Market investigation into payday lending

Response by Dominic Lindley to the notice of possible remedies

I am concerned that the CMA provisional remedies fail to take into account the current dynamics of competition in the payday loan market. Namely, that the current structure of the payday loan market means that firms may extra profit from irresponsible lending / debt collection practices, roll-overs and excessive ancillary charges. Indeed, it seems that customer acquisition costs are so high that payday lenders cannot make a profit unless the consumer is in debt for months and takes out repeated loans.[1] In these circumstances, the lump-sum business model creates its own demand by trapping consumers in a lifecycle of debt. Unless these dynamics change, the CMA's remedies of providing consumers with additional information or access to a price comparison site are unlikely to be effective. So in addition, the CMA should recommend:

- A cap on default charges, additional fees and default interest to reflect the net administrative costs incurred when consumers pay late.
- Controls on default charges to prevent the repeated application of default charges
- A price cap for the market which restricts the ability of firms to make excessive profits from roll-overs, repeat borrowers and from lengthening the time period of the additional roll-over payday loan
- Further restrictions on roll-overs by limiting them to 1, stopping firms from extending the duration of subsequent roll-over loans and strong enforcement of restrictions on the use of Continuous Payment Authorities
- The establishment of 'real-time' data sharing which will enable an overall cap to be set on roll-overs, instead of consumers being able to avoid this cap by switching between lenders.

In proposing its remedies the CMA should also take into account research which finds that there is no evidence that payday loans alleviate economic hardship or benefit consumers. Enhancing competition in the payday lending market which increases consumers' use of the conventional lump-sum payday loan (even if it lowers prices) could actually cause consumer detriment. This is particularly the case where payday loans are taken out to repay existing debt.

Instead, the CMA and the FCA should examine the experience of Colorado, which attempted to eliminate the conventional lump-sum payday loan and moving to more affordable installment loans.[2]

1. Price comparison website

[1] See ACCA, Payday lending, Fixing a broken market, http://www.accaglobal.com/content/dam/acca/global/PDF-technical/other-PDFs/pol-tp-pdlfab-payday-lending.pdf

[2] Pew Charitable Trust, Payday lending in America: Policy solutions, Report 3, October 2013

Before proceeding with this remedy, the CMA should evaluate the lessons from the lenderscompared.org.uk price comparison site which was recommended by the 2005 Home Credit Competition Commission inquiry. The main challenges in establishing a price comparison site will include:

- Difficulty in encouraging all lenders to participate
- Difficulty in encouraging consumers to use the comparison site when they value speed and accessibility over price
- Problems promoting the site with a very limited advertising budget when compared with commercial comparison sites which will gain revenue from selling leads to lenders

I also have concerns that by establishing a price comparison site the remedy will encourage more consumers to use payday loans. Researchers in the United States found that there was no evidence that "payday loans alleviate economic hardship". Worryingly, increasing access to payday loans causes difficulty paying rent, mortgage and utility bills – "Counter to the view that improving credit access facilitates important expenditures, the results suggest that for some low-income households the debt service burden imposed by borrowing inhibits their ability to pay important bills."[3]

2. Measures to improve customer awareness of additional charges and fees

I agree with the CMA's analysis that consumers' over-confidence about their ability to repay their loans on time may cause them to pay only limited attention to late payment, roll-over and default fees when taking out a loan.

A survey by Which? found that one in five users of payday loans were hit by unexpected charges. It also found that in the last 12 months, more than half of the payday loan users surveyed had incurred charges because of missed or bounced payments.[4]

As the market is not fully competitive, higher default charges can be used to increase overall prices. It also distorts competition in the market, increases in additional charges would lead to a smaller decrease in demand than an equivalent rise in the headline cost of the loan. The additional fees and charges for default are a type of discontinuous pricing strategy that can be used by lenders to exploit consumer errors. The cost of a payday loan increases dramatically when consumers pay as little as one day late and can continue to increase dramatically if firms impose additional charges.

Requiring additional transparency as proposed by the CMA is unlikely to be effective in remedying the detriment caused to consumers by excessive late fees. Over optimistic borrowers are unlikely to see themselves as being subject to default fees and therefore not going to take them into account. As the cost of default will also vary by the behaviour of

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[3] Melzer, The real costs of credit access: Evidence from the Payday Lending market, 2011, http://qje.oxfordjournals.org/content/126/1/517.full.pdf
[4] http://www.staticwhich.co.uk/documents/pdf/which-report-credit-britain-making-lending-work-for-consumers-319871.pdf

the consumer, the CMA remedy would rely on consumers having foresight about the extent of their late payment.

Instead of the CMA's provisional remedy, it should recommend an immediate cap on default charges. This cap should be set at the limited net additional administrative costs incurred when consumers pay late. To prevent lenders simply shifting to a higher interest rate when consumers default there would also need to be controls on the additional interest which could be charged beyond the term of the payday loan.

3. Measures to help customers assess their own creditworthiness

The CMA should recommend that all lenders should be required by FCA rules to use 'quotation' searches, enabling consumers to shop around for credit without affecting their credit score.

4. Periodic statements of the cost of borrowing

Periodic statements of the cost of borrowing could have an impact on those who take out multiple payday loans. However, if they are sent out at a random time or a fixed time of the year then they may lack salience in consumer's decision-making processes. Therefore, the statements should also be made available when consumers are considering taking out additional payday loans or rolling-over existing loans.

The statement should include the total number of loans taken out and the total cost of these loans. These statements should also include health warnings about using payday loans and where consumers could go to get independent debt advice. It could also include links to sources of affordable credit such as credit unions.

The precise format and content of these statements should be tested in randomised controlled trials. The CMA should recommend that the FCA be given additional powers to require these trials.

5. Measures to increase the transparency of the role of lead generators

The activities of lead generators and intermediaries in markets with weak price competition can increase, rather than decrease the total cost to consumers. By forcing firms to compete for customers' details and increasing the costs of those details, they also encourage payday lenders to engage in irresponsible activity such as encouraging roll-overs and repeat borrowing. The costs of buying the lead means that payday lenders cannot make money unless consumers take out more than one payday loan.
The consumer detriment is increased by lenders which claim to help consumers find the best payday loan, but in fact, do not cover the whole of the market and sell the consumer's details to the highest bidder.

To avoid scope for regulatory arbitrage, any remedy aimed at credit brokers would need to ban authorised lenders from accepting leads unless they were from authorised brokers.

Without this remedy, lenders could continue to accept leads from websites which were not authorised or which are based outside of the UK.

Given the evidence that increasing access to payday loans can cause consumer detriment, the CMA should also consider a ban on authorised lenders selling on customers' details. Credit brokers should also be prohibited from storing a consumer's details in their system and re-selling them to multiple lenders. The consumer's details should only be used in connection with their original application for credit.