in the contract period	No—new loan required	No—new loan required.	Yes—can revolve the debt
Secured/unsecured	Yes—unsecured loan	Yes—unsecured loan	No—logbook required	No—pawn required	Yes—unsecured loan	Yes—unsecured loan	Yes—unsecured loan
Speed	Some—instant to 7 days	No—average 5 days to 2 weeks	Yes—minimum 1 hour	Yes—5–15 minutes	No—48 hours from application to reception~	Yes—funds available in around an hour	Yes—funds available in 15–30 minutes
Top-up facilities	Yes	Yes—customers can refinance/renew loans	No—new loan required	No—new pawn required	No—new loan required	No—new loan required	Yes—if have available credit

Source: CC analysis.

*www.creditunion.co.uk/Loans.htm.
†Airdrie Savings Bank offers a personal loan of £550 (http://airdriesavingsbank.net/sites/default/files/images/PL%20Summary%20Box%202013.pdf). HSBC also lends smaller amounts to its customers through its flexiloan credit product. This allows customers to borrow up to £500 and gives them flexibility over how they repay the loan (www.hsbc.co.uk/1/2/loans/flexible-loans).
‡www.creditunion.co.uk/Loans.htm.
§www.ratesetter.com/borrowing/process.aspx.
¶Airdrie Savings Bank offers Express loans repaid over a maximum of six months (http://airdriesavingsbank.net/exloans, consulted 29 January 2014).
#www.ratesetter.com/borrowing/any_questions.aspx.
~www.ratesetter.com/borrowing/any_questions.aspx.

17. None of the seven products is similar across all the characteristics, but all share some characteristics with payday loans.

(a) Credit union loans involve similar small, unsecured credit which is paid and repaid through bank accounts, offer top-up facilities and in some cases one-month loans are offered. However, they do not offer rollovers and sometimes cannot be obtained quickly. On the issue of speed Leeds City Credit Union (LCCU) told us

> LCCU has not so far made changes to any of its lending products in response to pay day loans although we recognise that especially in respect of speed of loan approval that the credit union is under pressure to change. However, as a credit union, conversely to the pressure to compete on speed, we also regard that to take appropriate time to assess a loan and for the loan to be affordable remains a virtue.

(b) Home credit loans involve similar unsecured small amounts with top-up facilities. However, payment and repayment is made in cash, rollovers are not available, payback is generally over a longer period and it takes longer to obtain the loans.

(c) Logbook loans offer customers the option of borrowing funds, using the logbook of their car as security. Logbook loans involve similar small amounts with a short payback period. The loans can be obtained quickly and are paid and repaid through bank accounts. However, borrowers must have a car they can use as security and rollover and top-up facilities are not available.

(d) Pawnbroking loans involve similar small amounts, can have a similar payback period, offer rollovers, and can be obtained quickly. However, they do not offer top-up facilities, borrowers must have an item of value they can use as security, and payment and repayment is made in cash.

(e) Peer-to-peer loans are unsecured and are paid and repaid through bank accounts. While some loans are for six months, they are typically for longer and

are for larger sums. In addition, they cannot be obtained quickly and do not have rollover or top-up facilities.

(f) Personal loans are unsecured, can be obtained quickly and are paid and repaid through bank accounts.[14] However, they typically involve larger sums, have a longer payback period and do not have rollover or top-up facilities.

