CMA
Competition & Markets Authority

# PAYDAY LENDING MARKET INVESTIGATION

## Summary of hearing with Think Finance (UK) Limited on 6 March 2014

### Background

1. Think Finance UK Ltd (Think Finance) was a subsidiary of Think Finance (US) which was founded in 2001. Think Finance (US) was owned by Sequoia Capital and Technology Ventures (venture capitalists), private owners and employees. It entered the UK loan market which it viewed as a large and growing market in 2011 when it purchased Fortress Group UK Ltd, a payday lender, and launched Sunny loans (Sunny) in 2013. All its operations were online.

2. Think Finance was based in the UK employing 100 people in the fields of operations, risk, technology, finance, human resources, product and marketing. Think Finance (US) had a 14-year track record as a responsible and innovative lender and was committed to replicating its lending model in the UK. It believed that Sunny was a better product than the competition for consumers in every way.

3. Think Finance was committed to reasonable profits and capped its operating profit at 20% and had a track record (in the USA) of sharing operational improvements with consumers. This was reflected in lower pricing. In 2013, Think Finance (US) made [✄] and a net income of [✄]%. When it started trading in the USA its APR was about [✄]% and was now around [✄]%. Its revenue for 2013 was $[✄] million. In the last 14 years Think Finance (US) had issued around $[✄] billion of credit to [✄] million customers. Its loan book in the UK was in the region of £[✄] million and it processed several thousand transactions a month.

4. Think Finance believed that regulation could support innovation in the industry and increase competition but that regulation also had the real potential to hinder it significantly (eg with the introduction of a rate cap). It thought that regulation could lead to less competition and specifically to entrenching of customers with the existing big competitors. It calculated that in the USA, it had saved customers around $1 billion when compared to payday loans and while it wanted to do the same in the UK, the costs imposed by several forms

of regulation being contemplated by the FCA could prevent it competing successfully in the UK, which would lead to its withdrawal from the market.

5. Think Finance offered seven products in the USA. One of its goals was to bring real price competition to the UK as opposed to competing just on speed or convenience. It no longer offered payday products in the USA. All of its products in the USA were instalment loans, lines of credit or rent to own. It formally ceased offering payday loans in the middle of 2013. In the UK, it had withdrawn the 1 Month Loan product and was planning to do the same with its other line of credit product (quid.co.uk) in May 2014, leaving just its Sunny product which was a cheaper alternative to payday loans.

**The market**

6. [✄]

7. As its market intelligence increased, the intention was to decrease the price of the Sunny product. Risk-based pricing was applied to the product and multiple-use customers would see the loan's interest rate decrease. Think Finance (UK)'s rates ranged from 29% down to 15%, the latter figure being less than half of that currently offered by a typical payday loan provider in the UK and, critically, Think Finance's Sunny product did not charge any fees whatsoever beyond interest. Payday rates in the UK typically started at around 25%, increasing to 40–45%, whereas Think Finance's US credit products ranged between 3% and 30%. It hoped to achieve similarly aggressive pricing over time as it understood the UK market better.

8. Research had shown that there was a real consumer need for credit that could not be served by credit unions, home credit or other groups. In a stable, fair, competitive environment Think Finance could offer products at dramatically lower prices than its competitors. [✄] It thought that the market would move away from the traditional payday product to instalment products because of the affordability factor for consumers. While still an expensive loan, it was dramatically more affordable to the consumer to structure a loan as a monthly instalment product versus using a payday product with the associated rollovers and fees. Think Finance thought it was one generation ahead of instalment loans with its payroll advance product, but this product still had to prove itself financially viable.

9. While regulation offered opportunities, it also generated a lot of uncertainty in the market. There were also a number of regulatory bodies reviewing the industry and it was unclear how the regulatory landscape would eventually be shaped. Credit card associations were also increasingly worried about fraud and were increasing demands for how payday lenders worked with them,

thereby increasing operating costs. Banks were making it harder for loan companies to process certain customers and media pressure was also making banks concerned about working with any companies associated with high-cost, short-term credit (HCSTC) at all. Think Finance thought that as part of the review of HCSTC, the behaviour of banks should be reviewed in relation to the fees charged on unauthorised overdrafts which amounted to £1 billion in 2010.

