COMPETITION COMMISSION PAYDAY LENDING MARKET INVESTIGATION

SUBMISSION ON BEHALF OF MEM CONSUMER FINANCE LIMITED, INSTANT CASH LOANS LTD AND EXPRESS FINANCE (BROMLEY) LTD IN RESPONSE TO ANNOTATED ISSUES STATEMENT

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1. Executive Summary

1.1 The payday lending sector is a relatively immature and fast growing sector which has seen substantial expansion over recent years. It is estimated that the value of loans issued in 2012 was 47% higher than the value of loans issued in 2011 and 300% higher than the value of loans issued in 2010.

1.2 Since at least 2010, the industry has been subject to multiple, overlapping and wide-ranging regulatory reviews. As a result of those reviews, the sector is undergoing profound structural and cultural change.

1.3 A new regulatory framework will be in place on 1 April 2014 enforced by a new regulator, the Financial Conduct Authority (the "FCA"). The FCA is required to implement a price cap in the industry no later than 2 January 2015. At this point, the implications of the new regulatory framework for the way in which the sector will evolve are difficult to predict.

1.4 Provided, however, the FCA adopts a reasonable and proportionate regime (including in relation to the level and mechanism of the price cap) which is applied effectively and even-handedly across the industry, this should mean a level playing field for all operators in the sector and should lead to increased levels of certainty and stability.

1.5 This in turn should encourage increased investment and foster new entry and/or expansion in the sector.

1.6 In terms of the market in which payday lenders operate, payday loans compete with other credit products. There are any number of other lenders not currently engaged in payday lending (including retail banks, home credit providers and peer to peer lenders) which could provide payday loans or comparable products.

1.7 Historically, payday lenders have competed and continue to compete in a number of ways including in relation to customer service, product features, innovation and price. This competitive process has led to high rates of innovation in products and a uniformity of customer service features across many payday lenders.

1.8 The degree to which competition has focused on any one or more of these aspects at any particular time is a function of the maturity, size and dynamic nature of the sector.

1.9 As the industry continues to mature and rates of growth slow down, competition on price and innovation is further intensifying.

1.10 Historically, the sector has been characterised by high levels of entry and expansion. Estimates of the number of payday lenders currently operating in the UK vary but the most recent estimate is that of the FCA who predict that, as of 1 April 2014, they will regulate approximately 200 payday lending businesses.

1.11 Over the past 5 years or so, the evidence suggests there are low barriers to entry or expansion - of the 11 major lenders identified by the CC, eight of them entered the sector in the last 6 years.

1.12 The evidence also suggests the industry is currently highly competitive with new entrants taking revenue and volume share from existing operators.

1.13 In terms of profitability levels, [CONFIDENTIAL].

1.14 In relation to the first theory of harm, the evidence suggests that customers are given access to comprehensive, straightforward information. There are no barriers, contractual or otherwise, to customers shopping around and switching payday lenders.

1.15 A significant proportion of payday lending customers (an estimated 30-40%) do shop around and customers surveyed mostly felt that they spent the right amount of time shopping around. A substantial majority of those who shopped around obtained information about the cost, duration and speed of the loan and said that it was easy to compare information about lenders.

1.16 A high proportion of customers use more than one lender and there is a high degree of customer churn in the industry. The evidence is therefore supportive of reasonable rates of switching which are higher than rates in other comparable sectors such as PPI and personal current accounts.

1.17 In relation to the second theory of harm, the structure of the sector is not such that it suggests levels of concentration which give rise to a competition problem. The industry is dynamic and highly competitive and, according to the FCA, there will be 200 lenders operating in the sector in April 2014. Levels of entry and expansion have historically been high and thus provide evidence that barriers to entry and expansion have not previously existed.

1.18 Whilst more robust regulation may lead to some exit from the sector, those who exit [CONFIDENTIAL]. Insofar as a clear, robust and proportionate regulatory regime is put in place and enforced, it will lead to a stable regulatory environment which is likely to foster increased investment and entry. Such an environment will address concerns raised about barriers to entry arising from reputational issues, access to finance and banking services.

1.19 Access to customers can be obtained through lead generators, as well as by other means, which mean that new entrants can acquire customers on an equivalent basis to that of existing lenders. Existing operators have little or no advantage over new entrants in relation to the information held about customers. Payday specific credit scorecards are easily available at relatively low cost and can in any event be built by a new entrant in a relatively short period.

1.20 No barriers to entry have therefore been identified which would prevent or impede new operators from entering or expanding into the market in the future or being unable to enter the sector on equivalent terms to existing operators.

2. Introduction

2.1 This submission is made by DFC Global Corp ("DFC") on behalf of MEM Consumer Finance Limited ("MEM"), Express Finance (Bromley) Limited ("Express Finance") and Instant Cash Loans Limited ("ICL") in response to the Annotated issues statement ("AIS") of the Competition Commission ("CC") dated 31 January 2014. This submission (including Appendices) also includes responses in respect of all working papers published by the CC on or before 24 February 2014. Responses (if any) on the remaining working papers will follow. Prior to addressing the substantive matters raised in the AIS, DFC sets out some introductory information in relation to DFC and its current strategy.

2.2 DFC is listed on the NASDAQ and based in Berwyn, Pennsylvania. It is an international diversified financial services company. Its vision is to be the financial provider of choice for the short term lending needs of customers who are often inadequately served by mainstream lenders.

2.3 MEM, Express Finance and ICL are UK subsidiaries of DFC. They are the principal operating companies in the UK and trade under the following brands:

2.3.1 MEM trades as PaydayUK;

2.3.2 Express Finance trades as Payday Express;

2.3.3 ICL trades as The Money Shop and, in Scotland only, as Duncanson & Edwards and Robert Biggar.

2.4 References to DFC in this document should be taken to refer to MEM, Express Finance and ICL collectively as well as to DFC Global Corp.

2.5 DFC has operated in the US since 1979 and entered the UK market in 1999 through the acquisition of 11 stores. DFC decided to enter the UK market since it believed that there was an opportunity to develop and expand its operations, not least because of the lack of specific provision of short term lending products and services in the UK and Europe at the time. Whilst loans were available from banks and building societies, the procedure to obtain such loans was lengthy and complex and ill-adapted to supply short term needs. Obtaining funds through overdrafts (authorised and unauthorised) or credit cards was an expensive, opaque (in terms of fees payable) and difficult process.

2.6 Since then it has expanded its retail operations in the UK by the acquisition of a number of operating stores as well as by building new premises. As at December 2013, it had a total of 596 stores. DFC's retail business provides a mixture of services including pawn broking, gold buying, cheque cashing, money transfer and foreign exchange.

2.7 Having acquired retail operations in the UK, DFC decided to expand into online operations, which it believed would be the subject of future growth and expansion. This has been borne out by the fact that in 2012, online loans now represent 80% of total payday loan revenue across the sector with only 20% generated by high street lenders.[1] DFC commenced online operations in 2009 by the acquisition of Express Finance and in 2011 it acquired MEM (through the acquisition of Purpose UK Holdings Limited).

2.8 DFC's future strategy is to continue to develop its short term lending proposition, including the provision of longer term, high value loans and new products and services as required by customers. It aims to improve the position of its brand by further enhancing customer services and relationships. It also intends to develop and introduce new lending products and to expand product delivery channels (including mobile platforms).[2]

2.9 Going forward, DFC expects that it will face challenges in the form of new regulatory requirements, increased competition from existing competitors and new entrants and restrictions on advertising imposed by internet search engines. [CONFIDENTIAL]

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1 CC, The size and concentration of the payday lending sector working paper, 14 February 2014, page 3

2 DFC Global Corp 2013 Form 10-K, page 6 - see http://ir.dfcglobalcorp.com/phoenix.zhtml?c=177357&p=irol-reports

2.10 In order to address the two theories of harm identified by the CC in the AIS, DFC considers it is important to understand the regulatory context in which payday lenders have been and will be operating. In addition, it is important to identify certain characteristics of the sector and its customers in order to understand the way in which competition has evolved and continues to evolve in the industry. DFC therefore sets out various initial observations about the regulatory context, the sector and competition in the sector and then specifically addresses the two theories of harm.

3. The Regulatory environment

3.1 Since 2010, the payday lending sector has been the subject of wide-ranging regulatory scrutiny and reform (see Appendix 4). That continues to be the case. At the same time, the industry has also been the subject of unprecedented political and media focus.[3]

3.2 Full details of the regulatory and self-regulatory initiatives implemented by DFC and across the industry have already been provided in DFC's initial submission.[4] Those initiatives have resulted in important changes to the payday lending sector generally, including a voluntary commitment to a maximum of three 'rollovers', as well as changes to affordability assessments and the nature of the information provided to the customer.

3.3 In 2013, these changes, amongst others, have already had an impact on DFC's business. By way of example, DFC has noted the following changes in its business [CONFIDENTIAL]:

(i) [CONFIDENTIAL]

(ii) [CONFIDENTIAL]

3.4 Further changes to the regulatory regime will shortly be implemented. The FCA takes over the regulation of consumer credit from April 2014. The FCA's new rules relating to payday lending, published on 28 February 2014, include:

(i) limiting rollovers to two; and

(ii) limiting unsuccessful use of continuous payment authority and prohibiting use of CPA for part-payments.