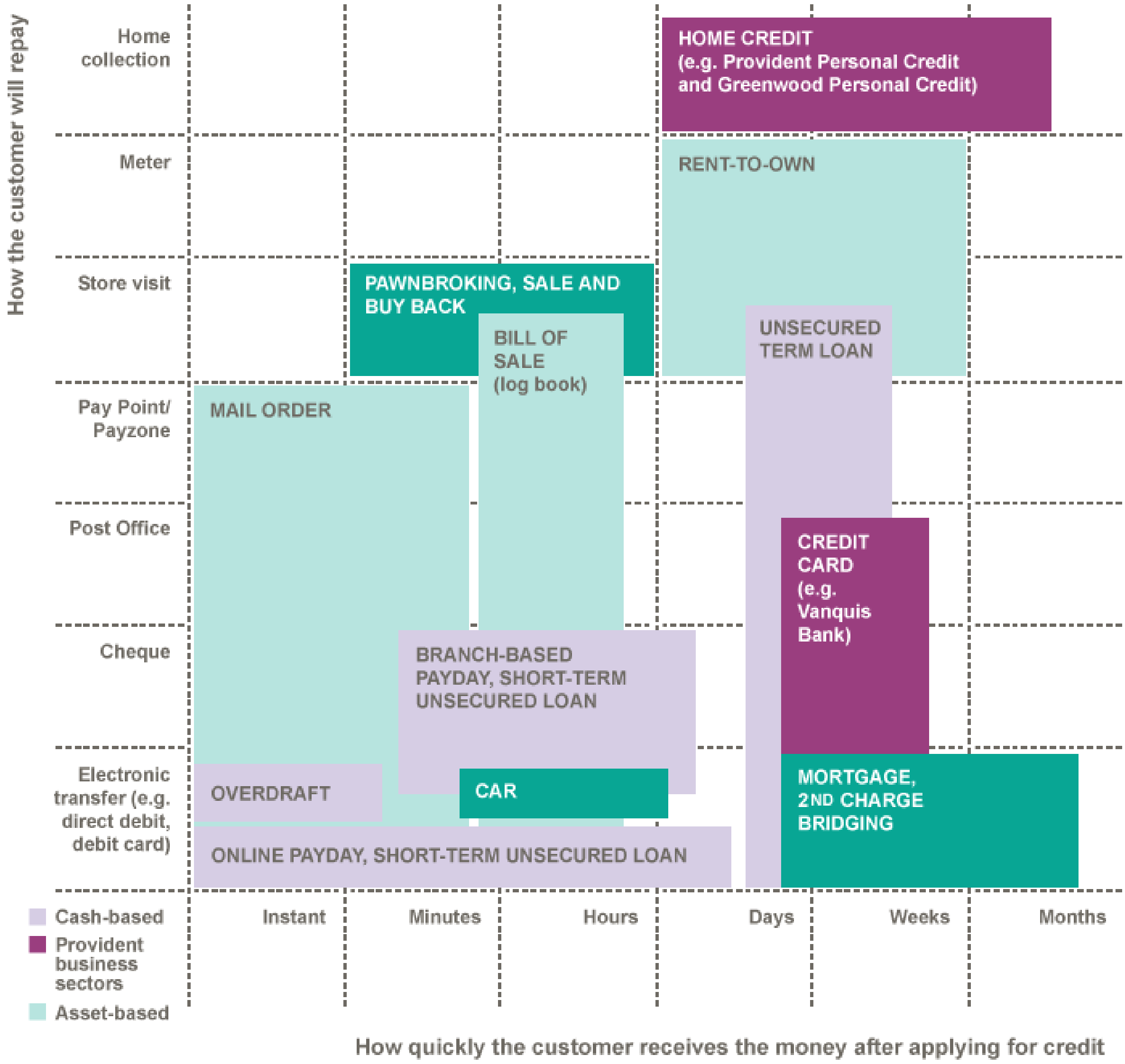
(g) Retailer credit can involve similar unsecured small amounts and the funds can be made available quickly. However, the credit must be spent with the retailer and the payback period can be longer as the credit operates like a credit card. Rollover is available through revolving the debt (ie not paying off the full amount each month) and top-up facilities are available if the customer has an available balance.

18. The results suggest that of this set, credit union loans and retailer credit share the most characteristics with payday lending. Our findings are generally consistent with the Provident Financial research shown in Figure 1 below, which looked at how non-standard credit products vary according to how quickly the customer receives the money after applying for credit and the repayment method. The major difference between its findings and ours is the speed of unsecured loans. The submissions from banks told us that unsecured personal loans were available within hours.

[14] We recognize, however, that customers' perceptions are that bank loans take longer to obtain than payday loans. For example, Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, p85.

FIGURE 1

Non-standard credit product comparison



Source: Provident Financial.

Other credit options[15]

19. There are other non-commercial credit options that may be open to some borrowers, including using savings and borrowing from friends and family.

