

Price comparison method

1. In this annex we describe the method we have adopted for our analysis of price comparisons between payday loans and other forms of credit.
2. The starting point was the following four scenarios which we have also used to compare the price of payday loans with each other. These four scenarios are where a customer:
 - (a) takes out a £100 loan for 14 days and pays back on time;
 - (b) takes out a £100 loan for 28 days and pays back on time;
 - (c) takes out a £100 loan for 28 days and then rolls over the loan for 28 days; and
 - (d) takes out a £100 loan for 28 days and pays back 11 days late.
3. We recognize that the cash flows associated with these scenarios may not always be capable of being precisely replicated using all the other credit products. For example, the minimum loan term available from the home credit provider Provident is 14 weeks and a loan of £100 would involve 14 weekly payments of £10. Consequently, these results should be seen as illustrative of the relative costs of borrowing using different credit products, rather than exact comparisons. More detail on the scenarios and the results are provided below.

Scenario 1

4. Scenario 1 consists of a borrower taking out a £100 loan for 14 days and paying back on time. For comparison purposes, we adopted the following scenarios for the other credit products:
 - (a) *Authorized overdrafts*. The borrower enters the authorized overdraft on day 0, going £100 overdrawn. The borrower exits the authorized overdraft on day 14,

returning to a zero balance. The costs of authorized overdrafts were calculated for Barclays, Halifax, HSBC, Lloyds Bank, RBS/Natwest¹ and Santander.²

(b) *Unauthorized overdraft.* The borrower enters the unauthorized overdraft on day 0, going £100 overdrawn. The borrower exits the unauthorized overdraft on day 14, returning to a zero balance. The costs of unauthorized overdrafts were calculated for Halifax, HSBC, Lloyds Bank,³ RBS/Natwest and Santander. For Barclays, calculations were based on the use of the Personal Reserve service, which is Barclays' alternative to an unauthorized overdraft.

(c) *Credit and store cards.* The borrower makes a purchase of £100 on day 0 with their credit or store card. The borrower repays on day 14, returning to a zero balance. The costs were calculated for Barclays, Capital One, MBNA, SAV⁴ and Topshop.⁵ In this scenario we have assumed that the credit and store card borrower does not incur any interest as the debt is not revolved.⁶

(d) Credit unions do not offer 14 day loans and therefore the cost of credit is based on borrowing £100 from the credit union and paying back on day 28, reflecting the minimum loan duration offered by London Mutual Credit Union.

(e) Home credit lenders do not offer 14-day loans and therefore the cost of credit is based on borrowing £100 for 14 weeks—the minimum loan duration—and paid back in 14 weekly repayments. The costs were calculated for Provident Personal Credit.

(f) *Pawnbrokers.* The borrower pawns an object on day 0 and repays the loan on day 14. The costs were calculated for Fish Pawnbrokers.

¹ We used the RBS/Natwest select account.

² We used the Santander 123 account.

³ LBG told us that the scenarios we used were unrepresentative of how customers used unauthorized overdrafts, as they were designed to support customers for short periods of time.

⁴ Two figures were calculated for SAV, based on the minimum and maximum interest rates offered on their Acqua credit card.

⁵ Two figures were calculated for Topshop, based on the minimum and maximum interest rates offered on their Topshop store card.

⁶ The exact charges incurred using a credit card or store card to borrow for 14 days will depend on the relationship between the purchase date and the statement date and the card company's charging policy. If we were to assume that 14 days' interest was charged on the amount borrowed this would not change the general conclusions we draw from this analysis.

Scenario 2

5. Scenario 2 consists of a borrower taking out a £100 loan for 28 days and paying back on day 28. For comparison purposes, we adopted the following scenarios for the other credit products:

- (a) authorized and unauthorized overdrafts, credit and store cards and pawnbrokers—as scenario 1, except the payback date (ie the date on which the customer stops being overdrawn and returns to a zero balance) was changed from day 14 to day 28⁷; and
- (b) credit unions and home credit—as scenario 1.

Scenario 3

6. Scenario 3 consists of the borrower taking out a £100 loan for 28 days and then rolling over the loan for 28 days, paying back on day 56. For comparison purposes, we adopted the following scenarios for other credit products, based on assuming a month was 28 days:

- (a) authorized and unauthorized overdrafts and pawnbrokers—as scenario 1, except the payback date was changed from day 28 to day 56;
- (b) for credit and store cards, we assumed that the debt was revolved for 56 days and therefore 56 days' interest was due on the £100 borrowed;⁸
- (c) for credit unions we assumed that the loan was for 56 days, with repayment was made in two equal payments: one on day 28 and one on day 56; and
- (d) home credit—as scenario 1.

⁷ The exact charges incurred using a credit card or store to borrow for 28 days will depend on the relationship between the purchase date and the statement date and the card company's charging policy. If we were to assume that 28 days' interest was charged on the amount borrowed this would not change the general conclusions we draw from this analysis.