3.5 On 12 March 2014, the FCA announced an in-depth thematic review into the way payday lenders collect debts and manage borrowers in arrears.

3.6 The FCA is also required to implement a price cap no later than 2 January 2015. The level of the cap, and the mechanism for determining and applying it, are currently unknown. The FCA also announced on 12 March 2014 that it will consult on the cap on the total cost of credit in the summer of 2014.

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3 In DFC's submission this focus has been out of all proportion to the size of the sector which represents less than 2% of overall unsecured debt in the UK. This estimate is based on information in the AIS at pages 10 and 11: where according to the CC, during financial year 2012, payday lenders issued loans worth around £2.8 billion, and the total amount of unsecured lending to individuals outstanding at 30 September 2013 was £158.7 billion.

4 Initial submission on behalf of MEM Consumer Finance Limited, Instant Cash Loans Ltd and Express Finance (Bromley) Ltd, 12 July 2013, section 2; Submission on behalf of MEM Consumer Finance Limited, Instant Cash Loans Ltd and Express Finance (Bromley) Ltd in response to the Issues Statement, 4 October 2013, section 4.

3.7 It is understood that enforcement activity under the FCA will be more likely to be effective and rigorous than hitherto.[5] Whether that will be the case is difficult to predict.

3.8 Over and above the changes to the FCA's rule book, there are additional changes in the market. CallCredit, with whom DFC is in discussions, is implementing a real-time credit sharing database, in which DFC intends to participate provided that the database is appropriately structured and administered. This will provide payday lenders with real-time (and therefore more comprehensive) credit information about borrowers.[6]

3.9 The fundamental changes that have already taken place across the industry (the full effects of which have yet to be felt within the industry) together with the changes which are yet to be implemented have a number of consequences:

(i) whilst the data and information obtained by the CC in the course of its investigation has meant that more wide-ranging and detailed evidence is now available in relation to the industry than was previously the case, some of that data and information is potentially out of date given the changes in the sector. For example, the transaction data obtained by the CC covers the period from 1 January 2012 to 31 August 2013. Such data does not fully reflect the impact of some of the changes that were made by DFC and others in November 2012, such as the cap on rollovers, and may therefore be misleading in some respects for DFC as well as many other operators in the market. As acknowledged by the CC, there have been many new products and changes to product features introduced fairly recently, and these new products/features may also be under-represented in the transaction data and other evidence obtained by the CC;

(ii) the market the CC is investigating is likely to experience even more change over the coming months. The form the changes will take is difficult to predict, in particular, the level and mechanism of the price cap. On that basis, the consequences of such changes are even harder to predict;

(iii) a more rigorous regulatory regime may lead to increased costs across the industry generally which may well lead to the exit of certain suppliers from the market. Insofar as such a regime leads to [CONFIDENTIAL] higher levels of compliance by those that remain in the sector, DFC accepts that such an outcome may be both necessary and desirable;

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5 See, for example, statements of Martin Wheatley, FCA chief executive

"*Our aim is to create a regime that protects consumers and allows businesses to operate. There is a balance to be struck here…*

"*We believe that payday lending has a place; many people make use of these loans and pay off their debt without a hitch, so we don't want to stop that happening. But this type of credit must only be offered to those that can afford it and payday lenders must not be allowed to drain money from a borrower's account. That is why we're imposing tighter affordability checks, and limiting the use of rollovers and continuous payment authorities.*

"*Today I'm putting payday lenders on notice: tougher regulation is coming and I expect them all to make changes so that consumers get a fair outcome. The clock is ticking.*" FCA press release, 3 October 2013, http://www.fca.org.uk/news/firms/consumer-credit-detail

6 See CallCredit press release, 15 January 2014: http://www.callcredit.co.uk/press-office/news/2014/01/callcredit-information-group-leads-the-way-with-real-time-data-sharing; referred to in CC, Entry and expansion working paper, 21 February 2014, page 19 [attached at Appendix 6]

(iv) provided that the FCA adopts a clear and fair regime that applies to all short term lenders and which is actively monitored and enforced, this should create a level playing field for those operating in the industry. In turn, this will lead to increased levels of certainty and stability. This should encourage greater investment and encourage new market entry and/or expansion. Effective and proper enforcement will therefore be of mutual benefit to consumers and compliant lenders;

(v) however, if the FCA's regulatory approach (including in relation to the price cap) exceeds what is appropriate or proportionate, there are a number of possible consequences which may not be desirable, including a disproportionate increase in costs which may lead to further market exit or remaining lenders restricting credit criteria. This may lead to the exclusion of some borrowers from access to credit. As acknowledged by the CC (and the Government), a price cap is *"likely…to affect the nature of competition*" and *"Depending on its level and the way in which it is implemented, a price cap in particular may significantly affect the incentives of companies to enter the market or the incentives of those within the market to remain in or supply certain groups of customers.*"[7] DFC agrees with this observation. If set at an inappropriate level (or if the mechanism for applying it is not appropriate), a price cap could mean that payday lenders cannot afford to serve certain categories of higher risk customer, again, leaving them to resort to higher cost and/or illegal sources of credit;

(vi) the relentless political and media criticism and focus has, in itself, [CONFIDENTIAL] on DFC customers who are stigmatised for using payday loans and may be discouraged from doing so.

3.10 In light of the profound nature of the regulatory changes that have taken place and are expected to take place, as well as the fact that the effects of those changes have not yet been fully reflected across the industry, DFC submits that the CC should be very cautious about any conclusions reached on historical data or focused too heavily on the current regulatory and competitive landscape. Accordingly, DFC welcomes the CC's acknowledgement that, in carrying out its work, it will be mindful of the implications of the forthcoming changes in the way payday lending is regulated.[8]

4. The Payday lending sector

4.1 In this section, DFC highlights some matters in relation to payday lending products and customers and in relation to developments in the sector generally, many of which emerge from the CC's own customer survey research (the "CC customer survey").[9] The initial analysis set out by the CC in its AIS should be considered in the context of the characteristics of the sector and customer base as identified and considered below as well as in the context of developments in the sector.

4.2 Payday loans represent an innovative and relatively new business model that has in recent years ensured access to credit to a range of borrowers, many of whom have been and are inadequately served by mainstream credit providers. DFC submits that payday loans meet a genuine customer need. As acknowledged by both consumer and debt services agencies and mainstream lenders, as well as

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7 AIS, page 3

8 AIS, paragraph 13

the FCA, there will always be a need for short-term credit.[10] The principal reasons causing a consumer to use short term credit are not themselves driven by the availability of credit. Demand for short-term low value loans will not go away even if the supply of such credit is restricted.

4.3 Over recent years, the sector has seen a period of rapid growth and change. The CC has estimated that in the financial year 2012, payday lenders issued £2.8 billion in loan value. This was 47% higher than the value of loans issued in 2011, and 300% higher than the value of loans issued in 2010 (as estimated by the OFT).[11] That growth is likely to have been caused by increased awareness of the product as well as increased demand for the product following restrictions on credit availability as a result of the 2008 financial crisis. While the broad industry continues to grow, actual rates of growth have slowed. In common with industry trends, DFC's operations also expanded [CONFIDENTIAL].

4.4 There has been, and continues to be, high levels of innovation in the industry. Payday loans are constantly evolving in response to changing customer demand and competition. As acknowledged by the CC, they now encompass a range of differentiated products including, but not limited to, single payment loans, instalment and revolving credit. Payday lenders compete to offer a range of loans that best meet borrowers' needs. In particular, DFC's products have evolved in order to meet changing customer demand and preference and to respond to competition. We attach at Appendix 1 a table which sets out some of the product innovations and improvements to customer service which have taken place in the industry over recent years.

4.5 In relation to payday lending customers, DFC notes the following matters:

(i) payday customers (especially online customers) are similar to the general population, including their average (median) net household income and level of education;

(ii) there are some characteristics that are particular to payday loan customers, including that they tend to be younger than the adult population as a whole, they are more likely to be employed, they are more likely to live in larger households/households with children and in private rented accommodation, and around 60% are male;

(iii) an estimated half of payday customers used the money for living expenses, such as groceries and utility bills, and a majority said the loan was for something they definitely could not have gone without;[12]

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9 Research carried out by TNS BRMB on behalf of the CC, Research into the payday lending market.

10 AIS, paragraph 31; Summary of hearing with Lloyds Banking Group held on 7 November 2013, paragraph 1; Summary of hearing with Barclays Bank plc held on 11 November 2013, paragraph 2; Summary of hearing with Provident Financial plc held on 20 November 2013, paragraphs 4-6; Notes of a multilateral hearing held at CC on 17 October 2013, page 84.

See also Martin Wheatley, FCA chief executive, FCA press release, 3 October 2013 - http://www.fca.org.uk/news/firms/consumer-credit-detail

11 Prior to 2010, it is estimated that the UK payday loans sector grew four-fold in the four years to 2009, from around £300 million in loan value in 2006 to around £1.2 billion in loan value in 2009. See [CONFIDENTIAL]; and Consumer Focus Report, *Keeping the plates spinning – Perceptions of payday loans in Great Britain*, 26 August 2010, page 12.

