Submission to the Competition Commission's '*Payday lending market investigation*'

- ***Entry and expansion working paper***
- ***Regulation of payday lending working paper***
- ***Payday loan products working paper***

on behalf of 118 118 Money

14 March 2014

About 118 118 MONEY

118 118 Money (the trading name for Madison CF Ltd) is affiliated to the well-known directory enquiries business 118 118 which launched in the UK in 2002 and soon became the largest and most well-known provider of directory services in the UK. Last year, it handled about 20 million calls, providing both core directory services and a range of enhanced offer, advertising and other information services. 118 118 and 118 118 Money both form part of a larger international group operating in Europe and the United States providing information, e-commerce and contact centre services.

In 2013 118 118 Money launched into the consumer credit market in the UK providing unsecured personal loans. We offer loans of between £1,000 and £5,000, with fixed repayments over 12 to 24 months with no arrangement or set up fees. Although we note that the Competition Commission has slightly amended the scope of its inquiry which now just includes £1000 loans for 12 months, we would highlight that we do not offer any loans for less than £1000 or for periods shorter than 12 months, as that is not a market in which we are in any way focussed.

As such, 118 118 Money does not operate within the traditional payday lending market and we fall outside of the FCA's definition of 'high-cost short-term credit. However, we have a strong interest in regulation of that sector because some of our customers may have previously taken out payday loans. Our particular interest relates to the need to access that credit information because it would very significantly enhance our ability to make informed lending decisions and provide thorough affordability checks for borrowers.

Despite not being a direct participant in the market which is the focus of this investigation, we hope that the Competition Commission will nonetheless find our perspective as a new entrant from outside of that market useful in conducting its analysis. As consumers do not limit themselves to participation in only one lending market, the effectiveness of competition (and regulation) within one has a very direct impact on the effectiveness of competition within the other.

Summary

- 118 118 Money operates in the consumer credit market and is currently targeting a gap in that market broadly between payday lenders and high street banks.
- The ability to conduct thorough affordability assessments is vitally important (particularly to new entrants) and inevitably depends upon the availability of reliable credit information.
- The issue of credit data-sharing does not appear in the Annotated Issues Statement, although it does feature (fairly briefly) in three of the working papers.
- 118 118 Money believes that it should be a much greater focus of the investigation because of its potentially widespread beneficial outcomes for both competition and consumers.
- The Principles of Reciprocity mean that consumer credit data available from the CRAs can be up to 60 days old,
- As 118 118 Money is targeting the market between high street banks and payday lenders, the reluctance of each of them to share credit data creates a double barrier to entry for alternative lenders including 118 118 Money..

- On the one hand, the credit data shared by the payday lenders with the CRAs is out of date and does not allow us to make a sufficiently well-informed lending decision.
- On the other hand, the banks hold the critical current account information which gives them a full and detailed overview of a consumer's financial position.
- Our business model (like others in the same market) relies on us being able to make lending decisions based on the most accurate and up to date information possible.
- Payday lenders set very high interest rates to compensate for a lack of up to date credit data, which means that the market is distorted towards providing loans at far higher interest rates than borrowers need or want simply because lenders do not have the data to be able to price them more accurately.
- In turn, consumers make their decisions according to the speed and convenience of obtaining a loan rather than the cost.
- If lack of credit information means that some consumers are unable to obtain a loan, many of them would make do without it, which is evidence of an underserved market which we would like to address.
- More accurate credit information would also allow payday lenders to make more informed lending decisions and thereby reduce default and bad debt and it would allow banks to offer loans to consumers who are not already their current account customers.
- In order to address these problems, both CRAs and lenders should be required to participate in a process of real-time data-sharing, although this is likely to be begin with a requirement for 24 hour data-sharing as a first interim step.
- The fact that the industry/SCOR has failed to take any meaningful action to bring it about despite many requests in recent years from Government and Parliament for them to do so, provides ample evidence that regulatory intervention is now required.

Interest in the Competition Commission's Payday lending market investigation

118 118 Money operates in the consumer credit market and is currently targeting a gap in the market broadly between payday lenders and high street banks. In so doing, we are appealing to customers to whom the banks no longer appear willing to lend (despite providing current accounts to them). This may be perhaps because of the relatively small amount of money which they are seeking to borrow (£1000 to £5000) compared to what banks would normally want to lend or perhaps because they do not have a completely flawless credit record.

