

PAYDAY LENDING MARKET INVESTIGATION

Summary of hearing with SRC Transatlantic Limited/ WageDayAdvance Limited held on Tuesday 11 March 2014

Background

1. SRC Transatlantic Limited (SRC) was the UK operation of Speedy Cash Intermediate Holdings Corporation (Speedy Cash), a US-based company. Speedy Cash operated two payday loan companies within the UK, SRC and WageDayAdvance Limited (WageDayAdvance).
2. The SRC Group had a turnover of US\$[~~£~~] million in 2013 and had an expected turnover of approximately US\$[~~£~~] million in 2014. It believed it could build a successful business in the UK and could finance this over a three- to five-year period through internally generated funds and accessing the debt market if necessary.
3. SRC opened its first UK branch in October 2010 and currently had 23 branches in the UK. The branches offered payday loans and also an instalment-based 'flex loan'. WageDayAdvance operated online only and was purchased by SRC in February 2013. At the time, it was one of the largest online lenders in the UK.
4. SRC established a call centre in Nottingham in 2012 and it represented a significant investment. SRC had centralised all its collection activities there and those for WageDayAdvance were in the process of being relocated to Nottingham.

The market

5. SRC believed that the Internet and the advertising drive pursued by Wonga had led to the payday loan becoming the ubiquitous product it was today. Its loan businesses in the USA and Canada were very successful and it described the current UK payday loan market as dynamic and turbulent, reflecting new entrants and a change in the regulatory environment, particularly with regard to continuous payment authority (CPA) and rollovers.
6. Demand for payday loans was still growing organically, though it had now probably levelled off, with annual growth in single figures. The downturn in

lending had affected SRC's high street operation more than its online business and branches were struggling to break even.

7. SRC's focus was on longer-term, instalment loans and product development and payday lending was a relatively small part of its high street activities. Around five years ago in the USA, payday loans accounted for roughly [X]% of its business. The dominant product now, though, was instalment loans and in the UK, [X]. Instalment loans were made available on the WageDayAdvance platform in 2014 and [X]% of new, online customers now applied for this product. The average first-time loan was £[X].
8. The growth in the use of mobile devices had driven the migration of customers from the high street to online applications. Around 50% of people who viewed its website used a mobile device. Customers wanted the convenience of making applications from their home or workplace. SRC expected to expand its online operation, especially as UK consumers were further ahead than those in the USA with regard to access to smartphones with a data plan.
9. SRC believed that a valid criticism of the payday loan product was that the short-term nature of the product did not always address the longer-term needs of a customer. Instalment loans offered longer repayment periods (in the USA up to 42 months), regular payment schedules and the ability to repay the loan early. This expanded the product's reach to more affluent customers who had previously not considered a payday product. Customers who had benefited from a payday loan and proved reliable could be graduated to an instalment product, which offered a cheaper APR.
10. There did not appear to be a large difference between the online and high street customer bases. Some customers enjoyed the face-to-face contact offered by a branch, whereas others preferred the anonymity offered online. Branches all offered the same terms regardless of its nearest competitor.
11. There was a different set of economic considerations between the high street and online businesses. There were a lot more fixed costs associated with a branch, such as rent, utility bills and property taxes, and a certain level of customer volume and performance was required to cover these costs. It was easier to underwrite a loan in a store environment because of the face-to-face interaction with the customer and the ability to ask more direct questions. Loan defaults tended to be higher from online applications and the online business was more reliant upon data gathering, which, coupled with credit scoring, needed to be reliable. The online operation did not have as many fixed costs in terms of infrastructure, but it incurred higher technology costs and more money was spent on underwriting and credit scoring.

12. The WageDayAdvance platform was a hybrid model of lending. It was purchased as an online lending business, but a lot of work was done by talking to customers and gathering additional documents before a loan was approved. Some online lenders wanted a totally automated process and WageDayAdvance was prepared to take customers rejected by other lenders because their application was incomplete, possibly missing a mobile number, having an address that did not match up with an address verification list or missing banking details. If the loan was approved, it would pay its affiliate partner a lower price for the loan, compared with what another company would pay for a fully completed application. It had a [%] success rate for authorising loans for people it contacted and approvals could be as quick as [%] or take up to [%].
13. If the WageDayAdvance loan was transferred via a 'Faster Payment', the customer would incur a fee of £15. The faster payment was optional, [%]. Not many other providers charged for this service, though Wonga charged £5. It had not considered reducing the price to attract a higher uptake, nor had it increased the price to try and get a customer to move to a BACS payment. [%]