12 Research carried out by TNS BRMB on behalf of the CC, *Research into the payday lending market* , page 68: 59% said the loan was for something they definitely could not have gone without; a further third (32%) thought it was something they only possibly could have gone without.

(iv) the CC customer survey also indicates that 70% said they needed a loan in connection with a change in their financial circumstances, of which 93% thought the change would be temporary;[13]

(v) the CC customer survey indicates that most customers currently in the market are new to the market in the last two years.[14]

4.6 Much of the CC's customer survey is supported by DFC's own experience and research as well as other independent research.[15] [CONFIDENTIAL][16] [CONFIDENTIAL]

Market definition

4.7 In the AIS, the CC's initial analysis in relation to market definition suggests:

(i) providers of other forms of credit will provide little competitive constraint on payday lenders;

(ii) different types of payday loan, including retail and online loans, should not be treated as distinct markets;

(iii) geographic markets are no smaller than the UK.

4.8 Contrary to the CC's initial analysis, DFC believe that payday loans have faced and continue to face competitive pressure from other credit products. Payday loans developed to supply a demand for low value, short-term borrowing. By their very nature, they provide an alternative to traditional forms of credit such as credit cards and overdrafts that is competitive both on pricing and in terms of product features.

4.9 Support for this position is contained in the evidence obtained from the mainstream banks that:

(i) payday loans, overdrafts and credit cards have a similar customer demographic;[17]

(ii) the growth in payday lending was "*partly linked to consumer misperceptions in relation to the application process and the pricing of overdrafts*";[18]

(iii) that they have adapted their product offering in response to innovation from payday lenders, for example by adopting the '*sliding scale*' introduced by payday lenders;[19] and

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13 CC customer survey, page 70

14 CC customer survey, page 35

15 See e.g. [CONFIDENTIAL]

Auriemma Report, *MEM Market Research – Customer Satisfaction, December 2012*

Personal Finance Research Centre, University of Bristol, The impact on business and consumers of a cap on the total cost of credit, http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1302.pdf, 2013 (the "Bristol University research"), page 15

16 [CONFIDENTIAL]

17 Summary of hearing with Barclays Bank plc held on 11 November 2013

18 Summary of hearing with Lloyds Banking Group held on 7 November 2013

(iv) similarly, consumer and debt services agencies indicate that overdrafts may provide an alternative to payday loans.[20]

4.10 The CC's own analysis indicates that credit cards and overdrafts share many of the characteristics of payday loans. Indeed, notwithstanding the CC's conclusion that "*other credit alternatives generally differ more significantly...*", the CC's analysis also indicates that credit unions also share most of the key characteristics (save for the ability to rollover).[21]

4.11 The CC customer survey indicates that 74% of payday loan customers had used some other form of non-payday loan credit in the last 12 months, which would indicate that a significant majority do have access to other forms of credit.[22] 61% said they definitely could have used at least one other source (excluding friends and family), with 20% saying they could have used an overdraft and 18% a credit card.[23] Only 39% said they could not have used an alternative source of credit, and this may in any case be an over-estimate, in light of both the 74% that had used some other form of credit and the fact that customers were thought to have responded with sources of credit they would have used and not only those they could have used.[24]

4.12 The CC's conclusion that only around 2% of payday customers would have used a credit card or overdraft had their payday loan not been available is inconsistent with the fact that 59% of payday loan customers said the loan was for something "*they definitely could not have gone without*"[25] (and around half needed the money to pay for living expenses) and that a significant majority[26] had access to other forms of credit. This would imply that, notwithstanding the responses to the CC's customer survey, a much larger proportion of customers would have used the alternative forms of credit available to them.

4.13 In DFC's submission, whilst there may be a minority of customers who have no alternative access to credit, for a significant proportion of customers, other credit products including credit cards and overdrafts constitute a viable alternative to payday loans and customers choose to use a payday loan. According to the CC customer survey, for 36% of payday customers, a payday loan is first or second choice, and for less than a quarter was it a last resort.[27]

4.14 Furthermore, as recognised by the OFT, lenders not currently engaged in payday lending impose a further competitive constraint in view of the fact there is

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19 Summary of hearing with Lloyds Banking Group held on 7 November 2013, page 2 – "*LBG noted that the payday lenders had brought innovation to the market notably by introducing the sliding scale which LBG had adopted.*"

20 Notes of a multilateral hearing held at CC on 17 October 2013, pages 22-23

21 CC, Competition between payday lenders and other credit providers working paper, 31 January 2014, page 10

22 CC customer survey, page 29

23 CC customer survey, page 78

24 CC customer survey, page 78: this indicates that whilst customers were asked what they <u>could</u> have used, they were thought to have answered the question on the basis of what they <u>would</u> have used. This may result from the fact that customer were asked to choose between "*Yes – definitely could have used this option*", "*No – definitely could not have used this option*" and "*Don't know*".

25 Even if, as suggested at paragraph 74 of the CC's customer survey, these customers over-estimate the necessity for a payday loan, this would nonetheless seem to reflect their state of mind at the time of making the purchasing decision. Additionally, even if an over-estimate, this still makes it unlikely that only 2% would have used a credit card or overdraft.

26 74% based on those that had actually used other forms of credit, or 61% based on their own perceptions of the alternatives definitely available to them – see above.

27 CC customer survey, page 71

significant scope for them to provide payday or payday-like products. In making its market investigation reference, the OFT found that "*Given the availability of relevant digital technology and sufficient finance to support a marketing campaign, there would appear to be scope for supply-side substitution by firms currently not engaged in payday lending.*" [28]

4.15 In that context, it is noteworthy that new products have recently been introduced by, for example, home credit providers and others. For example, Provident has introduced the Vanquis credit card which gives customers a credit limit of up to £250 (which can be increased over time), which is comparable to the average payday loan value, and is a similar product to a running account payday loan. In addition, Provident's new Satsuma product allows customers to borrow up to £800, repayable over a 13 week or 26 week term, and is similar therefore to a multi-payment payday loan.[29] Additionally, the shout Visa credit card, offered by R. Raphael & Sons plc, gives customers a credit limit of up to £300 and offers fixed monthly payments of £15 per £100 borrowed. Other potential competitors include retail banks, peer to peer lenders and mobile/internet operators.

4.16 DFC agrees that payday lenders compete on a UK wide market. However, DFC notes that in its retail operations, DFC faces competition at both a national and local level. [CONFIDENTIAL]

4.17 Whilst retail prices are determined on a national basis, there are good reasons for this. [CONFIDENTIAL] Uniform pricing [CONFIDENTIAL] ensures widespread compliance with legislation relating to the provision of information to the customer. It is also DFC's belief that its customers appreciate the clarity and simplicity of one straightforward and easily understood price. Pricing aside, there are, however, local aspects to competition. [CONFIDENTIAL]

5. Competition

5.1 DFC submits that payday lenders compete and have always competed on a variety of factors including product features, product innovation, customer service and price. The degree to which competition has focused on any one or all of these features at any particular time has been a function of the maturity, size and dynamic nature of the sector. As noted above at paragraph 1.1, payday lending is a relatively immature and growing sector. For much of the early years of payday lending in the UK, there was fierce competition between payday lenders in relation to customer service and customer offering including such aspects as speed and ease of access. As the sector has evolved, levels of service and offering have become more uniform across the industry and competition between lenders has increasingly focused on price and innovation. As the market starts to mature, DFC envisages that competition on both price and non-price elements will become even more intense. This is, of course, provided that the regulatory changes (including in particular the forthcoming price cap) are implemented in a manner that allows for ongoing price and non-price competition.

Competition through product features

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28 Appendix B of the OFT Market Investigation Reference, June 2013, paragraph B18 - http://www.oft.gov.uk/shared_oft/markets-work/payday-MIR.pdf

29 Summary of hearing with Provident Financial plc held on 20 November 2013

5.2 In DFC's view, the CC's initial analysis that "*the evidence suggests that there has been some competition between lenders on non-price loan attributes in the period since 2008…*" understates the extent of that non-price competition, and does not properly reflect the evidence obtained by the CC as summarised in its Product innovation working paper.

5.3 Payday lenders compete on a number of features including speed, convenience, reputation and customer service. In addition to DFC's changes to its product features, the DFC companies have made various changes to the way in which they provide services, [CONFIDENTIAL] Many other operators in the payday lending sector have been required to adapt their products and service offering as a result of developments in the competitive landscape. Other key competitors offer a differentiated product offering, giving customers further choice. We refer to Appendix 1 which, as noted above, sets out details of product innovations and improvements which have taken place over recent years.