⁸ For credit cards we calculated a monthly interest rate and applied this to the average monthly balance. For store cards we calculated a daily interest rate and applied this to the daily balance. The exact charges incurred using a credit/store card to borrow for 56 days will depend on the relationship between the purchase date and the statement date and the card company's charging policy. If we were to assume that zero interest was charged on the amount borrowed this would not change the general conclusions we draw from this analysis.

Scenario 4

7. Scenario 4 consists of a borrower taking out a £100 loan for 28 days and paying back 11 days late on day 39. For comparison purposes we adopted the following scenarios for the other credit products:
- (a) authorized and unauthorized overdrafts and pawnbrokers—as scenario 1, except the payback date was changed from day 28 to day 39;
 - (b) for credit and store cards, we assumed that the debt was revolved for 39 days and therefore 39 days' interest was due on the £100 borrowed. In addition, to more closely match the late payment fees incurred by a payday loan customer in this scenario, we assumed the customer incurred one late payment fee;⁹
 - (c) for credit unions we assumed that the loan was for 56 days, with repayment was made in two equal payments: one on day 28 and one on day 56; and
 - (d) home credit—as scenario 1.

Results

8. Our analysis suggests that borrowing using a payday loan is typically cheaper than using an unauthorized overdraft (due to the high charges associated with using an unauthorized overdraft). Borrowing using a payday loan is typically cheaper than using home credit in Scenarios 1 and 2, but more expensive than using home credit in Scenarios 3 and 4 (this is influenced by the minimum loan term for Provident's home credit products, which is significantly longer than 14 or 28 days). Payday loans are generally substantially more expensive than the other forms of credit considered in this analysis. Table 5 sets out the range of prices we observe for the different credit alternatives in greater detail.

⁹ For credit cards we calculated a monthly interest rate and applied this to the average monthly balance. For store cards we calculated a daily interest rate and applied this to the daily balance. The exact charges incurred using a credit/store card to borrow for 56 days will depend on the relationship between the purchase date and the statement date and the card company's charging policy. For example, one lender told us that in Scenario 4 no interest and charges would be due if the balance were cleared on day 39. If we were to assume that zero interest was charged on the amount borrowed this would not change the general conclusions we draw from this analysis.

TABLE 5 Comparison of pricing of different credit options

Scenario 1 – borrow for 14 days and pay back on time

£

	<i>Payday loans</i>	<i>Authorized overdrafts</i>	<i>Unauthorized overdrafts</i>	<i>Credit and store cards</i>	<i>Credit union</i>	<i>Home credit</i>	<i>Pawnbroker</i>
Minimum	11.35	0.68	25.70	0.00			
Median	29.25	6.61	72.50	0.00	2.00	40.00	2.80
Maximum	56.40	14.00	86.70	0.00			

Source: CC analysis. No minima and maxima are given for credit union, home credit and pawnbroker as we only had pricing data for one supplier.

Scenario 2 – borrow for 28 days and pay back on time

£

	<i>Payday loans</i>	<i>Authorized overdrafts</i>	<i>Unauthorized overdrafts</i>	<i>Credit and store cards</i>	<i>Credit union</i>	<i>Home credit</i>	<i>Pawnbroker</i>
Minimum	16.50	1.35	26.39	0.00			
Median	29.85	7.22	89.00	0.00	2.00	40.00	5.60
Maximum	56.40	28.00	100.00	0.00			

Source: CC analysis. No minima and maxima are given for credit union, home credit and pawnbroker loans as we only had pricing data for one supplier.

Scenario 3 – borrow for 28 days and roll over for 28 days

£

	<i>Payday loans</i>	<i>Authorized overdrafts</i>	<i>Unauthorized overdrafts</i>	<i>Credit and store cards</i>	<i>Credit union</i>	<i>Home credit</i>	<i>Pawnbroker</i>
Minimum	35.28	2.71	27.79	2.58			
Median	59.90	14.45	178.00	4.97	3.01	40.00	11.20
Maximum	92.40	56.00	200.00	6.74			

Source: CC analysis. No minima and maxima are given for home credit and pawnbroker loans as we only had pricing data for one supplier.

Scenario 4 – borrow for 28 days and pay 11 days late

£

	<i>Payday loans</i>	<i>Authorized overdrafts</i>	<i>Unauthorized overdrafts</i>	<i>Credit and store cards</i>	<i>Credit union</i>	<i>Home credit</i>	<i>Pawnbroker</i>
Minimum	28.50	1.89	26.94	13.78			
Median	55.78	13.71	147.50	15.43	3.01	40.00	7.80
Maximum	107.00	39.00	173.94	16.66			

Source: CC analysis. No minima and maxima are given for credit union, home credit and pawnbroker loans as we only had pricing data for one supplier.