10. The current uncertainty was stifling innovation. As a member of the Consumer Finance Association, Think Finance was aware of a number of companies with ideas for new products, but which were unwilling to make an investment until the regulatory environment became clearer.

**The customer**

11. The shrinking availability of consumer credit was changing the lending landscape. Since 2010, there was £32 billion less credit available and 62 million fewer credit cards. It was not only consumers experiencing dire financial circumstances who were taking out short-term loans, but those in the higher wage brackets.

12. Availability was the number one selection criteria for consumers when choosing a loan, followed by brand recognition. Price, fees and overall total cost of borrowing did not appear to factor heavily into consumer decision-making. Think Finance was flexible and allowed a customer to borrow for five days with no interest or fees. It also had a customer service that ranked highly versus others. However, many consumers were unaware how expensive competing products were relative to Think Finance's product. Consumers did not appear to find the representative APR helpful in making a decision. Think Finance believed that an overhaul to make the representative APR calculation more useful to consumers was needed to assist their search for the right loan, most specifically so they did not take on the additional burden of exorbitant hidden fees.

13. Think Finance saw unplanned overdrafts, which were dramatically more expensive than its products, as a competitor. When compared to a typical, unplanned overdraft in the UK, the Sunny loan was 44% cheaper than the fee incurred on the first day of the overdraft. For a five-day period, the typical overdraft fee was £76 from an institution a customer might have banked with for ten years, while Sunny would not charge a fee for a qualifying customer during this period.

14. Think Finance had undertaken its own research with Opinium, comparing short-term borrowers against mainstream borrowers. The research was not

confined to its own customers and covered participants across the market. Among the key findings were:

- 62% of loans were accounted for by four providers (QuickQuid, Wonga, PaydayUK and Provident Financial)
- 78% chose a short-term lender because of accessibility, speed and familiarity
- On average, 58% did not consider any other option than a payday loan because of a poor credit-score rating
- 15% considered borrowing from family or friends; 13% from a credit card; and 10% considered using their overdraft

15. When the income levels of certain categories of customers increased, so did their options.

16. Guarantor loans were not a great solution to the challenges of short-term lending. Think Finance did not anticipate developing such products at this time.

**Competition**

17. Think Finance used all six marketing channels as part of its advertising strategy. Despite this, Sunny loans averaged [✂] monthly searches, whereas Wonga averaged 823,000, three times as much as its nearest competitor, which was the generic term ‘Payday loans’ (at 246,000). Research had shown that 80% of borrowers would borrow from the same lender again as a default position, which for Sunny loans meant that it was only competing for the 20% of the market represented by new borrowers. It believed that some of the contemplated regulation could lead to even fewer new borrowers and more entrenchment of consumers with the existing competitors, which would likely lead to Think Finance exiting the market.

18. The three major loan providers in the UK all had high brand recognition. Total media spend in payday loans had increased from £24.5 million in 2011 to £48 million in 2013. Television advertising was a very important channel in terms of building credibility with the customer, although it was very expensive in relation to other acquisition channels. Wonga was the major media spender and Think Finance was committed to increasing its media spend to increase its brand awareness. [✂]

19. Think Finance did use three credit reference agencies (CRAs), but the data provided did not provide a complete indication of affordability. It thought that

real-time data would be a positive step and useful in assisting in affordability checks, some calculation or aggregation of expenditures as well as income validation.

**Price and non-price competition**

20. Think Finance believed that current regulations required that some information on price was provided to consumers but that the way the cost of borrowing was currently shown to consumers did not adequately inform them of the true cost of borrowing (for example, extra fees, the cost of rollovers and daily versus monthly interest). Think Finance thought that many consumers had given up comparing loans to get the best deal and elected to choose a branded product. Even when consumers did shop around, the price comparisons, which tended to be based on APRs, were all high.

21. In terms of non-price competition, Think Finance thought that accessibility (ie speed, convenience and availability) and brand recognition were the key factors in a customer's decision-making. Flexibility was occasionally considered but education and financial literacy were not factoring into consumer decisions at all at the present.

22. There were categories of consumers, such as young people, who viewed short-term loans as a lifestyle choice, who wanted money faster than they earned it and who had the funds to meet the repayments. There were also those whose credit history had been damaged during the financial crash of 2008 and were now on a more financially robust footing, but found that companies would not lend to them.

