PAYDAY LENDING MARKET INVESTIGATION

Summary of provisional findings report

Notified: 11 June 2014

Background and context to our investigation

1. On 27 June 2013 the Office of Fair Trading (OFT), in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act), made a reference to the Competition Commission (CC) for an investigation into the supply of payday lending in the UK. On 1 April 2014, the Competition and Markets Authority (CMA) took over many of the functions and responsibilities of the CC and the OFT, including in relation to this investigation.

2. This document sets out our provisional findings on whether any feature or combination of features in this market prevents, restricts or distorts competition, thus constituting an adverse effect on competition (AEC).

3. Payday lending has been, and continues to be, an issue which attracts a large amount of political and media attention. Our investigation is taking place against this background and changes to regulation of the sector. The Financial Conduct Authority (FCA) assumed responsibility for consumer credit regulation from 1 April 2014. In October 2013, it published its detailed proposals for the FCA regime for consumer credit, including payday lending, which formed the basis of its new conduct of business for consumer credit (CONC) rules now in force. As part of that new regime, the FCA has made new rules to address two issues which have been the subject of much publicity – namely the number of times that a loan might be ‘rolled over’ and the extensive use by lenders of continuous payment authorities (CPAs) to recover debt from a borrower’s bank account. Also, following an announcement in November 2013, Parliament passed legislation which places a duty on the FCA to impose a price cap on the cost of payday loans by 2 January 2015.

4. The question that we consider in this document – of whether competition is working well in this sector – is an important one. Effective competition benefits consumers. In a well-functioning market, the competitive process encourages suppliers to keep their prices low, to innovate and to improve the service they provide to consumers. There is a clear demand for short-term, small-sum credit, which many customers are currently meeting by taking out a payday

loan. Shortcomings in the competitive process can lead to customers paying more than they need to for their loans.

5. In conducting our investigation, we have been aware of the wide range of concerns that regulators, consumer groups, debt-advice charities and other interested parties have expressed about the operation of the payday lending sector. These concerns have centred on a variety of issues, including whether lenders are acting responsibly when assessing whether customers can afford to meet the repayments due on a loan, whether advertisements for payday loans are misleading or inappropriate and whether sufficient forbearance is shown to customers who get into difficulties in meeting repayments.

6. It is clear to us that a number of these important issues go wider than the question of competition in the provision of payday loans which we are required to consider under the market investigation regime. We have been aware of the work undertaken in parallel by the FCA and the other bodies responsible for other aspects of public policy in relation to payday lending, including the introduction by the FCA of its new CONC rules, to tackle a number of the problems that have arisen in this sector in recent years and which had been identified by the OFT in March 2013 in its review of compliance by payday lenders. In addition to the normal benefits of a competition review, we expect our in-depth market investigation to inform and enhance the work of the FCA and of the other stakeholders with an interest in payday lending, by providing detailed evidence and analysis of the way the market operates. We have kept closely in touch with the FCA during our investigation and have shared information and data with the FCA, in response to its requests, in accordance with our own statutory responsibilities in relation to the information we collect.

7. In carrying out our work, we have been mindful of the implications of changes to the way that payday lending is regulated and the evolution of the market. Our assessment of competition is, by necessity, based on how competition is working now and how it has been working over recent years. In reaching our final conclusions about whether any features of the market lead to an AEC, we will seek to take into account the impact on competition of regulatory changes and other market developments. Likewise, we will consider any remedies in the context of the proposed price cap, once details of the FCA's proposals are published, and other relevant developments.

An overview of the payday lending sector

8. Payday loans are short-term, unsecured credit products, which are generally taken out for 12 months or less. The average loan size is £260 and nearly all payday loans are for £1,000 or less. Within this broad definition a variety of

products are offered, including ‘traditional’ payday loans repayable in a single instalment within one month or less and longer-term loans where the loan is repaid in a number of instalments over several months. The average duration of a payday loan is just over three weeks.