20. The evidence from our survey suggested that few payday loan customers could use savings instead of a payday loan. Respondents were asked: ‘What would you have

[15] We use the term ‘credit options’ in this section as these are not commercially-produced credit products.

done if you had not been able to get a payday loan on this occasion?' 1 per cent said they would use savings they already had and a further 1 per cent said they would have saved up until they had the money.[16]

21. Borrowing from friends and family may be seen as offering similar characteristics to a commercial loan, such as the potential ability to delay repayments and speed of access. However, since borrowing from friends is based on a personal rather than a commercial relationship, this form of borrowing is inherently different. Its availability as an alternative and the factors that would be involved in practice are likely to differ considerably between potential borrowers.

22. It is therefore difficult to quantify borrowing from friends and family as an alternative to payday lending or estimate the extent of it as a competitive constraint on payday lending. We have asked questions about the availability of non-commercial loans in our survey and they remain a potential option to be aware of in seeking to understand consumer decision-making. However, it is difficult to see on what basis it could be concluded that loans from friends and family would be a significant competitive constraint on payday lending.

Direct evidence of the substitutability between payday loans and other types of credit

23. In this section we discuss direct evidence on the substitutability between payday loans and other forms of credit, largely based on our own consumer research. We consider evidence on what payday loan customers would have done had they not been able to take out a payday loan, and whether payday loans customers have access to and use other credit products. This is important, because if customers do

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[16] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, response to QPDSB1.

not have access to other credit products (perhaps due to low credit ratings) then they will be unable to switch to these alternatives, suggesting that these products will exert little competitive constraint on payday lenders, irrespective of how similar their characteristics are.

Payday customers' next best alternative

24. Respondents to our customer survey were asked: 'If you had not been able to get a payday loan on this occasion, what do you think you would have done instead?' Only 6 per cent of respondents said they would have borrowed from a different type of credit provider.[17] Instead, most individuals would either have gone without the loan or borrowed from friends or family.

25. Of those that said they would use an alternative product, credit card was the most common option (21 per cent). Other options mentioned included overdraft (15 per cent), bank/building society loan (12 per cent), pawnbroker loan (3 per cent) and home credit (1 per cent).[18] This suggests that only a very small proportion of payday loan customers (around 2 per cent) would have used a credit card or overdraft to borrow the money had their payday loan not been available.

26. The results of our survey are supported by the research carried out by Bristol University. A sample of payday customers were asked: 'What would you have done if you had been unable to obtain a payday loan?' The results are in Table 2 below and show that only 8 per cent of respondents reported that they would have borrowed in

[17] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, response to QPDSB1.
[18] ibid, response to QPDSB2.

some other way.[19] This is similar to the figure of 6 per cent obtained in our own survey.

TABLE 2 **Customers' responses to the question 'What would you have done if you had been unable to obtain a payday loan?'**

per cent

Response	*Online payday*	*High street payday*
Borrowed from a friend or relative	44	39
Gone without	29	29
Borrowed in some other way	8	8
Sold something	6	8
Saved up	4	4
Asked a friend or relative to give you the money or buy things on your behalf	3	4
Used savings	1	3
Don't know/too hard to say	2	2
Used overdraft	1	1
Asked for more time to pay off debt/different dates	1	1
Something else	3	2
Refused	-	1

Source: Bristol University Research, Table 20.

27. Our qualitative research suggested the existence of three groups of customers which might explain the reason for this finding: those who had tried alternatives and been rejected; those who assumed they would be rejected based on a bad credit history; and those who decided against alternatives that compared unfavourably.[20]

Access to other types of credit

28. We considered the extent to which payday customers were able to access other forms of credit.

29. Some of the non-payday lenders who responded to our questionnaires provided information on payday loan customers. A number of banks[21] told us that payday loan customers tended to be higher credit risk than their typical customers.[22] LBG told us

[19] The BIS Consumer Credit Survey 2012 was carried out by the University of Bristol's Personal Finance Research Centre and TNS BMRB. The survey comprised customers who had a short-term loan in the period from 1/11/2010 to 31/12/11. The sample included 393 who had used a high street payday loan and 395 who had used an online payday loan.
[20] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, p84.
[21] [✂]
[22] More detail on the submissions of non-payday lenders is provided in Annex 3.

that it monitored the proportion of lending to customers with payday loans as these customers tended to have worse repayment behaviour overall than customers who did not use payday loans.