Debt recovery

14. A large customer base provided more data for analysis and the focus was on customer retention and ensuring that the customer had a good lending experience. The riskiest loan it would make was the first loan to a customer because there was no prior credit history.
15. Retaining a customer was more cost effective than acquiring a new customer. It was therefore important to understand why a person defaulted and identify appropriate solutions. Customers were notified three days in advance of a payment due date and if a customer defaulted, prior to running a CPA, it would try to contact them, usually via email.
16. [%] of its customers defaulted on a loan and SRC would like to reduce this figure substantially. With a low level of new customers coming on to the market, SRC would seriously consider taking on applicants who had defaulted on, but eventually repaid, their loan. In its US operation, [%] of customers who defaulted but still repaid their loans returned as customers.
17. When considering a loan for someone who had previously defaulted, an important factor in the decision was whether a person had kept a promise to make a payment following a default. If it was kept, the loan was likely to be approved, though the amount may be less than previous loans and may contain additional restrictions.

18. Defaults rates on instalment loans were lower than the payday product and there was a larger capital outlay with regard to funding the instalment product.

Profitability

19. Profitability figures for the publicly listed payday loan firms demonstrated that the sector had experienced a downturn over the last 12 to 18 months. The acquisition of WageDayAdvance was undertaken with the knowledge that regulatory changes were imminent. [X]
20. In 2013, operating profits for WageDayAdvance [X]. The decrease in both figures was the result of complying with new regulations concerning rollover loans and CPAs. At its peak, WageDayAdvance made [X] loans per month, with about half of these rollovers. It was again close to this figure, but now [X]% of loans were rollovers and repeat business had decreased.
21. SRC believed that if the current regulations around instalment lending remained consistent, they would allow it the flexibility to develop new products. The running account was one product that it believed it could deliver and this would offer flexible repayment terms and pricing to reliable customers.
22. SRC believed that over time, the UK, short-term credit market would be a good business. Demand for short-term loans would persist and it could build its business through improved IT systems, underwriting and customer acquisition and retention.

Price competition

23. It did not believe it would increase volumes by lowering prices. A recent promotion offering a fee-free £200 loan had only resulted in a marginal increase in sales. The promotion had run for six months and was advertised in-branch and on billboards.
24. The payday loan product was need-based, usually to cover a rent or utility payment. UK customers had not demonstrated a willingness to seek out the cheapest loan product, whereas in the USA and Canada, customers respond to lower prices.
25. There appeared to be potentially some price sensitivity among UK customers, but they would only be made aware of this through promotions and advertising. In contrast to its UK experience, an in-store promotion for new customers in Canada, using television advertising, had proved very successful.

26. SRC believed that the market had delivered a pricing structure that everyone understood and which the customer was willing to endure. There was very little price differentiation between loan products and it was customer service, convenience and ease of access to funds that differentiated each product.
27. It was very difficult to compare online products. Price comparison websites did not receive a lot of traffic for payday loans and WageDayAdvance did not have the resources to test whether more advertising would be beneficial. It had tried some television advertising, but it was unable to compete with the larger firms. Wonga, The Money Shop and QuickQuid accounted for 70% of the market and Wonga spent around £30 million per year on television and football advertising.
28. A concerted media campaign by [REDACTED]. Since [REDACTED] it had spent around [REDACTED]% of its annual advertising budget on social media, which was primarily about building relationships and retaining customers, rather than acquiring new ones.
29. The WageDayAdvance payday product was priced at £29.50 and its recently introduced instalment product had a similar APR. For its high street operation, the price for the payday product had recently increased from £25.70 to £29. It had recently suspended an instalment product offered in-store as the take-up rate was disappointing.
30. More than [REDACTED]% of its customers selected the instalment product. It believed that the regular, monthly payment sat well with the fact that many people were now paid on a monthly basis. They were also able to adapt the length of the loan to their economic circumstances and if these improved, they could repay the loan early and save themselves interest. There were no early repayment penalties on the instalment products and interest was only paid for the number of days for which the money was borrowed. A 30-day instalment loan would work out cheaper with regard to the interest paid when compared with a payday loan.
31. SRC set its prices at a level that was competitive with the larger high street lenders such as The Money Shop and Cheque Centres, but it also ensured that they were not too far away from the larger online providers such as Wonga and QuickQuid.
32. It was not realistic to introduce price cuts that removed all of its margin, but promotions, as opposed to price-cutting, could be used to drive new customer volume in certain markets. SRC was unsure if such a strategy would be successful in the UK, but if it could achieve the relevant scale, it was something it would consider.