Price competition

5.4 DFC does not accept the CC's initial analysis that "*the extent to which lenders compete on prices is limited.*"[30]

5.5 DFC faces price competition from other payday lenders. The CC has acknowledged that there has been convergence on headline pricing over time and its evidence also shows few price increases during the period under review. This is indicative of price competition between lenders (and not, as the CC seems to have interpreted it, as a lack of price competition), especially when considered in light of the increasing costs faced by lenders (such as increased lead generator costs).[31]

5.6 In December 2011, at the same time as increasing the MEM price to £29, DFC introduced a promotional code on the moneysupermarket.com website, offering both its MEM and Express Finance loans at the original £25 price. [CONFIDENTIAL][32]

5.7 In September 2013, Express Finance introduced a price increase from £29 to £32.99 which it maintained for less than two weeks, [CONFIDENTIAL].

5.8 From October 2013, MEM has offered a cash back promotion under which customers are offered £5 cash back per £100 borrowed for loans paid back in full and on time. Currently, the same offer is available to customers of The Money Shop. We attach at Appendix 3 promotional literature/terms in relation to the cash back offers. As will be evident from the literature, the competitive nature of the price offered relative to other operators in the sector is emphasised by ICL. The promotions support the existence of keen price competition in relation to both online and retail payday lending.

5.9 In relation to late payment and rollovers, there appears to be some divergence between those active in the payday lending sector. However, DFC notes the following:

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30 AIS, page 14

31 CC, Entry and expansion working paper, 21 February 2014, page 17

32 [CONFIDENTIAL]

(i) a significant majority of payday loans are paid back on time (64%) (and this figure excludes rollovers, where the customer has made an active decision to extend the duration of his loan);

(ii) the proportion of loans rolled over is small (around 20%) and is likely to reduce further as a result of the cap on rollovers set out in the FCA rule book. In fact, the majority of the CC's analysis of rollovers appears to be based on loans taken out in 2012, and not based on the more recent 2013 transaction data obtained by the CC, so may not properly reflect the cap on rollovers already applied by many lenders;[33]

(iii) the scenarios used by the CC (to analyse payment on time, rollovers and late payment) are not representative. In particular, the CC uses a loan amount of £100. Whilst this is the modal average, it is not representative, with only 13% of all loans being for £100. The mean average is considerably higher at £260 per loan.[34] In respect of loans paid back late, in particular, given that the evidence obtained by the CC indicates that most of the major lenders charge a flat late fee, the divergence between lenders' pricing is overstated when looking at a loan for £100 rather than a loan for a larger amount.

5.10 DFC considers the competitiveness of its pricing on an ongoing basis, [CONFIDENTIAL].

5.11 DFC considers therefore that lenders do compete on pricing and that price competition is becoming increasingly fierce. Customers demand this. Based on the CC's customer survey, 86% of customers regarded the total cost of the loan as being at least fairly important, and more than half (55%) regarded it as extremely or very important.[35]

Competition to acquire customers

5.12 Lenders compete vigorously to acquire customers through a variety of channels.

5.13 For online lenders, they compete for new leads through lead generators. Whilst the cost per loan is significant, it can be lower than the cost per loan through, for example, Google pay per click advertising, and there is no upfront cost in using lead generators.

5.14 Payday lenders also compete through the effective use of search engines and pay-per-click advertising. For example, [CONFIDENTIAL] of the loans funded by both MEM and Express Finance come through pay-per-click advertising and/or organic searches.

(i) MEM spends around [CONFIDENTIAL] per month on Google pay-per-click ads, [CONFIDENTIAL], which in February 2014 resulted in around [CONFIDENTIAL] loans. [CONFIDENTIAL] MEM's funded loans come from lead generator applications, typically around [CONFIDENTIAL] come from pay-per-click ads and [CONFIDENTIAL] from organic search results, with around [CONFIDENTIAL] coming from other channels such as telephone brokers.

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33 CC, Customers and their loans – presentation based on analysis of the transaction data, 14 February 2014, pages 42-49. Only the analysis on page 45 is expressed to relate to both 2012 and 2013.

34 CC, Customers and their loans – presentation based on analysis of the transaction data, 14 February 2014, page 21

35 CC customer survey, page 91

(ii) Express Finance spends around [CONFIDENTIAL] per month on Google PPC ads [CONFIDENTIAL], which in February 2014 resulted in around [CONFIDENTIAL] loans. [CONFIDENTIAL] Express Finance's funded loans come from lead generator applications, typically around [CONFIDENTIAL] come from pay-per-click ads, [CONFIDENTIAL] from telephone brokers and other channels, and [CONFIDENTIAL] from organic search results [CONFIDENTIAL].

5.15 Payday loans also feature on price comparison websites, which provide customers with access to easily comparable information on the prices of competing payday lenders (see further below), and, by doing so, also enhance competition. Express Finance and MEM previously offered price promotions through moneysupermarket.com (see above), although moneysupermarket.com has now discontinued this service in response to the increasing level of media and political scrutiny into payday lender practices, and perceived non-compliance in the sector.[36]

5.16 More traditional above the line advertising remains important. According to Ofcom research published in December 2013, payday loans accounted for 0.1% of all advertising spots broadcast across all commercial TV channels in 2008, increasing to 0.7% in 2011 and 1.2% in 2012. [CONFIDENTIAL]

Competitor insight

5.17 DFC monitors its competitors closely through market intelligence. All three DFC businesses monitor a range of competitors on a regular basis. [CONFIDENTIAL]

Changes in market share

5.18 The competitiveness of the market is further evidenced by [CONFIDENTIAL].[37]

5.19 DFC has [CONFIDENTIAL] a decline in market share, as shown by the CC's analysis in its Size and concentration of the market working paper in which it is stated "*Wonga's share of total payday revenue increased and Dollar's share fell between 2011 and 2012*" and in which the CC estimates DFC's share of online payday lending to be [CONFIDENTIAL] (by revenue). As noted in paragraph 3.3, [CONFIDENTIAL].

5.20 [CONFIDENTIAL]

6. Profitability

6.1 DFC notes the CC's initial analysis that the profitability of some of the major lenders, including the three largest lenders, has been high across a significant part of the period under review.

6.2 [CONFIDENTIAL]

6.3 In brief, [CONFIDENTIAL]:

(i) [CONFIDENTIAL]

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36 CC, Shopping around working paper, 19 February 2014, page 36

37 [CONFIDENTIAL]

(ii) [CONFIDENTIAL] weighted average margins over the period 2008 to 2013 for DFC's online and retail operations as follows;

	DFC's Retail Operations	DFC's Online Operations
EBIT	[CONFIDENTIAL]	[CONFIDENTIAL]
ROCE	[CONFIDENTIAL]	[CONFIDENTIAL]

(iii) [CONFIDENTIAL]

(iv) neither ROE or ROCE are appropriate measures of profitability for the payday lending sector primarily because of the relative immaturity and capital structure of the industry;

(v) EBIT is a more appropriate measure of profitability for the industry. A review of EBIT margins for those companies identified as comparators by the CC shows that [CONFIDENTIAL].

6.4 [CONFIDENTIAL]

7. First Theory of harm: impediments to customers' ability to shop around and switch supplier

7.1 The CC's first theory of harm, that payday loan customers generally do not shop around and switch supplier, appears to be predicated on the following:

(i) possible weak incentives to do so, perhaps because of the perceived urgency of the loan or a perceived absence of benefits to shopping around;

(ii) restrictions on the availability of information required by borrowers and the role of lead generators;

(iii) borrower over-optimism in relation to the ability to repay loans and consequential insufficient attention to the fees and charges associated with repaying a loan late;

(iv) the perceived inconvenience of switching, including for customers rolling over an existing loan;

(v) uncertainty as to approval for a loan;

(vi) incentives offered by lenders to repeat customers.

7.2 The CC acknowledges in the AIS that key information as to the cost of a loan is available and can generally be easily found on lenders' websites (and also that APR is not the best indicator of the cost of a payday loan[38]). The CC also acknowledges that "*Compared with other financial products, traditional payday loans are relatively straightforward*" and that, unlike unauthorised overdrafts, customer surveyed by the CC did not consider payday loan charges to be hidden.

38 DFC considers that the total cost of a loan is a more appropriate measure of price in relation to payday loans. In addition to APR, the DFC companies provide information to their borrowers about the total cost of a loan.

In addition, 94% of customers understood very well or fairly well what they would need to repay at the point of taking out the loan.[39]

7.3 Not only is key information available to customers both via lenders' own websites and various price comparison websites[40], the evidence supports the conclusion that customers use this information in order to make comparisons across lenders:

(i) the CC customer survey indicates that nine in ten customers looked at the total amount repayable before taking out a loan and two-thirds looked at the charges that would be applied for late payment,[41] with a majority also indicating they were aware of how much it would cost if they needed to extend the loan.[42] This is supported by the Bristol University study, which found that 93% of online payday borrowers and 86% of retail payday borrowers had considered some form of costs information from their lender, and 89% of online payday borrowers and 80% of retail payday borrowers had considered the total amount to be repaid at the time of taking out a loan.[43]

(ii) the CC customer survey also shows that three of out ten customers shopped around between lenders prior to taking out their most recent loan and four in ten had done in relation to this or a previous loan.[44]

(iii) in fact, as acknowledged by the CC, the Bristol University research indicated that around half (46%) of online customers (and 26% of retail customers) reported having compared the cost of their loan with other lenders before taking out the loan.[45]

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39 CC customer survey, page 110

40 The CC's Shopping around working paper, has identified www.money.co.uk and www.moneysupermarket.co.uk (which operated a payday loan comparison site until spring 2013), as well as other smaller websites including http://www.whichpaydaylender.co.uk/, and http://www.allthelenders.co.uk/. We note that the CC is continuing to research the extent to which payday loan customers use price comparison websites. [CONFIDENTIAL] Although see footnote 32.