30. In addition to this, a number of other credit providers[23] said they were using or considering using information on payday lending as part of their credit checking process.

31. When asked about their existing use of credit products, our survey showed that 49 per cent of payday loan customers had used an alternative form of credit in the last 12 months. Credit cards were the most commonly used credit product (31 per cent). The others were retail credit (13 per cent), bank/building society loan (8 per cent), home credit (6 per cent), pawnbroker (4 per cent), Department for Work and Pensions (DWP) Crisis loan (5 per cent) and credit union (2 per cent).[24] 56 per cent of those with a bank account had been overdrawn in the last 12 months[25] and of those 51 per cent had been in unauthorized overdraft.[26]

32. There was also evidence that customers had experienced problems using credit products in the past. 29 per cent had been turned down for credit in the last 12 months. 52 per cent had experienced a debt problem in the last five years.[27] 37 per cent had experienced a bad credit rating, 35 per cent arrangements to pay off

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[23] [✂]
[24] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, response to QFCA1.
[25] ibid, response to QFC2. 96 per cent of respondents said they had a bank, building society or credit union account.
[26] ibid, response to QFC3.
[27] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, p28.

creditors, 11 per cent a county court judgment and 9 per cent had been visited by bailiffs.[28]

33. Respondents were asked whether—instead of taking out a payday loan—they could have borrowed using another credit product. The responses are in Table 3 below, which also shows the responses from customers who had used each credit product in the last 12 months and the percentage of respondents who said they had used this credit product in the last 12 months. The figures show that 18 per cent of customers said they could have used a credit card instead of a payday loan.[29] Of those that used a credit card in the past 12 months, 33 per cent said they could have used a credit card instead of a payday loan.[30] Of those that had an overdraft facility, 22 per cent said they could have used an overdraft.[31]

TABLE 3 **Customers who could have used other credit products**

Product	*% who said they could use this credit product*	*% who said they could use this type of credit of those respondents who had used it in last 12 months.*	*% of respondents who said they had used this type of credit in the last 12 months*
Bank/building society loan	20	26	8
Credit card	18	33	31
Credit union loan	15	39	2
DWP crisis loan/social fund	6	18	5
Home credit	17	43	6
Overdraft	20	22	73
Pawnbroker loan	27	44	4
Retail credit	13	20	13
Unlicensed lender	17	19*	1

Source: Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB. Responses QPDSB3, QFCA1 and QFC2. Bases are all respondents and all respondents who had used that type of credit in the last 12 months.

*Figure based on respondents who said they had used any other loan/credit in the last 12 months.

34. Combining the responses across credit products, 39 per cent of customers said they could not have used any alternative credit products to borrow the money. 21 per cent

[28] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB , response to QFC6.
[29] ibid, response to QPDSB3. TNS expressed concerns regarding the possible limitations of this question, noting that some people may have answered in terms of what they would have done, rather than what they could have done, and that it may be difficult to judge whether one could use some of the alternatives, eg unlicensed lenders. This may result in the responses underestimating the availability of other sources of credit.
[30] ibid, response to QPDSB3.
[31] ibid, response to QPDSB3.

reported they could have used one alternative, 16 per cent two alternatives and 25 per cent three alternatives.[32]

35. In its consumer research, Bristol University derived a measure of credit access from survey data, based on whether customers reported having unused balances on their overdraft or credit card or said they were most likely to have used mainstream credit if they could not have borrowed from a short-term lender. On this measure, the report estimated that mainstream credit was a feasible alternative to short-term credit for 14 per cent of high street payday loan customers and 24 per cent of online payday loan customers. In most cases this would have meant using a credit card or overdraft.

36. The Bristol University research also investigated customers' perceptions of the credit products they used. For online payday loan customers, 50 per cent agreed they used payday loans because they did not have access to anything else. For high street payday loan customers the figure was 57 per cent.

