CMA
Competition & Markets Authority

PAYDAY LENDING MARKET INVESTIGATION

Summary of a response hearing with the Financial Conduct Authority held on Friday 1 August 2014

The market's reactions to regulatory changes

1. Since the previous hearing with the FCA on 6 March 2014, the FCA rules on rollovers and CPAs have come into force.

2. The transfer from the OFT regime to the FCA had been perceived by lenders as a significant change and has caused some lenders to reassess their compliance with regulatory requirements. The FCA noted that it was too early to comment on the impact of the changes to regulation of consumer credit.

3. The numbers of firms with interim permission was consistent with the numbers that the FCA had anticipated. The full authorisation process will start towards the end of 2014, with priority being given to areas of high risk including high-cost short-term credit (HCSTC).

The price cap

4. Parliament gave the FCA a duty to introduce a price cap on HCSTC to secure an appropriate degree of protection for borrowers against excessive charges. This must be in force by 2 January 2015. In its consultation paper on the price cap the FCA set out three questions which formed the analytical framework for supporting a decision on the price cap proposals. Firstly, what happens to firms and their lending decisions as a result of the cap; secondly, what options are there for customers who would no longer have access to HCSTC; and thirdly, are those customers better or worse off as a result of no longer having access to HCSTC?

5. The rationale for the proposed overall cap of 100% of the original principal is to provide a backstop on the total cost of credit and stop customers from getting trapped in a debt spiral. It is simple to understand and could be easily interpreted by firms, customers and debt advisers.

6. The FCA also proposed an initial cap of 0.8% per day of the amount borrowed on all fees and charges accruing on HCSTC loans. At this level it is estimated there will still be a small number of firms able to continue providing HCSTC as well as protection for the group of consumers who would be better off, on

average, by losing access to HCSTC and an overall benefit for those who continue using HCSTC at a lower price. The FCA had identified a number of lenders operating at rates below this element of the cap.

7. The FCA has proposed a £15 cap on fixed default charges (part of the overall 100% cap) which would provide an incentive to repay on time whilst avoiding excessive charges for consumers. Firms can also continue to charge interest after default, but not above the initial cost cap of 0.8%.

8. The FCA's general approach towards credit was to encourage responsible lending, where lenders do not lend unless they are confident the customer will be able to repay the loan.

9. The FCA's static analysis estimated that after the price cap, there may only be three or four lenders at low risk of exiting the market. However, these are very cautious estimates: that modelling did not include dynamic effects which are by their nature hard to predict. Whilst the static analysis estimates that all high street lenders are at risk of market exit, the FCA anticipates that some high street firms will respond to the cap and continue to offer HCSTC as part of a mix of products or services offered in their stores. One trade association has told the FCA that they thought there will be more innovation as a result of the price cap. Many of the smaller payday lenders were active in other lines of business, such as pawn broking, and some occupied a very particular niche so were likely to adapt and survive.

10. The FCA expected there to be scope for some price competition if the price cap is implemented as proposed. The FCA considered that if the CMA remedies were effective, they might encourage price competition below the price cap.

11. Another potential impact identified by the FCA was on the nature of the products on offer, such as the available duration of loan. The FCA had in general tried to structure the cap to be neutral on the length of the loan so that short and longer loans were still offered. However, the overall 100% cap meant that longer term loans over 4 months would need to be priced at lower than the daily interest rate cap or they would breach the total cost cap.[1]

12. The FCA has evidence that customers at the margins already have significant financial issues at the point at which they were granted a payday loan, and

[1] The maximum duration of a loan at 0.8% per day would be 125 days and thus for a loan to be available for a longer duration the daily interest rate would need to reduce.

the use of payday loans tended to exacerbate the problem rather than improve it for certain customers.

Competition

13. The FCA was keen to see encouragement of price competition in the HCSTC market. It agreed with the CMA's provisional conclusions that existing competition in the market is primarily on non-price factors, such as speed in getting the loan, brand recognition and advertising. Under the price cap proposals, the FCA believed there will still be opportunities for firms to differentiate their pricing within the structure of the cap, since they have not specified a cap on specific types of charges such as contingent or optional charges for example. Firms could choose how to structure their charges, providing they fall within the framework provided by the price cap.

14. In introducing the price cap, the FCA had made it clear that it expected it to lead to the exit of many of the lenders that were currently active in the payday lending market. It considered that this would ultimately be in the interests of consumers.

15. Consumers tend to buy products on the basis that they expect to repay so if there is price competition it is more likely to be around the headline rates for borrowing rather than default charges.

16. The FCA agreed with the CMA's provisional findings that many individuals currently taking out payday loans do not shop around on price. The FCA agreed with the suggestion in the CMA's Remedies Notice that if there was a reasonably well-promoted and well-known price comparison website (PCW) it could enable individuals to shop around more effectively.

17. Rather than creating a single PCW, the FCA considered that an accreditation scheme might be preferable. It agreed that any accreditation scheme for PCWs would need to have basic principles such as neutrality of display. It would also need to be consistent with the EU Consumer Credit Directive.

18. A commercially run PCW is more likely to be successful than a neutrally-badged industry-run PCW; especially given their marketing budget and visibility on search engines. Key words and speed in online searches are important considerations in this market where the average consumer is younger than the norm for financial services and usually have lower incomes than the national average.