41 CC customer survey, page 109

42 TNS BRMB tables to CC customer survey, pages 1533 and 1553: 42% found out at the point of taking out the sampled loan how much extra it would cost if they needed to extend the loan; of those who did not, a further 27% said they were already aware of the cost of extending or rolling over the sampled loan.

43 Bristol University research – 89% of online payday and 80% of retail payday borrowers had considered "the total amount you had to repay, including the original amount borrowed plus interest". 52% of online and 42% of retail payday borrowers had considered other fees or charges, such as early resettlement or penalty charges.

[CONFIDENTIAL]

Citizens Advice in its 2013 summary of its payday loan survey reported that 79% of respondents were "*clear*" about the total repayment costs of their loan http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_20130528.htm - as referred to at paragraph 3.51 of the OFT Final Decision on making a Market Investigation Reference, June 2013.

44 CC customer survey, page 97: 31% shopped around between lenders prior to taking out their most recent loan, with the figure increasing to 35% when looking at customer taking out loans for £200 or more or those 33% for those who had experienced debt problems in the last 5 years.

45 Personal Finance Research Centre, University of Bristol, *The impact on business and consumers of a cap on the total cost of credit*, 2013 - http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1302.pdf

The CC comments on the "methodological differences" between the Bristol University research (and other customer studies to which parties referred) and the CC customer survey. We would note in this regard that the Bristol University research was a large study commissioned by BIS and carried out by the Personal Finance Research Centre together with TNS BRMB (which also carried out the CC customer survey) and included a telephone survey of almost 1,500 customers as well as in depth interviews and other analysis. See Bristol University research, page i

(iv) furthermore, the CC customer survey indicates that those customers that do shop around do so across a range of credit products.[46]

(v) DFC's own experience provides evidence that a significant proportion of customers shop around. [CONFIDENTIAL]

7.4 The significant proportion of customers who shop around is, in DFC's view, sufficient so as to ensure effective competition. In addition, these figures all potentially underestimate the proportion of customers who shop around by excluding those who may shop around and decide against taking out a payday loan (whether they opt to obtain alternative credit, or not to take out a loan at all, or to borrow from friends and family). It may also under-estimate the number of customers who shop around simply because they do not define their activities as 'shopping around' (or because they consider weighing up of pro's and con's[47] to be a more detailed exercise than they have carried out).

7.5 Given the wide range of payday loan products now on offer, there is a clear incentive for customers to shop around. Customers surveyed in the CC customer survey mostly felt they spent the right about of time doing so.[48] DFC does not consider that the evidence presented by the CC customer survey indicates either that urgency prevents customers from shopping around or that there is any perceived absence of benefits for which to shop around.[49] In DFC's view, the only disincentive upon DFC's customers to shop around, is that they have a very positive experience with a lender.[50] This is supported by evidence from the CC customer survey, in which 58% of customers who did not shop around said this was because they were happy with the service received from their existing lender.

7.6 In considering whether customers are able to identify best value offers, it is important to take into account what customers regard as best value. For many customers, speed, convenience and (for online loans) confidentiality are key components of best value.[51] Additionally, research by [CONFIDENTIAL] indicates that whilst speed is most customers' top priority when taking out a

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46 TNS BRMB tables to CC customer survey, page 608 – customers that could have used another form of credit (958 in total) were asked whether they got as far as comparing pros and cons of alternative credit against those of a payday loan. Excluding those that gave no answer (722) or did not know (17), a total of 219 customers gave 345 responses across 9 alternative forms of credit, indicating that some must have considered the pros and cons of more than one alternative.

47 In the CC customer survey, customers were asked whether they compared the pros and cons of different lenders (or alternative credit products). The wording of the question potentially excludes customers that have considered an aspect/features that are important to them but without necessarily weighing up all pros and cons of competing products. See TNS BRMB tables to CC customer survey, pages 608-, 933-, 971-.

48 CC customer survey, page 150: payday customers themselves mostly felt they spent the right amount of time comparing sources, shopping around and looking at costs/charges; only 2/10 thought they should have spent longer doing this.

49 Whilst the need to get a loan quickly/having no time to compare was the most common reason given by customers in the CC's customer survey, it was only cited by a fifth (21%) of respondents. The CC does not appear to have asked customers whether or not they considered there might be any benefit to shopping around.

50 See e.g. [CONFIDENTIAL]; Auriemma Consulting Group, *Customer Satisfaction Research prepared for MEM Consumer Finance*, 2012

51 Personal Finance Research Centre, University of Bristol, The impact on business and consumers of a cap on the total cost of credit, 2013 (the "Bristol University research") - http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1302.pdf – this research found that 61% of online payday borrowers had chosen their product because it was "easy and convenient".

loan, customer satisfaction is driven by whether it represents good value, the clarity of the explanation of charge and fees, and the fairness of the deal.[52]

7.7 As noted above at paragraph 5.11, price is also important for payday loan customers. The Bristol University study indicates around half were not very likely to have taken out their most recent loan if the cost had been higher.[53] [CONFIDENTIAL] research carried out for TMS also supports that over half compare TMS favourably to banks and building societies because of interest rates.[54]

7.8 DFC acknowledges that the wide range of products now on offer may make it more difficult to provide a comparison of all payday loan products and across all key product features (though, based on the CC customer survey, customers themselves have not said this). However, it must be borne in mind that the range of products on offer is a direct result of competition and customer demand. This innovation is in itself a good thing.

7.9 As regards the use of lead generators, from a customer perspective, lead generators allow customers to find a lender that will approve them for a loan, without the inconvenience of submitting multiple loan applications. However, the customer remains free to shop around. Around [CONFIDENTIAL] of loan applications approved by MEM and Express Finance, based on approved leads from lead generators, are not converted into funded loans because the customer chooses not to proceed with the loan.[55] It can be inferred from [CONFIDENTIAL] of customers who, despite being approved for a loan decide not to proceed with the loan offered by DFC, that at least some of these customers have taken up offers of other loans from other providers. This figure of course excludes customers who may shop around and, as a result of that exercise, may not get as far as submitting an application to MEM/Express Finance or via a lead generator.

7.10 DFC also does not accept that customers are over-optimistic about their ability to pay. The CC's evidence shows neither that customers are over-optimistic about their ability to repay their loans, nor that they pay insufficient attention to the fees and charges associated with repaying a loan late. On the contrary:

(i) the CC customer survey found that both during the term of the loan and after the loan repayment date, nine in ten customers were confident about their ability to repay (in fact, after the repayment date, 89% said they found it as expected or easier to find the money to repay the loan, including 30% who found it easier rather than more difficult);[56]

(ii) the CC's Customers and their loans presentation indicates that 64% of loans issued in 2012 were repaid on time or early, and of the 22% repaid late, a relatively high proportion appear to be repaid late by only one day (16%) or within a week (46%), giving around 74% of

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52 [CONFIDENTIAL]

53 See e.g. the Bristol University research – 55% of online payday borrowers were not at all likely (22%) or not very likely (33%) to have taken out a loan from this lender on this occasion had the cost been higher. 43% of retail payday borrowers said the same – 22% not at all likely and 21% not very likely.

54 [CONFIDENTIAL]

55 [CONFIDENTIAL]

56 CC customer survey, page 142

customers who repaid within a week of the due date.[57] In fact, even this might be an underestimate given that the CC has excluded rollovers, even those paid back in full and on time, from loans repaid in full on time/early.[58]

7.11 DFC submits that there are no barriers to a customer switching lenders or incentives to remain with the same lender, nor has the CC identified any evidence of such barriers or incentives.

7.12 The CC customer survey indicates that, when looking at customers who have taken out multiple loans, more than half (57%) have used more than one lender.[59] The more loans a customer has taken out, the more likely they are to have used multiple lenders (even of those customers who have taken out only two payday loans, almost half of them – 43% – have used more than one lender).[60] Even if only considering customers who took out their first loan in 2013, almost a third had used more than one lender.[61]

7.13 In fact, far from showing that customers remain with a lender, the evidence obtained by the CC through its analysis of transaction data and customer survey suggests high rates of churn:

(i) the majority (65%) of customers who took out a loan in 2012 did not come back to the same lender in 2013.[62] Even if only looking at new customers (so as to exclude those that may have taken out repeat loans already), 40% of customers who obtained their first loan in January to August 2012 took out no further loans with that lender within a year of their first loan.[63] [CONFIDENTIAL][64]

(ii) as noted above, a relatively small proportion of the loans made in 2012 (by number and value) were taken out by customers who started borrowing from that lender in 2010 or earlier,[65] i.e. most customers who took out a loan in 2012 were relatively new to that payday lender;

(iii) the extent to which customers do take out repeat loans from the same lender may be overstated in the CC's Repeat customers analysis, given that the CC has treated top up loans as separate (and therefore, repeat) loans. In fact a top up is not a repeat loan; it is an additional

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57 The CC notes that a relatively high proportion of those loans paid late appear to be paid late by only one day. DFC believes that an explanation for this observation may be that these customers have entered an incorrect pay date when taking out the loan or been paid later than expected, and not that they have over-estimated their ability to pay on their next payday.

