PAYDAY LENDING MARKET INVESTIGATION

Summary of hearing with Dollar Financial Corporation on 4 March 2014

Background

1. PaydayUK, Payday Express and The Money Shop were Dollar Financial Global Corporation's (DFC's) three primary businesses in the UK. DFC was listed on the NASDAQ exchange in the USA and was based in Berwyn, Pennsylvania. It was an international, diversified, financial services company operating primarily in the short-term lending sector with a current market cap of US$400 million. [✄] DFC also had operations in Canada and in seven other European countries.

2. DFC entered the UK market in 1999 with the acquisition of 11 stores. Since that time, its retail offering had expanded to nearly 600 stores throughout the UK. In 2009 DFC started its online operations with the acquisition of Payday Express and then Payday UK in 2011.

The market

3. During the time DFC had been operating in the UK, the market had seen rapid growth and change. The industry had seen a significant shift from retail to online business with around 80% of the market now based online. The market was highly competitive and was becoming more so, reflected by the fall in DFC's market share. Payday lenders competed vigorously for customers. Evidence of this competition was manifested in the levels of product innovation and the high levels of entry and expansion. Payday lenders also competed on price although this had been less of a feature with online businesses because of some of the marketing channels that had been used.

4. While the industry continued to grow, the actual rates of growth had declined. This could be attributed to the slowdown in the number of new entrants and due to the instability and uncertainty the industry was facing in terms of the effects of regulation (such as the limit on continuous payment authority (CPA) to be introduced on 1 April 2014 and the rate cap) rather than a reduction in consumer demand. There were no barriers to growth. The demand for payday loan products for short-term, small-sum emergency usage would remain relatively stable barring extreme economic fluctuation. The UK's economic

recovery would not have an impact on the provision of a short-term loan products.

5. Despite industry growth, payday lending still represented less than 2% of unsecured lending in the UK. DFC planned to compete more effectively with its competitors in the future [✄]. It believed that these actions would provide greater choice and service options for its customers.

6. Although DFC's operations had expanded during 2010 to 2012, its revenue had contracted over the last six months. DFC's payday lending revenue was down by [✄]% year on year for the quarter ended December 2013. [✄] DFC had sought to [✄]. It did not see a need to [✄] because it was a diversified company from a retail standpoint. [✄], DFC had other products that it could offer through its retail outlets which were [✄]. DFC would consider adding to its retail estate in towns in which it did not have a presence and in which it could service customers efficiently and profitably. However, DFC would await the outcome of the current regulatory processes before considering further expansion.

7. DFC was trying to [✄]. The age, demographics and earning power of its customer base was representative of the UK population. A large number of DFC's customers ([✄]%) chose to avoid banks because of past experiences. It prided itself on the professional environment of its stores and the excellent customer service they provided. It was looking at different marketing mixes and balances [✄] in order to overcome the declines in revenue it had experienced.

8. DFC was [✄]. Lead generators were a cost-effective and efficient way of acquiring customers but had the disadvantage in that they did not necessarily match all the aspects that were important to DFC's customers. As a result, [✄] (it [✄] converted [✄]% of leads). The cost associated with using a lead generator was in the region of £[✄] per lead. This price was driven by lenders other than those which had relied more on brands. Wonga, for example, was very much focused on its media image. There were a large number of mid-table companies in the industry at the higher end of the ping tree (between the £[✄] and £[✄] price points) which were buying the better-quality leads. DFC did not think that lead generators were as transparent as price comparison websites, noting that a customer could obtain different matches (ie with a lender) depending on the rules operated by the lead generator concerned. In many instances customers accessed lead generators indirectly (via Google), perhaps having visited several other sites on the way.

9. [✄] had been a source of good-quality leads for DFC's business. Since [✄] had decided to withdraw from the payday lending market, the number of

customers [✄]. DFC was hopeful that [✄]. Customers putting the effort into shopping around using these sites were probably more price sensitive and had a higher propensity to repay their loan than customers driven by other factors.