As a result, 118 118 Money clearly sits outside of the traditional payday lending market, but we nevertheless have a strong interest in it, because some consumers may be customers within both markets either at the same time or within a short period. Although, we are interested in all aspects of this investigation we have a particularly strong interest in the availability of credit data and specifically how up to date and therefore reliable the credit data is which is currently available from CRAs.

118 118 Money regrets that the issue of credit data-sharing was not included within the Annotated Issues Statement, which we feel was a significant omission that we hope will be addressed during the next stage of the investigation. However, we note that it is nonetheless referred to in three of the working papers, namely:-

- Entry and expansion working paper - paragraphs 56-79
- Regulation of payday lending working paper - paragraphs 103-109
- Payday loan products working paper - paragraphs 62-72

Only the '*Entry and expansion working paper*' in any way addresses the positive impact on competition which increased availability of credit data may have. It does so very briefly within its 'preliminary observations' at paragraph 79 where it states:-

> *"Default costs represent the largest category of costs for payday lenders. This indicates that differences in lenders' ability to assess credit risk are likely to have a substantial impact on their ability to operate profitably in the market and compete with established lenders. … A new entrant is likely to face higher default rates, and therefore higher costs, than an established lender. This is because the new entrant is likely to be reliant on a greater proportion of new customers (representing a higher expected credit risk) and is likely to hold less internal information on customer repayment behaviour, so will be less able to accurately predict default behaviour."*

Whilst 118 118 Money agrees entirely with this comment, we feel that it significantly understates the importance of up to date and reliable credit information to new lenders in the market and those like us, who are seeking to challenge from outside the payday lending market. More importantly, it does not fully capture the very significant benefits to competition which the availability of improved (and specifically real-time) credit data would generate which we feel would be widespread and extensive. Indeed, we were somewhat concerned that the '*Regulation of payday lending working paper*' only focussed on possible risks to competition from greater credit data-sharing and did not mention the far greater level of benefits.

118 118 Money believes that the availability of credit data is of huge importance to the entire lending sector. Therefore, the quality, breadth and most importantly, timeliness of that information is of critical significance to all concerned. Any limitations on the available data does and will continue inevitably to restrict the level and effectiveness of competition and the ability of new entrants to challenge. By contrast, any improvements to the data will have the most profound positive impact on the functioning of the market, which in turn will generate widespread benefits.

In the rest of this submission we address these issues in greater detail with a particular focus on the current adverse impacts on both competition and consumers, from lenders not being able to access sufficiently reliable up to date credit information.

Assessing Affordability

The importance of affordability assessments

118 118 Money believes that thorough affordability assessments are of critical importance. Self-evidently, if an affordability assessment is not sufficiently rigorous and comprehensive, there is a real risk that the lender will not know whether the consumer is truly able to repay the loan. That will lead to instances of loans being granted to consumers who are unable to pay them back, which in turn will inevitably lead to some borrowers failing to meet their repayments and going into default.

Any default will create negative consequences for the affected borrower and potentially the lender as well (depending on the nature of their business model and how much the borrower is ultimately able to repay). The consequences for the borrower could be very severe and long-lasting. The lender's business model will of course be built on the assumption of a certain level of bad debt (and they may in fact generate revenue from defaults, penalties and rollovers). But the bad debt which it generates will have to be reflected in the interest rates which it charges. Logically, this means that the greater the level of bad debt which is incorporated into the business plan, the higher the interest rate which it will have to set in order to maintain its profit margins. Therefore, all of its customers will suffer from having to pay those higher rates, even if they themselves are never in default.

The current consumer credit data-sharing process

The ability to conduct effective thorough affordability assessments inevitably relies on the availability of reliable credit information. As is noted within the working papers, the consumer credit data-sharing process has no regulatory or legislative foundation, but is instead governed by the '*Information Sharing Principles of Reciprocity*' set by the '*Steering Committee On Reciprocity (SCOR)*'.

Those Principles establish that data should be provided "*on a regular basis*", "*usually at a minimum monthly.*" The somewhat unnecessary "*usually*" caveat is symptomatic of the rather casual approach of some lenders/subscribers in providing the relevant data and there are examples where the data is not made available to other subscribers for several months. However, even where the data is provided monthly, it can be as much as 60 days old by the time that it is made available to other lenders to access, as the following example demonstrates:-

- Day 0 - lender pulls month 1 data from its systems in order to begin to verify and prepare it to send to the CRA
- Day 1 - a customer takes out a new loan with the lender (which now falls within month 2)
- Day 15 - following the necessary checks the lender actually provides month 1 data to the CRA (which excludes the borrowing taken out on the first day of month 2)
- Day 30 - lender pulls month 2 data from its systems in order to begin to verify and prepare it to send to the CRA
- Day 30 - following its own verification and uploading, the CRA makes month 1 data available for its subscribers to access
- Day 45 - following the necessary checks the lender actually provides month 2 data to the CRA which now begins its verification process
- Day 60 - following its own verification and uploading, the CRA makes month 2 data available for its subscribers to access

Therefore, it is clear that the operation of the Principles of Reciprocity mean that in reality other lenders may routinely not have access to the most recent 60 days of a consumer's credit history which has potentially significant adverse consequences in the consumer credit market, as we explain below.