9. During the 2012 financial year, total payday loan revenue was around £1.1 billion, with lenders issuing approximately 10.2 million payday loans, worth £2.8 billion. These figures represented a 35 to 50% increase on the preceding financial year – depending on the way in which the size of the market is measured – though more recent data indicates that this rate of growth has reduced substantially in 2013. We estimate that there were around 1.8 million payday loan customers in 2012. Customers often take out multiple loans over time and many use more than one lender – we estimate that an average payday lending customer takes out around six loans in a 12-month period, and that approximately four in ten payday lending customers used more than one lender in 2012.

10. Payday loans may be taken out online or on the high street. Most payday loan customers borrow online. We found that 83% of payday lending customers have taken out a loan online and 29% of customers have taken out a payday loan on the high street. There is some overlap, with 12% of customers having used both channels. The average amount borrowed on the high street (£180) was lower than that borrowed online (£290).

11. As part of the application process, payday lenders will carry out an assessment of a customer’s creditworthiness and their likelihood of successfully repaying the loan. Most lenders have developed their own automated risk models, of varying degrees of sophistication, to help them make decisions about the creditworthiness of potential applicants, developed using historical customer information. The rate of loan applications that are turned down is well above 50% for many of the major lenders.

Payday loan customers and their use of payday loans

12. The median net income of an online payday lending customer is £16,500 – broadly similar to that of the wider UK population (£17,500) and significantly more than high-street borrowers (£13,400). Overall, the distribution of payday lending customers’ incomes is somewhat narrower than that for the UK population – with fewer individuals with particularly low or particularly high incomes. Payday lending customers are more likely to be male and in full-time work than the population as a whole, to be younger than average and to live in larger households.

13. We investigated whether payday lending customers had experienced any credit or financial problems within the past five years. 38% of customers reported that they had experienced a bad credit rating, 35% had made arrangements with creditors to pay off arrears, 11% had experienced a county court judgment and 10% had been visited by a bailiff or debt collector. In total, 52% of customers reported having experienced one or more of these debt problems in the last five years.

14. We asked customers what they had used their most recent payday loan for. Just over half (53%) of customers told us that they had used the money for living expenses (such as groceries and utility bills), 10% said the money related to a car or vehicle expense and 7% said general shopping such as clothes or household items. When asked why they needed to take out a payday loan, 52% of customers said that the loan was linked to an unexpected increase in expenses or outgoings and 19% said the need was due to an unexpected decrease in income. 93% of those who said their need was due to a change in financial circumstances thought this change was temporary whereas 5% expected the change to be permanent. Payday loans are particularly likely to be taken out on Fridays and are somewhat more likely to be taken out at the beginning and end of the month.

15. 64% of payday loans issued in 2012 were repaid in full, either early or on time. 22% of loans were repaid in full, but after the originally agreed repayment date (including loans that were refinanced or 'rolled over'). 14% of loans issued in 2012 had still not been repaid in full by October 2013. Online customers are more likely to repay loans in full on time than high-street borrowers and the proportion of customers repaying in full on time varies significantly by lender. Customers who have previously taken out a loan with a particular lender are significantly more likely to repay a subsequent loan with the same lender in full and on time than are customers taking out their first loan with a lender.

16. When taking out their loan, customers were usually confident about their ability to repay it by the agreed date. However, a significant minority of customers (17%) reported having found getting money to repay their loan to be more difficult than they had expected. This proportion is significantly higher for those customers who: *(a)* had previously taken out payday loans in order to pay off debts to other payday lenders; *(b)* had a poor understanding of financial terms and conditions; *(c)* had been refused loans before; *(d)* had experienced debt problems in the last five years; and *(e)* said that they had taken out a payday loan as a last resort.

Repeat borrowing

17. Customers' demand for payday loans is typically recurring. Our analysis of loan-level data suggests that around three-quarters of customers take out more than one loan in a year, and that on average a customer takes out around six loans per year. These findings are broadly consistent with the results of our customer survey.