10. DFC's efforts were focused on [✄]. It was also investing in new products and had tested longer-term products. It had an instalment loan portfolio of about £[✄] million which it had been building slowly over the last [✄]. The average loan was approximately £1,000, with loan periods ranging from [✄] to [✄] months. It also offered loan guarantor products, having a doorstep lending product in Poland where a guarantor aspect was part of the design. This was a 40- to 52-week product. DFC thought that guarantor loans were more viable the longer the loan term and that alternative products were equally effective for credit required for 30 or 60 days. Secured or unsecured lending were also viable credit options, both of which DFC offered in its retail stores. DFC was also testing short-term products. During the last couple of months it had launched a multipayment loan product that offered lending from two to six months. [✄] A great deal of change would be driven by technology. DFC designed its products so that (with changes to certain modules) they could be used in multiple markets. For example, DFC used its online platform in Finland to launch online lending in Poland, the Czech Republic and Spain. [✄]

11. DFC competed at a local level by promotional marketing (by leafleting the local area), varying the opening hours of its stores and by engaging in Sunday trading. It did not vary the price of its retail offering as it was easier for DFC administratively and the stability and transparency of having one national price was appreciated by DFC's customers. DFC noted that there was more evidence of promotional discounting in the market than wholesale reductions of the headline price. [✄]

12. The payday lending sector remained a relatively immature industry and was continuing to evolve. It was also facing a number of challenges, not least of which had been the constant and often ill-informed media and political attention which was completely out of proportion to the size of the sector. This ranged from the expected comments describing payday lenders as loan sharks or other derogatory terms to the all-too-frequent situation where consumers were denied the ability to even consider industry products as a result of bans or restrictions placed on public computers by town councils.

13. In commenting on the Competition and Market Authority's (CMA's) first theory of harm, DFC believed that payday lending customers were given access to comprehensive, straightforward information and that many chose to shop around and compare payday lenders. There was strong evidence that

customers were shopping around in the form of duplicated applications through multiple channels (eg through paid-search, lead generation or above-the-line television advertising). [✄] of DFC's customers exercised their right to switch between lenders.

14. With regard to the CMA's second theory of harm relating to market power and barriers to entry and expansion, DFC did not believe that the sector was concentrated.

15. Some providers charged a fee to roll over a loan, which could create problems for customers who did not have the ability to repay, and so DFC thought that some limitation on rollovers was appropriate. The Consumer Finance Association (CFA) had put a three rollover limit in place last year and the Financial Conduct Authority (FCA) had indicated that it was planning on reducing the industry limit to two. However, DFC considered that some customers might have the ability to repay their loan but chose to roll it over because the option they really wanted, ie a multiple repayment loan, might not exist. Some providers had historically used rollovers as a substitute for effective underwriting. A well-structured, well-regulated, even-handed approach to underwriting and affordability would take care of a large number of the concerns regarding the ability of a customer to roll over.

Barriers to entry

16. Barriers to entry and expansion were low. There were a number of possible new entrants who could enter the market, not least because of evolving technology and its implications for all financial services in the future. It was now easier to enter the high street than before the recession because rents were cheaper and rent-free periods were also available for new entrants.

17. DFC did not consider that advertising was a barrier to entry as there were a number of different sources of advertising such as lead generators, radio and television. There was room in the market for new entrants as well as existing companies, although the market was becoming increasingly competitive. A third of all new loans were generated by companies outside the top three and somewhere between 5% and 10% of new loans were generated outside the top ten providers. Companies could be successful using one or more of these advertising channels. New entrants did not need a minimum capital requirement in order to compete effectively with existing brands. Wonga, for example, had started with a relatively low television advertising spend which had become more sophisticated over time.

18. The lead generator channel was easy to access and very competitive. DFC did not [✄] for PaydayUK and Payday Express. DFC based its [✄] on the

[✄]. It was not always [✄]. The credit quality of customers and their conversion rates were better higher up the ping tree and the same was true with above-the-line advertising. Customers at the top of the ping tree were better able to fulfil [✄].