37. Other studies provided additional evidence on payday loan customers' access to other forms of credit.

(a) A Consumer Finance Association study submitted by CashEuroNet UK, LLC (CashEuroNet)[33] asked whether customers would have had access to £200 through other sources had they not taken out their payday loan. 57 per cent said they would not have had access to other sources.

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[32] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, responses to QPDSB3.
[33] This research involved a telephone interview of 1,105 customers of the Consumer Finance Association. The research was carried out in September and October 2012.

(b) A Friends Provident, JMU and Policis report[34] found that 23 per cent of payday loan users had no other credit options.

(c) DFC Global Corporation (Dollar)[35] had asked customers of Instant Cash Loans Limited (Instant Cash Loans) which options they had considered as an alternative to payday loans, when taking out a payday loan. [✂] per cent said they had not considered other options.

(d) A Which? report[36] found that 53 per cent of payday loan users had been turned down for some form of unsecured credit in the last 12 months.

(e) [✂][37,38]

(f) YouGov[39] asked Instant Cash Loans' customers which other credit options were available to them the last time they used Instant Cash Loans credit. In response to that survey question, [✂] per cent said no other alternatives were available, where the list of options included a payday loan from a different provider.

38. IPSOS Mori[40] carried out some qualitative research relating to payday lending and found:

> Generally, participants who had taken out a payday loan typically reported that doing so was a "last resort"; they had done so because they lacked other viable credit options, and because their need for the money was immediate and critical at the time of taking out the loan.

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[34] The consumer research underpinning this study was undertaken with a nationally representative sample of 1,511 consumers in the lowest 50 per cent of household incomes, aged 18–65. The fieldwork was undertaken by GFK NOP in January 2010. This was supplemented with a telephone survey with non-standard lending users, to ensure adequate representation of this group for detailed analysis. This was based on a random representative sample of 500 home credit users and a random representative sample of 500 users of payday loans. This was undertaken in January 2010 by Teamsearch Market Research.

[35] [✂]

[36] Populus, on behalf of Which?, surveyed 4,031 GB adults aged 18+ online (of which 3,195 were credit users) in August 2012. The results were weighted to reflect the profile of all GB adults.

[37] [✂]

[38] [✂]

[39] [✂] The survey was carried out by telephone in February and March 2012.

[40] The research was carried out by IPSOS Mori and was commissioned and funded by the Department for Business, Innovation and Skills. It involved two components: four 90-minute discussion groups with six to eight people; and six hour-long individual face-to-face depth interviews.

Those who were able to access alternative sources finance – and, crucially, felt comfortable in doing so – were less likely to take out payday loans. Friends and families were the most important source of alternative credit across all types of people interviewed. Most participants who had taken out a payday loan felt that loans from high-street banks were unsuitable for their needs due to bank loans being longer-term or more difficult to obtain than payday lending.

39. Which? told us that credit reference agencies (CRAs) gave different responses when asked about the effect of using payday loans on customers' credit rating. One CRA said it could be positive as it built evidence of repayment. Another CRA said it was likely to have no effect. A third CRA said that many mainstream lenders would not lend to payday loan customers.

Other reasons for a lack of substitutability

40. Customers were also asked whether they had compared the benefits and costs of payday loans against other credit products. Table 4 below shows the percentage of customers who had gone as far as comparing payday lending with other credit options, where the base is all those customers that could have used each alternative credit source (excluding borrowing from friends and family). The figures show that only the minority of customers who had alternatives available to them got as far as comparing the pros and cons of payday loans against other credit products.

TABLE 4 **Percentage of customers who had compared pros and cons of payday loans with other credit products**

	Percentage
Credit card	22
Overdraft	20
Credit union loan	18
Unlicensed lender	14
Bank/building society loan	14
Retail credit	13
Pawnbroker loan	12
Home credit	9

Source: Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, p82. Base is all who had access to each alternative source of credit (excluding borrowing from friend and family).

