Competition Commission: Annotated Issues Statement

Consumer Finance Association response

- The Consumer Finance Association (CFA) is a trade association representing the interests of businesses offering short-term, unsecured personal loans, often referred to as payday loans, both online and through high-street stores.
- Following our evidence to the Commission's inquiry on 26th February, we welcome the opportunity to formally respond to the Annotated Issues Statement published on 31st January.

Summary:

- We believe that the short-term lending market has the potential to be a vibrant, competitive part of the wider consumer finance sector.
- There is already evidence of price and non-price competition in the sector.
- We strongly welcome the light that the Commission's research has thrown onto the reality of the industry, much of which supports our own research. This demonstrates that there is a clear demand for this form of finance and that the majority of customers repay their loans without difficulties.
- It is vital that the emotive external pressure which remains around the industry does not result in regulation which chokes the industry's ability to compete before it has been allowed to demonstrate its true positive potential.

Response to specific areas:

Market developments:

- Market developments have led to further innovation within this fast-growing sector. For instance we have witnessed an increase in the number of instalment loan products that fall within the Commission's definition of payday lending.
- As the Commission develops its inquiry and moves towards recommendations for remedies, it is essential that it looks at products rather than providers. We are already seeing a more diverse range of providers of short-term loan products than before, e.g. home credit companies offering short-term loans, and it is therefore vital that all potential players in the market are within the scope of the Commission's work.
- From the CFA perspective, our members have undergone a number of changes to their business practices over the last 18 months, in response to customer demand, compliance reviews by the Office of Fair Trading, the introduction of the CFA Code of Practice and in preparation for the FCA's regulatory regime.
- Whether it be online or in-store, there is still a clear customer demand for short-term loans, re-enforcing the need for proportionate regulation of the sector. There is a risk that unnecessarily punitive regulation will choke-off the supply of short-term credit from a substantial proportion of the current customer base.

Given the remaining demand, customers may well be driven to use other suboptimal products and/or providers which are not subject to the same standards as CFA members.

C*ompetition between lenders:*

Price competition

- We welcome greater price competition between lenders and there are several examples of lenders competing with each other on the price of their products. Some lenders offer loyalty schemes that give customers a reduced price when borrowing more than once. One of our member companies has a scheme which offers consumers risk-based tiered pricing. There is also an element of price competition in place when the pricing of instalment loans is compared with rollovers.
- However a key factor in the competitiveness or otherwise of the short-term lending market is the external environment in which lenders are operating. The almost unprecedented critical focus on the industry from politicians and the media has manifested itself in lenders being criticized for competing on price. At least two of our member companies have been criticized for offering discounts on their loans on the basis that they are encouraging people into an unwise borrowing decision.
- In addition, we have recently seen examples from the mortgage industry, suggesting that customers will be less likely to be granted a home loan if they have evidence of using payday loans on their credit file, even if the loans were successfully repaid. These allegations have been rebuked by credit reference agencies that have attempted to explain the complexity of credit scoring. There have even been calls for lenders to display the risk to customers' ability to access mortgages in their advertising. This is a concern, which we have raised with the Financial Secretary to the Treasury.

Non-price competition – affordability

- Lenders want to make a fair return on the capital they lend out; they do not want to lend money to customers who cannot afford to repay. This would be poor business practice and lead to consumer detriment.
- A key element of active competition between lenders is their ability to accurately identify the best customers from within the pool of prospective applicants.
- All CFA members have invested significant resource in developing the best systems possible for assessing potential customers' ability to afford a loan.
- Advances in the provision of real-time data-sharing should enhance the ability of lenders to make these critical assessments
- In addition, many high street lenders offer a wide range of services and products of which payday lending is only a part, including pawn broking, second-hand goods, money transfer, cheque cashing and currency exchange, and across which there is active competition. For example, a customer may initially be purchasing second-hand goods as a result of an advertised promotion and may also choose to take out a short-term loan whilst in-store.