The impact on competition

As explained above, 118 118 Money is targeting the market between high street banks and payday lenders, but in so doing we are also caught in trap in which both of those types of lenders are reluctant to share credit information with us. For reasons now explained, this provides a double-barrier to our entry into the lending market.

On the one hand are the payday lenders. 118 118 Money is not targeting customers seeking small value short-term borrowing. Nevertheless, a significant proportion of those applying to us for loans have either current or previous payday loans. Whilst many of them will not meet our lending criteria, there are some who we may wish to consider. We would not want to refuse someone purely on the basis that they had previously had a payday loan.

However, the out of date data which we can currently obtain from the CRAs does not allow us to make a sufficiently well-informed lending decision. For example, we may see a customer who took out and repaid a single payday loan 4 months ago. Without access to the most recent 30 to 60 days of their credit history we do not know whether they have taken out one or more subsequent payday loans (which may be outstanding or in default) or whether they have no new liabilities. Naturally, the most recent period of a customer's credit history is the most important as we seek to understand their need for an additional loan and most importantly, whether they can afford to pay it back. It is primarily for this reason that we regard the availability of improved credit information in the consumer market to be so important.

On the other hand are the high street banks who hold the most critical current account information which allows them to have a full and detailed overview of their customers' financial position. They have long-term historical data on income and expenditure and on outstanding liabilities. Importantly, this relates not only to liabilities to the bank itself, but also to any other lender. Of course, none of this current account data is provided to the CRAs or otherwise shared.

This unrivalled access to credit data gives the banks a unique position in considering further lending to these consumers with minimum risk and therefore at the most competitive rates. There is still a major issue even in relation to consumers to whom the banks themselves do not wish to lend, which may be the case for many potential 118 118 Money customers. That is, even though we may not be competing with the banks to offer lending, we still suffer considerably from not having access to current account information in order to assess risk and therefore offer the most appropriate interest rate. The result of that uncertainty is that some customers will be denied credit and others will be paying higher interest rates than would otherwise be the case.

Our business model (and ability to offer interest rates far below payday levels) therefore relies upon our being able to make lending decisions based on the most accurate and up to date information possible. Without that information we are forced to adopt a more cautious approach and therefore to deny credit to some consumers to whom we may otherwise have been able to advance credit, if we had had access to better information. We mention below the impact which this lack of access to real time data has on consumers, but in this section we are focussed on the impact on competition because the availability of credit data inevitably impacts our entry and position in this market.

It should be noted that better data is critically important not only to 118 118 Money, but to any provider who seeks to operate in this sector of the market. Indeed, it is highly likely that part of the reason why there are not more lenders providing unsecured loans at the levels of interest rates that we are offering is precisely because of the difficulty of making these loans profitably without the ability accurately to assess the customer’s ability to repay with better data. It is probable that if better data were available and lenders could be more confident in their lending decisions, that many more lenders would be attracted to this market segment. We would hope and expect that the Government would wish to encourage more lending in the consumer market in the same way as it does in the SME market.

It is evident that payday lenders do not have the same requirement because their business models are based on very high interest rates and a related assumption of a very high level of bad debt. As is clear from the exponential growth of providers in this market, they most are able to operate profitably without access to more current data because their lending decisions are not informed by the need to conduct such thorough affordability assessments. (Aside from their profitability, we discuss below that there is still an adverse impact on their borrowers due to the lack of real-time data).

The market is therefore distorted towards providing loans at far higher interest rates than borrowers want simply because the lenders do not have the credit data to be able to price them more accurately. To be clear, it is not only the poor risk customers who are being required to pay these interest rates (which would perhaps be a sign of market efficiency), but rather all customers of the payday lenders, because lenders are unable effectively to distinguish between them owing to the lack of accurate information. Payday lenders themselves insist that the vast majority of their customers have good credit histories and are able to pay back their loans on time. Consequently, the majority of borrowers must pay higher than necessary interest rates because of the impossibility of being able to identify the members of the minority. This is the clearest evidence possible of a poorly functioning market unable to deliver in the best interests of consumers because of a simple operational obstacle, which could easily be removed.