18. Furthermore, repeat custom typically accounts for a large proportion of lenders' business. More than 80% of all new loans in our data set that were issued in 2012 were made to customers who had previously borrowed from the lender. On average, payday lending customers take out a further 3.6 loans from the same lender within a year of their first loan from that lender. Around 40% of customers had a borrowing relationship with their lender of more than one year.

19. Many customers also borrow from more than one lender. We estimate that around four in ten payday loan customers borrowed from more than one payday lender in 2012, and that on average a customer used 1.9 lenders. In line with this, 45% of respondents to our customer survey reported having ever used more than one lender. Much of the use of multiple lenders that we observed took place concurrently – ie while a loan was outstanding with another lender – or following a repayment problem with a previous loan.

20. In addition to taking out new loans, many borrowers extend the duration of their credit with their current lender by rolling over an existing loan. In 2012, around 20% of the loans in our data set were subsequently rolled over – with 16% of online loans and 26% of high-street loans rolled over. On average, loans which were being rolled over were extended 2.5 times.

Payday lenders and other market participants

21. There were at least 90 payday lenders offering loans to UK customers as of October 2013. However, the market is more concentrated than this figure might suggest, with the three largest lenders (CashEuroNet, Dollar and Wonga) accounting for around 70% of total revenue generated from payday lending in the UK in the 2012 financial year and the ten largest lenders accounting for more than 90%.

22. Around 40% of payday loan customers taking out their first loan with an online lender apply via the website of a lead generator. Lead generators are companies that contract with payday lenders to provide potential customer applications (or 'leads') in return for a fee for each lead provided. Online customers who do not apply via a lead generator may access lenders' websites directly, or by other means including using a search engine such as

Google, via the websites of marketing affiliates and, to a lesser extent, by using price comparison websites.

23. Most payday lenders purchase information from credit reference agencies (CRAs) regarding applicants when carrying out a credit risk assessment. These CRAs hold large databases of individuals' personal information, past credit history and current credit commitments. This shared data is available on commercial terms to lenders. Currently, lenders usually provide information to the largest CRAs on a monthly basis; however, two CRAs (Call Credit and Experian) have publicly announced that they are developing systems to allow lenders to provide and access information in real time or near real time.

The regulation of payday lending

24. As part of its response to the financial crisis of 2008, the Government made important changes to the regulation of financial services and banking in the Financial Services Act 2012. This resulted in the abolition of the Financial Services Authority and the transfer of its functions to two new bodies: the FCA and the Prudential Regulatory Authority. That Act also enabled the transfer of regulation of consumer credit from the OFT to the FCA.

25. Payday lenders, like any other consumer credit providers, are subject to a variety of regulatory obligations, most of which are now overseen by the FCA. As such, for example, payday lenders are required to give borrowers specified information before entering into a consumer credit agreement, to conduct a reasonable assessment of affordability, to monitor repayments and to show forbearance in resolving customers' repayment problems. Now that consumer credit is regulated by the FCA, no person may issue a payday loan, or offer any other form of consumer credit, unless that person holds either an interim permission from FCA, or has been authorised by the FCA. Over the next two years, payday lenders and other credit providers will be invited to apply for full authorisation. Like other firms regulated by the FCA, all firms providing consumer credit loans will have to comply with the high-level Rules in the FCA's Handbook, for instance with regard to treating customers fairly and cooperating with the regulator.

26. In addition, a number of further rules apply specifically to high-cost short-term credit lenders (essentially payday lenders). The rationale for these stems from widely expressed concerns about the operation of the payday lending market, including a review by the OFT of compliance by payday lenders which it published in March 2013. This pointed to a significant degree of non-compliance with consumer credit legislation and regulatory requirements. In particular, the FCA's CONC rules and guidance prohibit lenders from rolling over payday loans more than twice and provide that from 1 July 2014 no more

than two unsuccessful attempts to take a payment with a CPA can be made and a CPA must not be used to take part payment.