41. Those who could have used an alternative source of credit were asked why they did not use the alternative source of credit. The main reasons for favouring payday loans were that the alternatives were not as convenient (45 per cent) and that they could not get the money as quickly (31 per cent).[41]

42. In addition, our qualitative research suggested that mainstream credit was also sometimes associated with long application processes, high costs and potentially serious debt.[42] Customers who actively decided against bank loans disliked banks and perceived bank loans to be for large amounts and serious long-term commitments. Customers who actively decided against overdrafts felt that overdraft charges were hidden and found them to be more expensive than payday loans. Customers who actively decided against credit cards thought it was easy to lose control and there were serious and well-known consequences for not repaying.[43]

Lenders' views on competition between payday and non-payday credit products

43. In this section we discuss lenders' views on the extent of competition between payday lenders and other credit providers, in particular focusing on whether any evidence exists of payday and non-payday lenders taking actions to compete with each other for customers. First we set out the submissions of payday lenders on how they compete with non-payday lenders. Second we set out the submissions and evidence of third parties.

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[41] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, response to QPDSB6.
[42] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, p85.
[43] Research into the payday lending market report—results of quantitative and qualitative research undertaken by TNS BMRB, p85.

Payday lenders' evidence

44. In this section we present the submissions of payday lenders on the extent to which they compete with providers of other credit products.[44] Some payday lenders took the view that they did compete with other forms of credit: CashEuroNet, Cheque Centres Group Limited (Cheque Centres), Dollar, Microlend, SRC Transatlantic Limited (SRC), ThinkFinance (UK) Limited (ThinkFinance) and Wonga.

45. Wonga said that there was also substantial evidence that customers with access to alternative sources of credit did see these as genuine substitutes for payday loans. It said that evidence from the USA suggested that in states where payday credit expanded, returned cheque and bank overdraft fee income decreased. This demonstrated that, at the margin, payday credit was a substitute for alternative forms of credit.

46. However, other lenders, including CFO Lending Limited (CFO Lending), Lending Stream LLC (Lending Stream), Txt Holdings Limited (MYJAR) and The Cash Store (UK) (The Cash Store) did not see themselves as competing with other credit products.

Third parties' evidence

47. In this section we summarize the submissions and evidence of other third parties.

48. Many of the lenders that we contacted believed they did not compete directly with payday lenders and/or told us they had not taken actions to respond to competition from payday lenders. These were: banks (Barclays, HSBC, LBG, RBS/Natwest and Santander); credit card providers (MBNA and SAV); home credit providers

[44] More detail on the submission of payday lenders is given in Annex 2.

(Shopacheck); Logbook loan providers (CarcashPoint); pawnbrokers (Fish Brothers and Mays Pawnbrokers); peer-to-peer lenders (Ratesetter); and retail credit providers (SDFC, Next and Arcadia Group). LBG told us that when considering the actions of competitors its prime focus was on other personal current accounts, cards and loan providers, however, it had reacted to the growth of payday lending by undertaking research into why customers made use of payday loans and was giving consider-ation to what this might mean for its product suite.

49. However, other respondents provided evidence of some competition between payday lenders and other lenders. Capital One told us that it had tested two credit card products as potential alternatives to, and partly in response to, the growth of payday lending. Citizens Advice also told us that there was some evidence of consumers comparing payday loans with other credit types in the case studies it had reviewed. Mobilemoney said the growth of payday lending was adversely affecting its business for loans of £200–£1,000. S&U, a home credit provider, told us that it was competing for customer loan business, but did not compete directly online with payday loan companies.

50. Leeds City Credit Union said that its business volumes had remained steady and therefore there was no evidence it was losing customers to payday lenders. However, it was trying to win customers from payday lenders, working with local partners and media to raise its profile. It said that it had not changed any of its products, but speed was important to payday loan customers and it was under pressure to change its approach.

51. Provident Financial, a home credit provider, told us that its home credit offer did compete at the margins with payday lenders. Provident Financial told us it had sought to update and modernize its home credit offer in response to the general

trend in customer behaviour and preferences for greater convenience, speed and online interaction.

Price comparison method

1. To be published mid-February 2014.

Payday lenders' evidence on competition

1. In this annex we summarize the submissions of payday lenders on the extent to which they compete with providers of other credit products.