23. Think Finance saw an opportunity in the UK market to bridge a gap between payday lending and mainstream lending. [✄] The Sunny loan did not set out to circumvent regulation or interpret it in the most general sense. Regulators, experts and activist groups had been consulted during the design of the product and their views taken on board.

24. The interest rates for Sunny ranged from 15 to 29%. The top rate had been determined purely by wanting a rate that was lower than Wonga. It did not have any fees, only an interest rate; repayments were flexible; and consumers could work towards lower interest rates by making payments on time and participating in financial literacy training. [✄] New customers could get the 15% rate on their first application, but the number of customers who could obtain this was limited to a percentage of loans. It saw this as an advantage for future development.

25. Sunny was currently on its third generation of risk model in the UK. It took around three to four months to gather enough data about performance and as a new company, it expected its risk modules to improve in the future. Communicating risk-based pricing to customers had proved challenging due to advertising regulations and various channels were being explored.

26. Think Finance believed that a combination of a simple product design and more financial literacy would lead to a better understanding for consumers of what they would actually pay for a loan, and thus better consumer decisions. The high profit margins of the major loan companies provided an opportunity for Sunny loans to deliver a good product at a better price and remain profitable. Sunny was still in the early days and was not yet profitable but Think Finance believed it was progressing towards this. Pending regulation could dramatically change this, however, which would force it to reconsider its position in the UK.

**Profitability**

27. Think Finance was still losing money but that monthly figure was steadily shrinking as it made progress in terms of its risk modelling, improving its underwriting, understanding which marketing channels worked and which ones did not and tailoring its advertising to attract the right population. Think Finance was comfortable that it would eventually become profitable as it had done so before in the USA but noted that other companies might not have the resources to last the course.

**Barriers to entry**

28. It was possible to enter the market but barriers to entry were high. It was only well-funded companies with risk expertise that could enter the UK market and compete with the three largest companies. Think Finance thought that with the current regulatory uncertainty and the severity of some of the regulations being contemplated, potential new entrants might struggle to secure the necessary funding needed to enter the market and compete in a meaningful way.

29. Think Finance identified a number of barriers to entry in the short-term loan market, including the limited number of price comparison websites available, the difficulty associated in comparing APRs and customer inertia. More experienced customers were less likely to switch. High acquisition costs for new customers (in terms of the high marketing spend needed to overcome entrenched brands), developing understanding of risk and reputation were also difficult barriers to overcome.

30. Think Finance saw the marketing spend and investment in brand awareness of the three largest short-term loan providers in the UK as a significant barrier to entry for any new company, no matter how innovative its product was. This, coupled with the time required to develop robust risk models, led to a very expensive cost to enter the UK market.

31. Think Finance noted that a large number of comparison websites did not include payday lending because of media pressure, which had resulted in Google penalising sites that offered payday loans. This had had the effect of diminishing consumer awareness and the potential for better comparison options.

**Regulation**

32. Think Finance was in favour of a true cost of borrowing comparison tool funded by all the lenders and run independently, which it believed would encourage companies to compete on the total cost of credit, and an information sheet highlighting free debt advice for customers before they rolled over a loan. It considered that real-time data sharing would make a big difference for new entrants, reducing the risks to business through inappropriate lending. However, the way in which the real-time data sharing was used and the timing and specifics of the data sharing were essential to these benefits being realised. Critically, limiting the number of loans could prove highly anti-competitive because entrenched competitors would have the advantage of knowing pay-off dates and consumers would not have the ability to experiment with new and possibly better lenders, thus entrenching them in what could be a less than optimal financial relationship with a single lender. Think Finance also thought that APRs should be replaced with a usable metric for consumers.

33. It supported the limit on two rollovers, which it thought would encourage consumers to shop around more and prevent them from being locked in with a lender because they would not be able to roll over continually.

34. It believed that caps on default and late fees would be a positive development, but that the proposed rate cap on the cost of customer borrowing would damage the market because capping the first loan would reduce competition, as new entrants would find the early days of lending, where risk models were still maturing, to be too expensive.

35. It believed that limiting the use of continuous payment authority to two failed attempts would reduce collection efficiency, thereby affecting default rates and possibly resulting in higher pricing. It could also lead to outsourcing of

collections and/or departure of businesses from the market if firms were not able to collect by other means.