58 CC Repeat Customers – presentation based on analysis of the transaction data, 14 February 2014, page 29. Whilst customers who roll over loans may do so because they have made an over-optimistic assessment of affordability at the outset, they may also do so simply because they wish to take out a further loan, or because their circumstances have changed during the initial term of the loan.

59 CC customer survey, pages 33 and 132

60 CC customer survey, page 133

61 CC customer survey, page 36: almost a third (30%) of those customers who took out their first loan with that lender in 2013 had used more than one lender.

62 CC customer survey, page 13

63 CC customer survey, pages 18-20

64 CC, Repeat Customers – presentation based on the analysis of transaction data, 14 February 2014
http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/payday-lending/140214_repeat_customers_presentation_based_on_analysis_of_the_transaction_data.pdf

65 CC customer survey, page 8

drawdown based on the customer's existing loan agreement – a customer may make multiple drawdowns pursuant to a single loan agreement. Both ICL's and Express Finance's loans are running account products, allowing repeated drawdowns. For these companies and any other offering this facility, the average number of repeat loans per customer is likely to be overstated;

(iv) the degree of repeat business varies widely across the lenders, and the proportion of customers who did not borrow again from the same lender within a year of taking out their first loan varied between 23% and 82%.[66] The high degree of variation shows that, even to the extent that some customers do remain with the same lender, this is not a feature of the market but may simply be a function of that lender's competitive offering.

7.14 Customers are not deterred from switching by any perceived inconvenience in doing so, nor uncertainty as to approval, nor has the CC identified any evidence in respect of either:

(i) for customers who did not switch, the main reason given in the CC customer survey is that they are happy with the service provided by their current lender: a significant majority of those customers with multiple loans that did not switch or consider switching (61%) gave this reason, and even amongst those that did consider switching, this was the most common reason given by more than a third (36%);

(ii) only 4% of those that considered switching but did not switch, and 9% of those that did not consider switching, cited as their reason for not switching that their current lender was more likely to approve their application;

(iii) furthermore, of those that did switch, whilst around a third of customers (34%) may switch lenders because they cannot obtain a further loan from their previous lender, the majority do not indicate they were forced to switch and almost a third of those who switched cite that they preferred the loan/service offered by the other lender.[67]

7.15 In any case, there is no certainty that by returning to the same lender, a customer will be approved for a repeat loan. [CONFIDENTIAL][68]

7.16 Overall therefore, DFC does not consider that the CC's analysis provides evidence of barriers to shopping around or switching, or that there is any lack of shopping around or switching. In fact, the high incidence of customers who have used more than one lender and the high rates of churn would seem to indicate that rates of switching payday lenders are likely to be significantly higher than rates seen in other industries. By way of example, in personal current accounts, in 2012, after action resulting from the OFT market study, the annual rate of

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66 CC customer survey, page 21

67 CC customer survey, pages 134-136

68 In addition, whilst repeat customers do generally borrow more, most stay well within their credit limits. See the CC's Customers and their loans presentation, page 25: this indicates that over 75% take out less than the maximum available to them, with over half of customers taking out less than half of their credit limit.

switching was 3.1% and 75% of customers had never switched their main account.[69]

7.17 Some customers do choose to remain with the same lender, and the main reason for this is that they are happy with the service provided by their existing lender. This is consistent with the constantly high levels of customer satisfaction reported by DFC's customers. DFC does not consider that there are any impediments to customers' ability to shop around or switch supplier. On the contrary, the evidence contained in the CC surveys and working papers indicates not only that customers can easily shop around and face no contractual or other barrier to switching, but more importantly that a significant proportion of customers do in fact shop around, and more than half of customers who have taken out repeat loans have in fact used multiple lenders.

8. Second Theory of harm: Market power and entry and expansion

8.1 The CC's second theory of harm is predicated on the following matters:

(i) that the payday lending 'market' is relatively concentrated (and the CC has implicitly accepted that the market is not concentrated or close to highly concentrated, as suggested by the OFT[70]);

(ii) that, notwithstanding high levels of new market entry over the last decade, barriers to entry and expansion are increasing; and

(iii) that there may now exist certain barriers that may reduce the likelihood of entry and expansion. The CC has divided these into seven business requirements (of which the CC considers that five raise barriers to entry), reputation risk, and additional costs of entry for retail.[71]

8.2 DFC welcomes the acknowledgement by the CC that online payday lending is a relatively new sector in the UK and that many firms have entered over the past decade.[72] The CC's own estimate is that around 90 lenders offer payday loans in the UK and the CC has also stated that this might under estimate the true number of firms operating in the sector. More recently, the FCA issued a press release on 12 March 2014, in which it estimated the number of payday lenders that will come under its authority on 1 April 2014 will be 200.[73]

8.3 DFC notes that of the 11 major lenders identified in the CC's Entry and expansion working paper, eight (including two of the biggest lenders, Wonga and Cash America) started payday lending in the UK within the last 6 or so years only. Furthermore, since 2010, there have been over 60 new market entrants,

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69 OFT, Review of the personal current account market, January 2013

70 OFT, Final decision on making a market investigation reference, June 2013, page 40

71 As regards any additional factors influencing the likelihood of entry and expansion in high street payday lending, we support the CC's preliminary conclusion that the barriers to entry through the opening of additional high street stores are not substantial.

72 CC, Entry and expansion working paper, 21 February 2014

73 CC, The size and concentration of the payday lending sector working paper, 14 February 2014, page 1

FCA press release, Consumer credit countdown – Review into debt collection practices of payday lenders starts on day one of FCA regulation, 12 March 2014, http://www.fca.org.uk/news/consumer-credit-countdown-review-into-debt-collection-practices-of-payday-lenders-starts-on-day-one-of-fca-regulation. The FCA further states that it is expected that a quarter will decide that they cannot meet the FCA's higher consumer protection standards and will leave the market thus suggesting that they expect at least 150 payday lenders to be active in the market after 2014.

with more than 10 as late as 2013.[74] The CC's own analysis suggests that one in three of all new loans written in 2012 was supplied outside the top three largest lenders and that somewhere between 10 and 20% of loans were issued outside the largest 10 lenders identified by the CC.[75]

8.4 Based on the data obtained by the CC relating to 2012, it would appear that at least[76] 35 online lenders generated revenue of £500,000 or more; and a quarter of all high street lenders operated more than ten stores.[77] In DFC's view, lenders of this size, individually and collectively, impose a significant competitive constraint on larger lenders.

8.5 Many of these new entrants into the sector have been able to establish themselves as major lenders in a short period of time. The ability of a new entrant to start payday lending and expand significantly is illustrated by the entry of Wonga. Wonga entered the UK market in 2007 only and in less than 6 years, as identified by the CC, has grown to be the largest payday lender in the UK.

8.6 That said, in order for a new entrant or smaller incumbent lender to present a real competitive constraint to incumbent lenders, it would not need to expand on anything like the scale of Wonga. Therefore some of the entry costs incurred by Wonga may not be representative of the costs of entering the market or expanding on a reasonable scale.

Business requirements

8.7 DFC accepts that the business requirements identified by the CC are key requirements in operating a payday lending business. However, DFC does not consider that the costs associated with any of these operate (or, in the case of regulation, ought to operate) as a barrier to entry or expansion.

8.8 As a general matter, save for a limited, initial period, DFC does not accept that a new entrant would be any more dependent on new customers than an established entrant. The CC's own analysis indicates that of the largest lenders, two lenders made the majority of loans to new customers, and most [CONFIDENTIAL] made a significant proportion of loans to new customers. Furthermore, the CC's analysis indicates that every month, a lender loses around a quarter of customers (including existing customers and those that were new that month).[78] The cap on rollovers contained in the CFA Charter and the further cap contained in the FCA rule book are expected to reduce any difference in this regard between new and established entrants. Even if a new entrant is initially more dependent on new customers, any additional costs associated with new customers would be incurred by the new entrant only on a short-term basis. In any industry, a new entrant will initially face higher costs of acquiring customers.

8.9 DFC accepts that in principle the requirements of FCA authorisation (which are not yet fully known) could constitute a barrier to entry. DFC also notes the FCA's own expectation that, based on its proposals, "*a quarter will decide that*

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74 CC, Entry and expansion working paper, 21 February 2014, page 7, figure 1

75 CC, The size and concentration of the payday lending sector working paper, 14 February 2014, page 4

76 The CC has stated that it obtained data from only 58 lenders; therefore the actual number may be higher – CC's Size and concentration of the payday lending sector working paper, paragraph 17

77 CC, The size and concentration of the payday lending sector working paper, 14 February 2014, page 7

78 CC, Repeat customers—presentation based on the analysis of the transaction data, 14 February 2014, page 12

they cannot meet the FCA's higher consumer protection standards and leave the market".[79] However, as noted above at paragraph 1.18, and subject in particular to the way in which the FCA implements the price cap, it is DFC's view that reasonable and proportionate regulation by the FCA ought not to operate as a barrier to entry, and by the FCA's own estimate there are currently some 200 lenders active in the sector. On the contrary, reasonable and proportionate regulation should create a level playing field for compliant lenders and provide appropriate protection for customers. A robust and even-handed enforcement of the regulatory regime should give rise to greater certainty and stability and thus encourage new investment and entry. On that basis, DFC does not consider that the new FCA regulatory regime should represent a barrier to entry.