19. The FCA has looked at PCWs generally in a number of sectors, but it has not to date considered whether it could or should run an accreditation scheme for PCWs comparing payday loans.

Additional fees or charges

20. The FCA supports the idea that as a matter of principle, charges should be as clear and comprehensible as possible. The FCA emphasised that remedies in this area would need to be consistent with the EU Consumer Credit Directive.

Creditworthiness

21. FCA guidance already makes clear that firms undertaking credit reference agency (CRA) searches should not leave evidence of an application if the customer is not ready to apply. The use of quotation searches at some points in an application for credit might encourage customers to shop around without affecting their credit files.

22. There may be value in firms making it clear to customers whether a credit check is going to happen or not. However, it is necessary to ensure that any requirements on firms take into account the need for firms to carry out adequate affordability and responsible lending checks, particularly in relation to how close lenders can get to making an offer without having done a full credit check. There is a balance to be struck between the potential lender's visibility of a customer's credit check history and ensuring that consumers are not deterred from shopping around. This is a difficult balance to find.

23. The FCA saw the potential for greater use of CRA products by lenders in complying with requirements to perform an assessment of affordability. The FCA said that current rules require proper affordability checks but stop short of saying that a credit check is always necessary. If a lender advances money without credit checking it would be very unlikely to meet the FCA's affordability requirements. The FCA has said that they expect at least 90% of the HCSTC market to be using and reporting in real-time by November.

24. The FCA noted that for a consumer to be certain about whether a lender was going to lend them the money, they had to go all the way through the application process and have a credit check done. There may be cases where customers had applications for credit refused simply because they were shopping around, but it is not feasible for firms to offer certainty to consumers without carrying out a full affordability assessment.

25. The FCA was concerned about limiting the visibility for firms of certain information held by CRAs, simply to allow the shopping around process to

occur. However, it would give further consideration to whether it would be possible to make it clearer to consumers when a credit check is going to happen.

26. However, the FCA was doubtful that a message warning the customer when a credit check was about to occur would make much difference, and this would need to be weighed up against any potential costs of requiring such a message to be provided.

27. The FCA was working with the industry on real-time data sharing and is supportive of the principle. The FCA think that comprehensive information on outstanding HCSTC commitments would be beneficial to lenders.

28. The FCA was not satisfied that there was currently enough sharing of information by lenders with CRAs in real-time. It would like to see lenders sharing with at least two CRAs. Having given a very clear steer of what it expected from players in the market, both in terms of the frequency of information provided and the number of agencies to whom it is provided, the FCA has indicated that it will take a view by November 2014 whether there is sufficient progress. If it does not see evidence of progress by November 2014 it would consider introducing data sharing requirements.

Periodic statements of borrowing

29. In its qualitative research, the FCA found that HCSTC customers could be more cash aware than the average consumer and recognised that payday loans were an expensive way of borrowing but took the view that they have no choice. Therefore some consumers may already be well aware of the information in the statements.

30. The FCA expressed the opinion that sending an annual statement for a customer who only ever takes out a single loan might be considered disproportionate, but it may be more useful when a customer takes out a number of loans with a single firm. It considered that it would be very difficult to construct an industry scheme whereby a customer going to several lenders would somehow be able to see an aggregated statement.

31. The FCA stated that any remedy on issuing a statement of borrowing costs would need to be carefully specified in order to avoid lenders using it as an opportunity to sell another loan to the customer.

Lead generators

32. Many lenders are currently dependent on lead generation, therefore in considering the effect the cost cap would have on lead generators, the FCA looked at what would happen to acquisition costs after the cap. It concluded that there might be a short-term effect whereby lenders would have less money to spend on leads as their revenue would be reduced by the cap, while at the same time specific types of lead would experience more demand since certain customers would no longer be profitable to serve and thus lenders would target certain customers. Despite this short term effect the FCA expected lenders' willingness to pay for leads to go down over time. Current feedback from lenders to the FCA suggested that there was more bargaining on the price for leads, as arrangements with lead generators were changing and some lenders were reducing the number of lead generators with whom they did business.

33. Since taking over the area of consumer credit, the FCA has found that lead generation is an area which generates a considerable amount of complaints. In relation to whether lead generators should disclose who they are and what they do, the FCA explained that this is already required by FCA rules, and it has put in place a range of supervision action in relation to this.

34. In terms of whether lead generators should disclose the nature of the commercial relationship between the lead generator and the lender, the FCA were concerned that a warning statement about this may not be effective as borrowers principal concern is borrowing money quickly.

35. The FCA requires firms to be clear, fair and not misleading in their communications with consumers. In particular, a firm stating that it is a lender when it is not is likely to be a breach of that rule. Where it has risk warnings in place, whether on payday loans or other products, it tended to specify exactly what the form of words to be used were because it could otherwise be open to quite subtle variations that can quite significantly reduce the impact of such warnings.

36. The FCA supervises credit brokers and looks at their relationships with third parties to see if the credit broker is properly managing those relationships, to the extent that they were, for example, outsourcing certain functions to third parties.

37. FCA rules already required lenders to take reasonable steps to satisfy themselves that the business they obtain from lead generators had been procured in compliance with FCA rules and data protection law.

38. The Consumer Credit Directive also applies to credit intermediaries but contemplates that Member States can go beyond its provisions and maintain or introduce additional obligations on credit intermediaries (see Article 21 and Recital 17).