33. SRC believed that people were creatures of habit and it was difficult to get them to try other providers if they were satisfied with the service they received, particularly if price was not a consideration. Customers were aware of the cost of the credit and often this cost was less than incurring late fees on a utility bill or rent.
34. The late fee for WageDayAdvance had increased in December 2013 from £12 to £20 and the high street fee increased from £12 to £25. The increases reflected changes in the market caused by a new entrant, the increased costs incurred by the Nottingham call centre and an escalation of costs in supporting those customers who were in arrears.
35. The increased default fee and new collection strategies had facilitated an increase in its contact rate with customers. It was unsure as to the percentage of customers that ended up paying the late payment fee, but where a payment was missed and the customer agreed to make a payment on the due date or within three days, the late fee would be waived.
36. SRC believed that the market had set a fair range of prices for the loan product. Customers did not spend much time comparing prices because the differential was not substantial. What distinguished the product was the ease with which access could be gained to the capital/credit and the customer service level offered by providers.
37. SRC believed it offered a level of customer service that was superior to its competitors. In the USA, an average branch would do two and a half times the turnover that a competitor would do and staff were paid accordingly. A branch manager would earn 50% more than a rival and other staff would receive a higher starting wage. It had struggled in the UK to replicate the success of its US branches. It did believe that it paid a better wage than its competitors, but the difference was more muted compared with Canada and the USA.
38. SRC believed it had a competitive advantage over its rivals in that it allowed staff at its branches an element of discretion in helping customers that was outside its standard, operating procedures. Staff would still have to adhere to the regulatory obligation to act as a responsible lender, but the transaction could take a little longer, which was a proposition its competitors would not entertain.
39. Friend-to-friend referrals at its branches were the best way to generate new customers and financial incentives were offered to encourage this. Lead referrals and affiliates were sources of new customers for WageDayAdvance. In the USA and Canada, SRC found that those customers recruited organically through its online portal had a better credit performance, and the

ability to retain the customer over time was improved, than those recruited through affiliates.

Comparison websites and affiliates

40. Comparison websites for payday loans did not operate in the same way as those for credit cards and mortgages. Mandated disclosure around the cost of credit could help the sites to function more effectively and over time impact on price competition. To be effective, comparison websites needed to focus on more than price and compare items such as collection policies and the documentation and references required.
41. Online affiliates and lead generators were core channels for WageDayAdvance to attract new customers. Lead generators had to be constantly monitored to ensure that they were adhering to the terms of an arrangement and did not forward inferior customers. As the market matured, SRC hoped that the power they had with regard to pricing would decrease.
42. Google's influence was stronger for organic searches for payday loans than on the pay-per-click advertisements. Google managed the market well and whoever paid the most per click found themselves in a better position. Google policed its site effectively and SRC would have discussions with Google about content and rankings and Google would change its algorithms if results proved irrelevant.
43. Lead generators would not put applications into Pingtree unless they were complete and the price of a lead was affected by the quality of the customer. If the quality of the customers was to decrease, lenders would identify this and where they were once willing to bid £30, they may seek a lower price.
44. When considering a loan application, SRC had around 100 data points it looked at, for example pay frequency and the ratio of the loan requested to a customer's disposable income. Much of this evaluation was done manually and it was hoped that fully automated approvals would increase from the current figure of [X] to [X]%.
45. SRC believed that the dominant providers should share their credit data through a credit reference agency. In the USA, data sharing was very prominent and it used Experian, Equifax and Credit Union, which it called 'bureau data'. There were also five or six specialist credit-reporting firms that dealt with bank customers and virtually all the large lenders bought and reported data from these. A couple of these companies had tried to establish themselves in the UK, but had been unable to as they could not get data from the three largest payday lenders.

46. SRC would benefit from seeing a more complete credit history from its customers. Those who were over-extended would be offered less credit, while the better customer would be offered more credit at a better rate. Credit options would be expanded and product development would increase. Larger, longer-term instalment loans were offered in the USA and Canada and these were credit scored in a much more sophisticated way than was possible in the UK.

Banking

47. SRC had banked with Barclays since it started operating in the UK and WageDayAdvance banked with Barclays from its inception. [✂]
48. SRC spent a lot of time with Barclays to inform its understanding of SRC's work and the evolving regulation. Banks had a lot of concerns regarding regulations and money laundering and wanted payday lenders to be members of industry groups. SRC believed it was difficult for new banks to enter the payday loan market and it believed more banks were required to increase competition.