27. Following an announcement in November 2013, the Government introduced legislation to impose a duty on the FCA to place a cap on the charges which may be imposed in relation to payday loans. The FCA plans to consult in July 2014 on its new price-capping obligations, which must come into force no later than 2 January 2015.

Assessment of competition in the UK payday lending market

28. In assessing whether competition was working well for payday lending customers, we looked first at evidence on pricing and other outcomes of the competitive process. We then considered the causes of these market outcomes by examining the adequacy of the competitive constraints acting on payday lenders from other forms of credit, the need to attract and retain customers and the threat of new entry and expansion.

Evidence of market outcomes

29. Payday lenders use a variety of different pricing structures, and the amount that a customer pays for a loan will usually consist of several distinct charges or fees. Among other factors, the cost of a loan will typically depend on the desired loan amount, duration and instalment structure; whether the loan is repaid on time, extended or topped up; and whether the customer opts to pay an additional fee in order to receive the sum borrowed more quickly.

30. We found that the prices of payday loans tend to cluster around a headline price of £30 for a £100, month-long loan. The lenders charging monthly interest around this level include some of the largest providers. In addition, several products with prices that are above £30 for a £100 month-long loan nevertheless carry headline interest rates of approximately 30% a month or 1% per day. This clustering in headline prices has emerged over time as increasing numbers of lenders have increased their prices to this level.

31. Nevertheless, we continue to observe some significant variation in the prices that different lenders charge in a number of representative borrowing scenarios. For example, the difference between the cost of borrowing £100 for 28 days using the cheapest product included in our review and the most expensive alternative was £39. The extent of price dispersion was even greater in the event that a customer repays their loan late.

32. Headline price changes are infrequent, and many lenders have made at most one change to their products' headline rate since 2008. Aside from a small

number of relatively recent developments, price reductions, whether by reducing the price of existing products or via the introduction of new products, have been particularly uncommon. There is some evidence of competition between lenders taking place via the use of price promotions, but the coverage of the price promotions used by payday lenders is usually limited.

33. We found that customer demand responds weakly to prices. Where lenders have changed their prices, this has not generally resulted in a significant customer response. Lenders that have offered substantially lower rates have not been particularly successful in attracting new business. The submissions of lenders and patterns of price dispersion that we observe suggest that customers may be particularly unresponsive to changes in late fees and other charges incurred if a customer does not repay their loan in full and on time. We have observed a significant proportion of customers taking out loans that are significantly more expensive for their given borrowing requirements than other payday loan products potentially available to them at the time.

34. We concluded that our analysis of pricing behaviour indicated significant limitations in the effectiveness of competition between payday lenders on prices, and that the competitive constraints that lenders face when setting their prices are weak.

35. This conclusion is consistent with our profitability assessment, which shows that the three largest lenders have had high and in some cases exceptional returns that have been substantially above the cost of capital over much of the past five years. The average annual return on capital employed of the major lenders included in our analysis ranged between 28 and 44% during the period 2009 to 2013. There is significant variation in the profitability of smaller lenders – with some making losses – and some evidence that future profitability may be lower than recent levels, both because of a slowing down in market growth compared with historic rates and due to regulatory changes which may increase costs and/or reduce revenues.

36. In contrast to the evidence on pricing, our analysis suggested that lenders compete on certain non-price aspects of the product offering – including launching new products and introducing faster payment services and other product features – and lenders told us that they sought to provide good customer service in order to retain borrowers. To some extent, this was supported by reported levels of customer satisfaction, which were high for some lenders. We were also aware, however, that the serious problems identified by the OFT and others about irresponsible lending and compliance with lenders' regulatory obligations clearly indicate that not all payday lending customers have benefited from good customer service. While noting this evidence of non-price competition, we took the view that lenders in a well-

functioning market would also be expected to compete on prices to a greater degree than we had observed.