8.10 As regards customer acquisition and the role of lead generators:

(i) lead generators provide new entrants with easy, straightforward access to a large existing customer base meaning new entrants can enter the market on equivalent terms to existing operators;

(ii) lead generators will also reduce marketing/acquisition costs for new entrants. Unlike some channels which may involve an upfront cost, such as television advertising, lead generators generally only involve a cost per approved lead (and, in some cases, per funded loan);

(iii) a new entrant with a competitive product offering/good customer service, ought fairly quickly to start winning some repeat business. Therefore, any differences in the acquisition costs incurred by new and existing lenders are likely to be short-term;

(iv) there are a number of other channels for acquiring customers, which can be used instead of or in addition to lead generators. One alternative is to invest in advertising. Wonga has successfully entered the market and grown to be the largest payday lender in a very short period of time, as a result of a successful media campaign;

(v) other channels for acquiring customers include the use of pay-per-click ads and organic search engines, which DFC addresses above. [CONFIDENTIAL][80] indicating that smaller lenders and new entrants can make effective use search engines. Lead generators are therefore not the only method of customer acquisition: the CC's analysis indicates that whilst customer acquisition commissions represent the largest single cost for online payday lenders, advertising and promotion is also a significant channel for customer acquisition;[81]

(vi) [CONFIDENTIAL] However, customer acquisition costs – whether lead generators, above the line advertising or pay-per-click/search engine optimisation – are faced by all lenders, and not only new lenders. Incumbent lenders cannot simply rely on repeat business from existing customers, and must compete to win new customers.[82]

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79 FCA press release, FCA press release, Consumer credit countdown, 12 March 2014, http://www.fca.org.uk/news/consumer-credit-countdown-review-into-debt-collection-practices-of-payday-lenders-starts-on-day-one-of-fca-regulation

80 [CONFIDENTIAL]

81 CC, Profitability of payday lending companies working paper, 24 February 2014, page 16

82 As noted above, we estimate payday lenders retains customers for only two years, and even during this period, customers with multiple loans tend to use multiple lenders.

8.11 DFC accepts that default costs are a significant cost to DFC, and DFC accepts therefore the importance of robust credit/affordability/identity checking. DFC accepts also that new customers generally present a higher credit risk than existing customers. However, DFC does not consider that either heavier reliance on new customers, or lack of internal information on customer payment behaviour, constitute a barrier to entry for the following reasons:

(i) as noted above, to the extent that new lenders are more dependent on new customers, DFC consider that this is likely to be short-term;

(ii) whilst new customers generally present a higher credit risk than existing customers, this difference is less pronounced than historically, owing to the greater availability over the last two or three years of payday-specific credit scorecards, which can be purchased from credit reference agencies at low cost (approximately £10,000);

(iii) alternatively, in DFC's view, a new entrant could develop its own credit scorecard, comparable to that used by the DFC companies, within a relatively short period of operating in the industry, that is, six to twelve months. Consistent with this observation, it is necessary for an existing lender to refresh its credit scorecard every nine months or so, therefore an existing lender with its own scorecard benefits from its own scorecard for limited period of time only;[83]

(iv) in addition, the CallCredit and Experian real-time databases due to be launched in April 2014 will provide all payday lenders with much more up-to-date credit information, and will allow even those payday lenders without their own scorecards access to more and better information so as to compete on a more even footing.

Reputation

8.12 DFC notes that Barclays and Lloyds Banking Group have identified reputational risk as a barrier to entering the payday lending sector. DFC acknowledges that the ongoing – and disproportionate – political and media attention has the potential to tarnish the industry. Nonetheless, given the strength of the brands of the high street banks (in particular), should they choose to do so, they could enter the market and seek to enhance the reputation of the industry. In any case, the effective and robust regulation promised by the FCA should address any reputational risk associated with payday lending.

8.13 In addition, in the case of Lloyds Banking Group, their concern appears to relate to the fact that payday loans have high APRs. DFC has already commented in DFC's response to the CC's Issues Statement on the inappropriateness of using APRs for payday loans, which DFC understands the CC accepts.

8.14 As regards payment processing services, financing and access to capital, DFC accepts that payday lenders need access to these services in order to compete in the sector but notes that there is little or no evidence to suggest that access to these services is denied to new entrants. Insofar as any restrictions on access to these services and/or facilities might arise as a result of reputational issues, a more effective regulatory framework will contribute to improving the reputation of payday lending and any barrier to establishing such relationships and/or obtaining access to these services and/or facilities will be removed. In addition,

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83 [CONFIDENTIAL]

the payment services sector is itself undergoing substantial change and liberalisation, proposed under draft EU legislation, which DFC would expect to make it easier to establish the relevant payment processing relationships.

Evidence of low barriers

8.15 The CC has reviewed the significant new entry (both online and retail) that has taken place over the past few years. DFC does not propose to reiterate the analysis undertaken. We note also the assessment of the OFT in its decision to make a Market Investigation Reference. The OFT identified up to 131 firms that issued payday loans in 2011/2012. Of these only 106 were operating in the previous year and only 77 were operating in 2009/10.[84] In fact, in November 2012, the OFT said it was writing to "all 240 payday lenders"[85], and as noted above, the FCA has recently referred to 200 payday lenders coming under its authority.[86] DFC considers that the number of payday lenders identified by the OFT may well be an under-estimate as it may not take account of the numerous small and independent payday lenders that have entered the market.[87] In sum, large numbers of actual entrants into the sector have not experienced any meaningful hindrance in building successful businesses.

9. Conclusion

9.1 DFC does not consider that either of the CC's theories of harm is borne out by the evidence.

9.2 The payday lending sector is highly competitive. Over the years there has been substantial innovation in relation to new products, product features and service offering, driven by intense competition and customer demand. As a result there is now a range of products on the market, allowing customers to choose the product that best suits their needs. The service offering of the major lenders is acknowledged by its customers to be high. More recently and going forward, we expect to see increased focus on price competition subject of course to the way in which the FCA implements the price cap.

9.3 Payday lending is not concentrated to a degree that causes any adverse effect on competition. There are a large number of payday lenders currently operating in the sector: 200 by the FCA's recent estimate and at least 90 even by the CC's conservative estimate. The evidence clearly demonstrates that existing firms, even the larger ones, do not benefit from market power. Furthermore, barriers to entry and expansion are low. This is evidenced by the significant new entry and expansion in recent years. In light of the ongoing increase in demand for payday loans, and in particular the massive growth of the online sector, DFC expects new entry to continue to take place. Provided of course that the new FCA regime is appropriate and proportionate, its arrival should herald an era of more effective and rigorous enforcement, and therefore a level playing field for those lenders – whether existing lenders or new entrants – that comply with the rules.

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84 OFT's final decision on making a Market Investigation Reference, paragraph 3.1.2

85 See OFT press release, 20 November 2012 - http://www.oft.gov.uk/news-and-updates/press/2012/110-12

86 See note 70

87 Furthermore, the OFT in its decision on Dollar's acquisition of MEM identified double digit numbers of successful entrants over the five years to 2011.

See the OFT's decision on reference under section 23 (1) given on 4 March 2011, full text of decision published 24 March 2011 "Anticipated acquisition of Purpose UK Holdings Limited, together with certain shares in the capital of MEM Holdings Limited by Dollar Financial UK Limited", ME/4842/11.

9.4 Customers are very aware of the choices available to them. Almost all obtain key information in relation to their loans and a significant proportion shop around between lenders. Customers are also prepared to switch between lenders. More than half of customers who have taken out more than one loan have used multiple lenders, and even those customers that remain with a lender for more than one loan generally do not remain with the lender for a prolonged period of time.

9.5 Such market characteristics and developments are not consistent with the presence of a genuine competition problem. To the extent that there have been issues in relation to effective enforcement and potentially with compliance on the part of some lenders, the transfer of regulation to the FCA with effect from 1 April is expected to resolve such issues. DFC hopes therefore that the CC's evidence-based and analytical review of payday lending will pave the way for an even-handed enforcement regime under the FCA, and a competitive industry in which lenders can continue to compete vigorously, innovate and in doing so, meet the needs of customers.