It will be apparent why competition will not address this problem and remove these obstacles. Whilst we do not wish to pre-judge the outcome of this market investigation, it seems evident from the work which the OFT and others have already undertaken that the market is not sufficiently price sensitive. Consumers are motivated in their decisions by the speed and convenience of obtaining a payday loan, rather by the cost of the loan and the interest rates being charged. As there is limited apparent demand from borrowers for low interest rates, there is an equally limited demand for lenders to be able to offer those rates. 118 118 Money and others are attempting to break that cycle in the interests of consumers, but it requires regulatory intervention in order to achieve.

The impact on consumers

Whilst increasing effective competition is inextricably linked to furthering the interests of consumers, it is worth highlighting how access to more accurate data will deliver significant specific benefits for consumers, although we recognise that is not the primary focus of this market investigation.

As we have highlighted above, the availability of better data will allow 118 118 Money (and others) to operate in the personal loans market between payday lenders and banks. Consumers in this market do not wish to pay the very high interest rates of payday lenders, particularly because they are looking to borrow larger amounts of money over longer periods of time than the payday market is designed to offer. In addition, they do not generally 'need' the money in the same way as a payday loans customer might, but they would 'like' to be able to borrow to fund some discretionary activity. These consumers would usually expect to be able to borrow from their bank, but have found themselves unable to do so.

In the absence of being able to obtain a bank loan, these consumers would generally make-do without a loan. This is clearly an underserved market which 118 118 Money would like to be able to address. We are very willing to advance credit to consumers in this sector, which we believe will be of significant benefit to them and to the market generally. But in order to be able to offer loans at interest rates which are a fraction of those offered by payday lenders, it is essential that we are able to minimise the risk of default, which means conducting thorough affordability assessments, which requires access to up to date data.

We believe that the availability of better data would also have clear benefits for payday loans customers. Whilst noting that payday lenders have very different business models to our own, their very high interest rates are clearly driven in part by the high level of default and bad debt which they encounter (although we acknowledge that there are other factors). The availability of more accurate data would allow payday lenders to make more informed decisions and more accurately to identify consumers who will clearly be unable to repay their loans. This will reduce the level of bad debt which they incur.

Naturally, this will create dual benefits for consumers. Firstly, it will prevent those who are unable to repay from incurring unsustainable debt, which will inevitably escalate and force them into even greater financial difficulty. Secondly, the reduction in bad debt will allow the payday lenders to reduce their interest rates, to the obvious benefits of all of their remaining creditworthy customers to whom they will want to be able to continue to lend.

As an aside, real-time data might also allow the banks to offer loans to consumers who are not already their current account customers. This could create a significant increase in competition in that sector, which would be of obvious benefit to consumers in terms of greater choice and lower interest rates. At the moment, banks are very reluctant to make loans to consumers who do not hold current accounts with them as the banks want to be able to see several months of their financial history. Typically, a bank is likely to require that a customer has held a current account with them for a year. The introduction of real-time data could help overcome that hurdle by giving them access to information that they do not otherwise have.

Remedies for the consumer credit market

118 118 Money understands that this investigation is not yet at the stage of considering what remedies may be required to address any failures in competition that it might identify.

However, we take this opportunity to note that the problems which we have identified would be resolved by the adoption of real-time data-sharing. At its simplest, this would mean:-

1. the CRAs must be required to upgrade their systems such that they are able to receive credit information from lenders on a real-time basis and make it available for other lenders to access on a real-time basis
2. all lenders must be required to report credit information to the CRAs on a real-time basis

As an interim step towards moving to real-time, all lenders should be required to report credit information on a daily/24 hour basis. This interim step would require lenders to report credit information at the end of each business day and require the CRAs to make it available to lenders during the course of (or at least by the end of) the following day.

Whilst 118 118 Money notes that three of the working papers mention the issue of real-time data, we believe that it should be a much greater focus of the investigation because of its potentially widespread beneficial outcomes for both competition and consumers.

The fact that the industry/SCOR has failed to take any meaningful action to bring it about despite many requests in recent years from Government and Parliament for them to do so, provides ample evidence that regulatory intervention is now required. Despite their good intentions, 118 118 Money simply does not believe that the FCA's current request that the industry do so will have any greater effect unless it is backed by a regulatory mandate. The longer this information is not available on a real time basis, the longer this market will be dysfunctional.