Market definition and competition from other forms of credit

37. The characteristics of payday loans differentiate them from many other credit products, which often do not allow customers to borrow such small amounts for short periods, access funds as quickly, or require some security. With the exception of unauthorised overdrafts, borrowing using alternative credit products is generally significantly cheaper than using a payday loan (borrowing a similar amount for a similar duration using an unauthorised overdraft can be substantially more expensive).

38. We noted that it was relatively common for payday loan customers to use other forms of credit. However, a significant proportion of payday lending customers have experienced credit repayment problems in the past, and the evidence that we saw suggested that many customers would be constrained in the extent to which credit would be available using alternative products at the point at which they take out a payday loan.

39. Customer research suggests that in general customers taking out a payday loan do not consider other credit products to be a close substitute – only 6% of respondents to our survey reported that they would have used another credit product had they been unable to take out a payday loan. Partly this is due to the fact that many payday customers do not have credit alternatives available to them when taking out their payday loan. In addition, some customers may prefer payday loans because of the convenience, speed or discretion associated with these products, or because of a negative perception of alternatives such as a concern that spending on credit cards could more easily get out of control. We saw no substantive evidence of payday lenders taking developments in the pricing of other credit products into account when setting payday loan prices.

40. Given this evidence and the market outcomes that we observed, we reached the view that competition from other credit products was likely to impose only a weak competitive constraint on payday lenders, and in particular on their pricing.

41. We considered whether it was necessary to define separate markets for online and high-street lending and/or to identify distinct geographic markets within the UK. We found that, while some customers may have a preference for particular distribution channels, the level of segmentation was not sufficiently great to require us to define separate markets for online and high-street payday loans. We noted, in particular, that the possibility of substituting

to online lenders was likely to impose a significant constraint on high-street lenders. Given this, the lack of local variation in high street lenders' offering and the relative ease with which lenders are able to open new stores in different local areas, we also did not consider that competitive conditions would differ across local areas such that it was necessary for our competition analysis to define separate local geographic markets.

42. We therefore provisionally concluded that the market relevant to our assessment of competition is the provision of payday loans in the UK.

Competition for payday lending customers

43. We reviewed patterns of shopping around and switching among payday loan customers. Our customer survey indicated that more than half of all payday loan customers do not shop around at all prior to taking out a loan. High-street customers are particularly unlikely to compare different lenders' products before taking out a loan. Where customers do shop around prior to taking out their loan, they most commonly report doing so using information on lenders' websites.

44. Around four in ten payday lending customers have used more than one lender, and so will have some direct experience of the loan terms offered by different suppliers. However, we found that much – though not all – of this use of multiple lenders takes place in situations where customers are constrained in their ability to borrow further amounts from an existing lender – for example, where they already have a loan outstanding with a lender, or have experienced a repayment problem with a previous loan. Where customers are able to access credit from an existing lender and are happy with the level of service provided by that lender, they often do not consider alternative lenders when looking for a subsequent loan.

45. We identified the following combination of market features which have given rise to the limited responsiveness of customer demand to prices that we have observed in the UK payday lending market, and which reduce the pressure for lenders to compete to attract customers by lowering their prices. These features act in combination to deter customers from comparing the different loans available, to impede their ability to do so effectively, and to discourage repeat customers from considering and/or selecting a new lender that offers a better value loan for their needs:

   (a) The context in which customers take out payday loans is often not conducive to customers shopping around to find a good-value loan and may amplify the adverse effects of other barriers to shopping around and switching lender. Customers often perceive the need for their loan to be

urgent, and attach considerable importance to the speed with which they are able to access credit. Many payday loan customers are also uncertain, often with good reason, about whether, and from whom, they will be granted credit to meet their borrowing requirements. These aspects of the decision-making environment can tend to make customers reluctant to spend time shopping around for the best deal available, and can cause customers to focus on which lender is willing to lend to them (or, for a repeat borrowing, to stay with a lender that they previously used) rather than which lender offers the best-value product.