APPENDIX 1

PRODUCT AND SERVICE IMPROVEMENTS AND INNOVATION[88]

		DFC			Competitors		
		ICL	MEM	Express Finance	Wonga	QuickQuid	Sunny
Product Innovation	Minimum loan term of 7 days or less[89]	✓	✓	✓	✓	1 month minimum	✓
	Longer term flexible loans and running accounts		[CONFIDENTIAL]		30 days max	✓[90]	✓[91]
	Increased loan amount (from around £500)	£1,000*	£1,000*	£750*	£1,000*	£1,500	£1,000
	Multi-payment loan with a variable term	[CONFIDENTIAL]	[CONFIDENTIAL]				
	Daily interest vs fixed fee per £100	Fixed fee/£100	Fixed fee/£100	Fixed fee/£100	Daily interest plus fixed fee[92]	Fixed fee/£100	Fixed fee/£100
Customer Service	Access to funds	✓ Longer opening hours, some stores open on Sundays	Online only	Online only	Online only	Online only	Online only
	Reduced loan payout times with Faster Payments[93] and more frequent payment runs[94]	✓	✓	✓	✓	✓	✓

88 Table prepared on the basis of internal information of DFC and publicly available information relating to Wonga, QuickQuid and Sunny.

89 Previously, customers applying for a loan within 5-8 days of their next payday would have had to take a loan repayable on their next payday. The introduction of shorter term loans allows customers greater control and cheaper products.

90 QuickQuid offers loans of up to 12 months. FlexCredit is a running account product offering customers flexibility in paying off the loan, including an instalment option over ten months.

91 Sunny also offers running accounts with continued access up to the agreed credit limit.

92 Wonga allows customers to choose how much they borrow and for how long, with the cost of the loan calculated on a per day basis.

Technological progress	Online customer service login	✓	✓	✓	✓	✓	
	Alternative and improved means of communication- live chat/ SMS/ email / automatic dialler	✓	✓	✓	✓	✓	✓
	Mobile specific website /	✓	✓	✓	✓	✓	

* Available to repeat customers only

93 Lenders are now able to provide customers with access to funds limited only by lender working hours, rather than transfer mechanisms.

94 Multiple daily payment runs ensures customers are no longer subject to cut-off points.

APPENDIX 2

[CONFIDENTIAL]

APPENDIX 3

MEM AND ICL CASH BACK PROMOTIONS

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Promotional Terms and Conditions

£5 cashback offer Terms and Conditions

We would like you to benefit from this cashback offer. However, MEM Consumer Finance Limited trading as Payday UK reserves the right to refuse to make a payment in respect of the cashback offer if any of the following Terms and Conditions are not met.

Terms and Conditions

- The offer commencement date is 15th October 2013
- The offer end date is March 31st 2014
- You must be 18+
- The £5 cashback offer cannot be used in conjunction with any other offer
- You must have taken out a new loan during the offer period; existing loans with a balance above zero will be excluded from this offer, however loans subsequently taken out during the offer period will be eligible for the offer
- The loan must be repaid in full (principal, fees and all interest) by 7pm on its original due date. You will not be eligible for any cashback if the loan is settled after this time, or if the loan is deferred
- If you repay your loan in full and on time you may subsequently take out a new loan to benefit again from this offer (as long as subsequent loans are for at least £100, are repaid in full and on time, and are taken out during the offer period).
- Cashback will be paid out in relation to the loan amount (increments of £100); for example, a loan of at least £100 will receive a cashback of £5 and a loan of at least £200 will receive a cashback of £10, up to a maximum loan amount of £1,000.
- If you are eligible for cashback this will be paid via BACS using the bank details we hold on your account, and could take up to 7 working days.
- Cashback offer is only available for 30 days following payment of the loan in full on or before the due date.
- The cashback amount available is non-deductible from any future loan

The offer can be withdrawn without prior notice

- If you cancel your agreement within the first 14 days (your statutory cancellation period) you will not be eligible for the cashback offer.
- The offer is not open to employees of the promoter and anyone else involved in the operation of the offer, their agents, families or partners.

The Money Shop®

Short-Term Loans

New Customers get £5 cashback for every £100 borrowed and repaid on time*

Looking FOR CASH...

GET UP TO £1000**

Apply instore or online through moneyshop.tv

£100 loan for 28 days and repaid on time costs you less

The Money Shop®	✓ Cost £24.99***
Cheque Centre	Cost £29.99
Cash Converters	Cost £30.00
Wonga.com	Cost £35.04

2962% APR (variable) representative.

*£5 offer is only available to customers taking out a short-term loan for the first time with The Money Shop and repaying in full on or before the original due date. Offer can be withdrawn without prior notice. Full terms and conditions are available instore and online.

APPENDIX 4

INDUSTRY WIDE INVESTIGATION/ACTION

Department for Business, Innovation & Skills ("BIS")

- In 2011, BIS commissioned the Bristol report, to provide up to date evidence on short-term credit markets.
- In November 2011, BIS published the Consumer Credit and Personal Insolvency review.
- On 7 March 2012, BIS published its Report on Debt Management, following its inquiry into consumer debt.
- On 6 March 2013, BIS announced a package of measures, outlining plans for the Office of Fair Trading, the Financial Conduct Authority and the Advertising Standards Agency.
- On 3 October 2013, BIS produced reports on two commissioned surveys assessing payday lending good practice and codes of practice.

Office of Fair Trading ("OFT")

- On 24 February 2012, the OFT launched a review of compliance by payday lenders with the relevant legislation and guidance, sending out questionnaires and launching its inquiry into payday lending, publishing an interim report on these findings in November 2012.
- In November 2012, the OFT published debt collection guidance, and supplementary consultation guidance on continuous payment authority.
- In March 2013, the OFT published a report on its plan of action on compliance with relevant legislation and guidance. It wrote to 50 payday lenders demanding compliance within 12 weeks. (The OFT also announced that it proposed to refer payday lending to the CC for investigation.)
- Following a report from the Controller and Auditor General in December 2012, the OFT announced a new licensing regime in June 2013. (The OFT also made its market investigation reference to the CC.)

Financial Conduct Authority ("FCA")

- In February 2014, the FCA published its rule book including specific rules with application to payday lending.
- The FCA intends to publish plain language guidance on the new rules in March 2014 and a paper on the risks and potential action in the consumer credit market in April 2014.
- On 12 March 2014, the FCA issued a press release stating that lenders will be subject to an in-depth thematic review into the way they collect debts and manage borrowers in arrears. The statement also confirmed that from 1 April 2014, the FCA will consult on a cap on the total cost of credit for all high cost short term lenders in the summer of 2014, with rules to be implemented in early 2015.

- From 1 April 2014, the FCA takes over regulation of payday lending.

Other Government action

- In November 2013, the Government introduced legislation (The Financial Services (Banking Reform) Act 2013 amending FSMA) to impose a duty on the FCA to place a cap on payday loan charges no later than 2 January 2015.

- For April 2014, the Government is working with the OFT, Advertising Standards Agency and the Committee of Advertising Practice to take action restricting advertising, to increase consumer protection.

Other

- In April 2011, the Money Advice Service was launched, and is now responsible for the co-ordination and funding of all free debt advice. The MAS is to undergo a Government review.

- In July 2012, the CFA published an enhanced Code of Practice, building on its earlier Code. This Code came into effect in November 2012.

- In July 2012, a Good Practice Customer Charter was published by the four trade associations representing payday lenders. This Charter came into effect in November 2012.

- In May 2013, the Citizens Advice Bureau published a review of the Charter.

APPENDIX 5

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APPENDIX 6

CALL CREDIT PRESS RELEASE

Callcredit Information Group leads the way with real-time data sharing

15 January 2014

Callcredit Information Group has announced its intention to enable real-time data sharing which will be available to lenders across its portfolio of clients from April 2014.

Callcredit is continually looking to encourage greater data sharing, in order to provide lenders with the additional information. This wealth of data, enables lenders to ensure they make accurate and responsible lending decisions. Callcredit currently has a number of such initiatives and providing more timely data sharing is one of these projects.

Peter Mansfield, Managing Director of Callcredit Limited, commented, "The lending landscape has changed considerably over recent years. There is a growing consensus that the availability of more frequent data sharing is required to ensure responsible lending in certain sectors. In response to this, together with feedback from our clients, trade bodies and other stakeholders we are delighted to announce that Callcredit will be implementing a real-time reporting solution. As well as addressing specific and immediate concerns in the Alternative Lending sector we believe that it is crucial to build a solution that benefits a broad spectrum of lenders".

Callcredit is already working with many lenders, including 9 of the top 10 online Short-Term Lenders, with its range of innovative credit reporting, fraud prevention and affordability products. Callcredit collect the vast majority of search and performance data within the Alternative Lending sector, providing lenders with the most comprehensive and accurate source of data, assisting them to make the best possible risk assessments and lending decisions. Combining this extensive level of data with real-time reporting will make it unrivalled in terms of performance and insight.

We can confirm that many of the largest lenders in the Alternative Finance market have already agreed to take part in the real time data sharing initiative.

Peter added, "Our history of innovation in this area, as demonstrated by our daily triggers product and our Overindebtedness Initiative, clearly puts us in an ideal position to be at the forefront of this development which will ultimately benefit all lenders and the consumer".

http://www.callcredit.co.uk/press-office/news/2014/01/callcredit-information-group-leads-the-way-with-real-time-data-sharing

APPENDIX 7

[CONFIDENTIAL]

APPENDIX 8

[CONFIDENTIAL]

APPENDIX 9

[CONFIDENTIAL]