19. DFC [✄] PaydayUK and Payday Express. New customers were [✄] and so had [✄], whereas returning customers had demonstrated that [✄]. Research showed that 81% of customers repaid their loan on time or within the first couple of days after the repayment date. In making a credit risk assessment DFC considered customer-reported and traditional data. It was currently looking at [✄]. It was now much easier for a new entrant to obtain a good credit scoring capability (from the CRAs) than it had been three or four years ago.

20. DFC thought that some customers might use multiple lenders because the sums of money they had obtained from their lenders were not sufficient. DFC [✄]. However, it [✄]. Research indicated that of those customers with two or more loans, almost 50% said that they had switched because they preferred the product or the terms of the other lender. It also showed that the reason why less than 10% of those who had not switched had not done so because they were unsure or concerned about their ability to actually get approved for a loan from another lender.

21. DFC planned to participate in the real-time data-sharing initiative, which it considered would provide companies with better-quality data, enabling them to make the right decisions for customers. However, it thought that there might initially be a time lag until sufficient data had been collated. [✄]

22. The paid-search space was a key deliberator for customers, helping them to shop around more easily. In the past the speed of the transaction, ease of use and convenience had been the key variables, but price and some of the other product features were becoming more important. The paid-search channel was very competitive. The conversion rates were greater the higher up a page a company appeared.

23. The challenges and restrictions Google placed on the sector remained challenging. For example, DFC could only advertise against a very limited set of payday-related loan terms (key words) and there were restrictions concerning the appearance and content of the page. All of DFC’s brands in the UK and in many markets around the world had, when using Google, to be represented in the same way. DFC also noted that [✄].

Profitability

24. Profitability was not overly high within the industry. The increasing competition had, particularly during the last 6 to 12 months, [✂]. DFC had tried to maintain its profitability [✂]. However, DFC did not necessarily believe that [✂] as there had to be some stabilisation in the marketplace and in its profitability. It thought that it would be possible to generate adequate profitability in a reasonable regulatory environment and with a reasonable price cap.

25. In commenting on the profitability of its two online businesses, DFC noted that Payday Express had [✂] PaydayUK (which had a different customer base). Payday Express's customers [✂] than PaydayUK's and so [✂]. There were some nuances and differences in the products as well which affected the type of customer the companies attracted. DFC had also focused more attention on the PaydayUK brand during 2013 and indeed The Money Shop brand as well.

26. DFC's conversion rate from pay-per-click to loans was around [✂]%. It was looking to [✂] by improving the user experience, the landing page and its terms. Paid-search was a changing landscape, with companies entering and leaving the market and changing their bids. Changing organic search result affected the conversion rates from a page. For example, between [✂] and [✂] DFC's click rate made up [✂]% of acquisition channels while it currently represented about [✂]% its total mix (acquisition channels).

27. New customers carried a [✂] than customers who had [✂]. If a company's portfolio comprised a large proportion of new customers, the loss rates would be higher. Of the [✂] monthly loan accounts in DFC's high street stores, between [✂] and [✂] comprised new customers. The split for DFC's online operations [✂], although both of these ratios could be [✂].

Pricing

28. The costs associated with small-sum, short-term credit were higher than those seen in typical financial services markets. For example, every time a customer sought a loan from DFC it would have to undertake an affordability assessment to determine a reasonable product offering for that customer. The risk profile of the business influenced the pricing needed to generate a reasonable return.

29. DFC [✂]. However, it did use [✂] in loan size with existing customers, [✂]. Customers appreciated the transparency of DFC's pricing model.

30. Default fees covered the [✄]. On the retail side of the business (cheque-based loan), the default fees had been reduced from £25 in August 2009 to £16 in September 2012 before being increased to £29 in August 2013. DFC had also introduced a default fee of £15 for its online operations (namely PaydayUK), which was largely based on [✄].

31. The introduction of a late fee for Payday UK in 2012 had not had any noticeable impact on either customer behaviour or demand for the product. There had been a [✄] of some customers but nothing DFC would view as particularly material.