(b) It can often be difficult for customers to identify the best-value loan product on offer given their borrowing requirements. Despite information on headline rates generally being available on lenders' websites or in the shops of high-street lenders, customers' ability to use this information to identify the best-value payday loan is impeded by the complexity associated with making effective price comparisons given variation in product specifications and pricing structures across lenders, and the limited usefulness of the annual percentage rate in facilitating comparisons between payday loans. Existing price comparison websites, which might otherwise help customers compare loans, suffer from a number of limitations and are infrequently used.

(c) Customer demand is particularly insensitive to fees and charges incurred if customers do not repay their loan in full on time. Customers tend to be less aware of these potential costs of borrowing than they are of the headline interest rate when choosing a payday loan provider. This is in part because over-confidence about their ability to repay the loan on time can cause some customers to pay only limited attention to these costs when taking out their loan. Even where customers seek to anticipate the costs associated with late repayment, the information generally provided about such costs is significantly less complete, less easy to understand and/or less prominent than information on headline rates. It can therefore be difficult for customers to estimate, and so make effective comparisons about, the likely cost of borrowing if they do not repay their loan in full on time.

(d) Many online customers take out their first loan with a lender via a lead generator's website. Lead generators typically promote their ability to find customers a lender willing to offer them a loan within a short period of time. The value for money represented by different lenders' loan offerings is not taken into account in the auction process operated by lead generators, who instead sell customer applications to the highest bidder. Furthermore, there is often a lack of transparency in how the service that lead generators provide is described in their websites – particularly the

basis on which applications are matched with lenders – and many customers do not understand the nature of the service offered by lead generators. An implication of the operation of this distribution channel is that lenders acquiring customers through lead generators are unlikely to have a strong incentive to lower their prices. The lead generator model may also create an incentive for lenders to increase prices to customers, as lenders offering cheaper loans would find it harder to bid high prices in lead auctions and hence acquire valuable leads.

(e) Where their choice of lender is not dictated by concerns about credit availability, customers can be dissuaded from looking at alternative suppliers by the perceived risks associated with using a new lender (ie one they had not used previously), particularly in light of the negative reputation of the payday lending sector. Customers may perceive a loss of convenience associated with applying to a new lender, particularly if the alternatives are rolling over or topping up an existing loan with an existing lender. These factors further reduce the constraint placed on lenders by the threat that existing customers will switch to another lender offering a better-value product.

Entry and expansion

46. We noted that the first UK payday lenders began offering loans ten years ago or more. Since then, we have observed firms employing a variety of different entry strategies, including start-ups, firms entering by acquisition, entry by North-American-based lenders, and diversification by lenders originally offering non-payday credit products. The payday lending sector as a whole (high street and online) has expanded rapidly in recent years, with growth particularly strong between 2010 and 2012. Wonga has expanded particularly rapidly since its entry in 2008 and CashEuroNet has also increased its share of supply significantly. Entry by companies into the payday lending sector has been observed regularly since 2008, at a rate of at least two to five new entrants per quarter. These patterns indicate that historically large numbers of lenders have managed to enter the market, and that a few lenders have been very successful in growing their businesses. Further, recent entrants were often optimistic about their ability to expand successfully to the next stage of their development.

47. Notwithstanding these historic patterns, and as indicated by the evidence on market outcomes, entry by new firms into the payday lending market does not appear to have resulted in existing lenders facing an effective constraint when setting their prices.

48. One reason for this is the factors described above which reduce payday customers' sensitivity to prices, and weaken price competition between lenders. For example, on many occasions where we have observed new providers entering payday lending, these lenders have relied to a large extent on lead generators for new customers: a lender sourcing new customers via a lead generator is likely to have little or no incentive to compete on prices (see paragraph 45*(d)*45(d)).

49. In addition, the competitive constraint that might otherwise be imposed on payday lenders' prices by the prospect of new entry or expansion is further weakened by the following market features:

(a) New entrants will face certain disadvantages relative to more established lenders, in particular:

(i) The ability of new entrants to expand and establish themselves as effective competitors is likely to be obstructed by the difficulties associated with raising customers' awareness of their product in the face of the barriers to shopping around and switching summarised in paragraph 45, the strength of the well-established brands that already exist in the market and the costs associated with advertising on a sufficient scale to be effective in overcoming these obstacles.