Entry and expansion:

- For new entrants without access to an existing customer database, the use of lead generators and brokers is almost essential. While we believe it is entirely justified for lenders to use third parties to attract business, we would support moves to make the process more transparent so that customers are aware of whether they are dealing with a lead generator or directly with a lender.

- As with competition more broadly, the intense scrutiny from external parties, in particular the regulators, is a significant barrier to entry to the market and to expansion for those already present. See below our specific comments on the regulatory environment.
- We have seen a significant growth in CFA membership and interest in joining the association, driven in part by lenders acknowledging the extremely challenging climate in which they are operating.

Switching:

- While it is entirely logical for the Commission to look for evidence of switching in this market it is important to note that, for single-repayment loans, normal models of switching that apply to running credit products do not apply in the same way.
- For example, it is difficult to see how Lender B could be incentivised to buy out a customer's loan with Lender A without needing to encourage that customer to take out further credit, potentially leading to Lender B being accused of encouraging irresponsible borrowing.

Impact of regulation:

- The CFA welcomes well-designed, well-implemented regulation. This is good for consumers because it protects them from irresponsible lending and provides a level playing field for competition.
- However, it is vital that regulation does not inadvertently cut off customers from credit, drive market exit and reduce competition.
- The CFA has been at the forefront of the industry, driving improvements through our independently-monitored Code of Practice which has helped pave the way for FCA regulation.
- Uncertainty about the regulatory climate has been a major deterrent to competition in the sector as well as market entry and expansion. Following the publication of the FCA's rule for consumer credit, we now have some clarity for firms but the rules must be enforced consistently across all lenders.
- A major consideration, which has arisen since the announcement of the Commission's investigation, is the duty on the FCA to cap the total cost of credit. It is impossible to understate the potential impact of this measure and the uncertainty it has created is far from ideal for the prospects for increased competition in the immediate future.
- The FCA's consultation on the rules predicted a likely market exit of between 25 and 30% as a result of the changes made. There has been no estimate of the likely further market exit resulting from the cap on the cost of credit.
- The CFA is actively engaged with the FCA as they develop the nature and level of the cap.
- The FCA faces an extremely challenging task in setting a cap which protects consumers without inadvertently excluding excessive numbers of people from credit. We have welcomed the open approach that the FCA has taken thus far.
- The CFA has always supported moves (whether voluntary or statutory) which protect consumers from irresponsible behaviour. This is why we implemented our Code of Practice and why we have worked closely with the FCA as they develop the new regulatory regime for the sector.
- The potentially industry-changing cap on the total cost of credit is a major intervention. It is therefore essential that we get it right.
- The CFA position is driven by the following principles:
    - We believe that the cap should focus on the areas of charging that have the potential to cause the most detriment to consumers

  - We think it is fair that lenders receive a return for the capital they lend and are able to recover reasonable costs
  - We don't believe lenders should profit from customers who default on their loans
  - Any cap should reflect the duration of the loan

- If the cap does not reflect these principles there is a real risk that:

  - Lenders will stop operating in the market
  - Products will be restructured
  - Customers will be excluded

- We have the opportunity to learn from the best and the worst examples of caps in place around the world and to develop a regime which works for UK consumers.
- In a climate of heightened media and political pressure, it is crucial that the regulator, the industry and stakeholders work together to develop a cap which is based on evidence, with consumers' best interests at the centre.

Specific CFA recommendations:

Transparency

It is crucial that customers have the facts they need to make an informed choice of loan. CFA members already display the upfront cost of loan in pounds and pence.

Regulation

- As we have remarked above, the impact of regulation on competition in this sector cannot be over-stated. We would therefore strongly urge the following:

  - **There should be an annual assessment of the impact of the FCA regime on competition**
  - **A dynamic, competitive market should be a critical objective as the FCA develop a cap on the total cost of credit**