32. Although the majority of loans clustered around £30 for a £100 loan, there were companies offering products above and below that price and there were differences in the product offering across the market. DFC thought that most customers considered that £30 was a reasonable price for the service and product they received. [✄] DFC's tariff structure had been relatively simple and straightforward and it competed on price in a variety of ways. It had, since October 2013, offered a discount (£5 on the £29.99 price) to its headline rate of £30 for its retail and online customers who paid in full and on time.

33. Customers tended to borrow for the time period beneficial to them. They did not always select the cheapest loan available in the market, although price was an important part of the product offering. Short-term loans tended to be less expensive than 30-day loans. More than 55% of customers felt that cost was a major consideration for the provider that they picked and the loan that they selected, but there were other factors as well such as reputation, ease of the application process, convenience and flexibility of the product. DFC considered that it was no longer an option, but a given, that a lender would offer a self-service portal.

34. DFC thought that flexible products (such as instalment loans, smaller loans and mobile apps) would supplant traditional payday loans. Customers were already demonstrating that they preferred the flexibility to choose a term and repayment pattern that suited their needs and the growth of these products would continue. The market would also continue to see new means to deliver these products (such as mobile wallet, peer to peer, traditional banks or finance-type companies and backers).

35. Shifting pay dates in the UK, customer confusion as to when they were paid and a failure by employers to pay by Bankers' Automated Clearing Services were the main reasons for the cases where payment was late by one day. Customers could make a payment throughout the repayment deadline date without incurring any charges. [✄]

36. DFC had taken competing products, such as authorised overdraft charges (of £30), into consideration before aligning the prices of its loans from The Money Shop and its online product in September 2013.

Regulation

37. The industry had been the subject of numerous regulatory investigations from multiple organisations including the Department for Business Innovation and Skills, the Office of Fair Trading (OFT) and the FCA. DFC accepted the need for appropriate and proportionate regulation which was enforced in an even-handed way. It had been working with the OFT over the last couple of years in relation to the regulatory framework of the industry and would continue to work with the FCA. DFC believed that it had been at the forefront of regulatory initiatives, for example as a founding member of the CFA, which had taken a leading role in establishing an industry-wide compliance network.

38. Major changes had been required to DFC's operations as a result of regulatory changes. Some of these changes had had a substantial impact on DFC's business, [✂]. The full impact of these changes had yet to be reflected in DFC's business. Additionally, DFC would be facing a new regulatory regime as well as a price cap beginning sometime in January 2015. These changes would inevitably have further fundamental implications for its business and its business model, although exactly what they would be would be impossible to predict at the present time. However, DFC believed that the industry was undergoing profound structural and cultural change, resulting in changes to customer behaviour.

39. The new regulatory regime would more than likely result in companies exiting the market, which would be a good thing provided it cleaned up the market. Regulatory stability could unlock competition in the market, encouraging further investment and entry. There were companies which had the capability of participating in the market but had not done so because of the current uncertainty and instability.

40. DFC would expand its product offering into more multi-term loans if the FCA reduced the number of rollovers. If [✂] was affected as a result of the new regulatory regime, DFC would need to adjust its [✂] and so there would be [✂].

41. DFC thought it was in a better position than most other lenders in the market to cope with changes to CPA. It was used to operating in markets without CPA and had the infrastructure and staffing in place in the UK to work with customers on a more traditional and manual basis.

42. Competition was best served when the market determined pricing. Although DFC had worked with price caps in other markets, it did not believe it was necessary to have a total cost of credit cap in order to have a functioning marketplace. It hoped the cap would be set at a level that would not reduce provider engagement and that would not ultimately reduce access to credit for customers.

43. DFC considered that there was and would always be a need for short-term lending. Most of DFC's customers had a legitimate need for small-sum, short-term credit and used that credit in a way that worked for them. DFC believed that consumers should be able to access and have a choice of types of credit that met their needs at the relevant time. There was a risk that regulatory intervention, including the proposed price cap to be introduced in 2015, might lead to credit criteria being tightened and access to credit for certain borrowers being reduced. This, in turn, would lead to consumers using illegal lenders, thus cutting themselves off from the protection afforded by the regulatory regime and trade association codes.