(ii) While the ability to assess credit risk accurately is a necessary requirement for any provider of personal credit, it is likely to be a particularly important determinant of a provider's success in the payday lending sector, because of the relatively high credit risk profile of payday lending customers and the significant limitations associated with the information available to lenders about these customers from CRAs. Because of their greater reliance on new customers and the role of learning in the credit risk assessment process, new entrants are likely to face some disadvantages in their ability to assess credit risk for a period, which would put them at an initial cost disadvantage relative to more established providers.

(b) The history of non-compliance and irresponsible lending by some payday lenders and the resulting negative reputation of the sector are likely to reduce the constraint imposed on payday lenders' pricing by the prospect of new entry. In particular, the reputation of payday lending is likely to deter some businesses with established reputations in other sectors – such as mainstream credit suppliers – from entering the market. This reduces the likelihood of entry by parties with the capability to transform the nature of competition in the market. Potential entrants may also be dissuaded from entering payday lending by the difficulty – itself linked to

the current reputation of the sector – in establishing banking relationships, and the very small number of suppliers currently willing to provide banking services to payday lenders.

Provisional findings

50. For the reasons set out above, we have provisionally found, pursuant to section 134(1) of the Act, that there are a number of features in the provision of payday loans in the UK which contribute to, and help to explain, the failure by many payday lenders to compete on price and which either alone or in combination give rise to an AEC within the meaning of section 134(2) of the Act. These features are:

(a) The structural and conduct features set out in paragraph 45, which limit the extent to which customer demand is responsive to the price of payday loans, and so reduce the pressure for lenders to compete to attract customers by lowering their prices. These features relate to: (i) the context in which customers take out payday loans; (ii) difficulties customers face in identifying the best-value loan for them; (iii) customer insensitivity to fees and charges incurred if they do not repay their loan in full on time, itself linked to the difficulty of finding out the relevant information; (iv) the operation of the lead generator distribution channel; and (v) the perceived risks and loss of convenience of switching lender.

(b) The structural features summarised in paragraph 49 which weaken the competitive constraint that might otherwise be imposed on payday lenders' prices by the prospect of new entry or expansion by smaller lenders. These features relate to: (i) disadvantages faced by new entrants in raising customers' awareness of their product (partly because of the features described above in subparagraph *(a))* and in assessing credit risk; and (ii) the impact of the reputation of the payday lending sector in deterring potential entrants.

51. We identified two sources of customer detriment which are likely to arise as a result of the AEC. We have provisionally identified:

(a) Some customers currently pay more for their loan than they would if price competition were more effective.

(b) There may be less innovation on pricing (eg in relation to the introduction of risk-based pricing or flexible pricing models) than we would observe in a market in which price competition were more effective.

52. Our initial assessment indicates that the scale of the customer detriment caused by the AEC is likely to be material. On the basis of a range of

plausible assumptions about the level of prices that might be observed in a market in which price competition were more effective, we estimated that, on average, borrowers are overpaying by around £5 to £10 per loan. This is relative to a typical loan of £260 taken out for just over three weeks, and with a total cost of credit for a customer that repays in full and on time of around £75. Applying these savings to the total number of loans issued in 2012 that were repaid in full would imply potential annual savings to customers from having more effective price competition in excess of £45 million per year. In addition, we considered that the current use of risk-based pricing and flexible pricing models was undeveloped relative to the level that we might expect to see in a well-functioning market, and so a further detriment (which we did not seek to quantify) was likely to exist associated with the overall level of market efficiency and the extent to which prices currently reflect the cost of supplying different groups of customers. These figures are indicative, and we will examine further the extent of customer detriment, and the benefits of effective intervention, during the next stage of our investigation.