2. CashEuroNet said that the most important alternative borrowing options available to customers included: borrowing from other online payday lenders; taking bank over-drafts (including unauthorized overdrafts); drawing down credit cards; borrowing from informal sources, such as family and friends; and paying the late fees charged by utility and other service providers. It said that its survey showed [✄] of its customers had used other lending sources in the past three years. The results are shown in Figure 1 below.[1]

FIGURE 1

Sources used to borrow money in the last three years

[✄]

Source: CashEuroNet.

3. CashEuroNet also said it monitored overdraft pricing and said it competed with unauthorized overdrafts, pawnbrokers and home-collected credit. CashEuroNet said it was strongly affected by the actions of other credit providers and that it believed that the recent growth of payday loans was linked to a decline in unauthorized overdrafts—customers had learnt that unauthorized overdrafts fees were more expensive than payday loan fees.

4. CFO Lending told us that other credit products affected the size of the overall payday loan market. For example, the lending policy of credit card providers could mean they

[1] Response to issues statement, pp2 & 3.

were in direct competition with CFO Lending. It told us, however, that typically customers would have been turned down for this type of credit and were therefore looking for alternatives that met their needs.

5. Cheque Centres told us that customers considered the payday product against a range of other options, from pawnbroking to unauthorized overdrafts. For those with assets, and facing financial pressure, a payday loan provided a rational choice in many circumstances.

6. Dollar said that products that might be said to impose a competitive constraint on payday loans included, but were not limited to, authorized and unauthorized over-drafts, revolving credit, short-term instalment loans (three- to six-month terms), rent-to-own and possibly, pawnbroking and home credit. Dollar told us it monitored the performance of [✂] firms.

7. Harvey and Thompson told us that the key alternative to a payday loan was an overdraft (frequently unauthorized).

8. Microlend said it competed with high street banks, lenders and other financial institutions.

9. SRC told us that the actions of other credit providers did affect its business, but it could not measure this as it did not do any tracking or analysis.

10. ThinkFinance told us that it competed in a market that was wider than payday loans and included all forms of higher-cost credit, rapid access to cash, and alternative credit options that consumers accessed outside mainstream credit cards. This included payday loans, bank overdrafts (especially unplanned bank overdrafts which

were the highest-cost credit one could take on), pawnbrokers, precious metal exchanges, doorstep loans (home credit), and possibly more. It said that the fully unregulated world of illegal loan-sharking should not be ignored as it was a real alternative that some consumers would turn to should other forms of credit not be available to them.

11. Wonga said that *(a)* 18 per cent, ie almost one-fifth of online payday customers, compared the costs of loans from non-payday providers before choosing to take out their loan (as found by a Bristol University study); *(b)* customers perceived payday loans as functionally similar to other types of short-term credit; *(c)* payday lenders perceived themselves to be competing against mainstream and other credit products; *(d)* industry commentators treated payday loans as an alternative to unauthorized overdrafts; and *(e)* this was consistent with how Wonga viewed its business. Wonga cited Airdrie Savings Bank, which was offering express loans to existing customers, and credit card companies, which were refining their credit assessments.

12. Wonga said it had created a proposition which competed head on with the banks by delivering improved customer service and convenience. [✂]

13. Wonga said that the case for recognizing a wider market for short-term credit was enhanced by the fact that the cost of alternative sources of credit such as unauthorized overdrafts or credit cards could be compared. As noted above, the Chartered Institute for Securities & Investment identified that £200 borrowed from a payday lender would cost £66 compared with a charge for borrowing the same amount by way of an unauthorized overdraft of £84.22 for Lloyds Bank and £110 for NatWest. Customers also considered and evaluated other features of short-term credit beyond price such as the potential impact of payment delinquency.

14. Wonga told us that it monitored the cost of unauthorized overdrafts and compared itself to credit cards for cash advances. [✄]

15. Wonga told us [✄].

16. In contrast to the payday lenders above, other payday lenders said they did not believe they competed against other credit products.

17. Lending Stream told us it considered itself in a different category from other credit providers such as pawnbrokers, credit card providers and providers of overdraft facilities, and did not compete with them directly. For individual customers, it was possible that Lending Stream was in the same consideration set as some of these other providers, but it did not actively try to compete with other types of credit.

18. MYJAR told us it did not actively compete with other credit providers. It did not undertake formal analysis or reporting of the products, strategy or performance of other credit providers, and did not take steps to win customers from other provider types. It told us its feedback indicated that some customers were unable to engage with credit card and overdraft providers because they could obtain credit and/or did not fully understand the charging structures.

19. The Cash Store told us it did not see itself as competing directly with credit cards and overdrafts as these lenders practised more stringent underwriting based on credit scoring. It served the customers that these lenders could not assist. It saw pawn-broking as significantly different to payday lending and it felt that consumers who chose a payday loan knew the difference. Therefore, it did not see itself as a direct competitor. Furthermore, the trending it saw in its loan volumes and sales did not suggest that the actions of other credit providers negatively affected it.

Non-payday lenders' submissions

1. Barclays told us that its customers who had used a payday loan did not typically have any large overdraft available. Barclays told us that payday loan customers were on average 6.5 times more likely to go into arrears than non-payday-loan customers. Barclays typically processed a very broad range of internal and external data every month to enable it to calculate how much it would be willing to lend to each customer (a 'pre-approved limit'). If a customer then requested an amount of credit which was within this pre-approved limit then they would be granted that credit, effectively instantly, subject to the customer confirming their acceptance of the relevant terms. Customers who had used a payday loan within the past 12 months were likely to be treated differently and would be unable to benefit from pre-approved limits through this automated system. Instead, payday loan users were assessed manually [✂].

2. HSBC told us that it had seen an increasing proportion of its customers using payday loans over time and an increasing proportion of these customers were using payday loans in consecutive months. Its historical analysis suggested that even customers who had used payday loans 18 months previously continued to default at higher rates than average customers, suggesting that payday lending did not fix a short-term need. [✂] Potential albeit not verified reasons for this were *(a)* convenience of the payday lender; *(b)* perceived lower costs for small value loans; and *(c)* not wanting to be seen to use overdraft facility. [✂]

TABLE 1 **HSBC acceptance and rejection rates for identified payday loan customers**

per cent

Product	*Acceptance rate*	*Rejection rate*
Current Account—Overdraft Limit Review	[✂]	[✂]
Credit Card—Limit Review	[✂]	[✂]
Credit Card—New Card	[✂]	[✂]
Personal Loan	[✂]	[✂]

Source: CC analysis based on HSBC's historical (ie pre-2012) data.

3. LBG told us that of its customers, [✄] had received at least one payday loan credit into their current account(s) in the tax year April 2012 to March 2013. Of these customers, [✄] per cent had a current account that offered an overdraft facility (as at March 2013) and [✄] per cent had spent at least one day in excess of their agreed overdraft limit in the 12-month period (including those customers with no overdraft facility). These customers were in excess of their agreed overdraft limit for an average of [✄] days over the 12 months.

4. LBG told us that payday loan customers tended to be in the higher-risk, higher-indebtedness end of its customer base. LBG internal research from April 2012 suggested that of the Lloyds Bank customers that used payday loans, [✄] per cent would be rejected if they applied for a personal loan. For HBOS customers using payday loans, the figure was [✄] per cent. Follow-up research in July 2012 gave rejection figures of [✄] per cent for Lloyds Bank and [✄] per cent for Halifax.

5. LBG provided some analysis of payday loan use by HBOS customers. This showed that most customers using payday loan companies either did not have an authorized overdraft, or were already heavily using their authorized overdraft. However, there was still some appetite from HBOS to lend further amounts to two subsets of these customers.

6. RBS/Natwest told us [✄]. RBS/Natwest told us [✄].

7. A large bank ([✄]) told us that 4.4 per cent of its retail customers had evidence of an active payday loan facility or had taken or applied for a payday loan facility in the last 12 months. Of those customers 80 per cent were currently in arrears on other credit facilities with 73 per cent having a registered default, county court judgment or insolvency marker. It told us that customers with recent payday loan activity had

default rates up to ten times higher than those customers without payday loan activity.