CMA
Competition & Markets Authority

PAYDAY LENDING MARKET INVESTIGATION

Summary of a response hearing with Global Analytics held on Tuesday 29 July 2014

Recent developments and financial performance

1. Global Analytics (Global) trades in the UK under two brands: Lending Stream and Zebit, both of which are online loan providers. It told us that it generated a significant proportion of its business from lead generators.

2. In the first half of 2014, business had remained fairly steady and was recovering from a reduction in business in 2013. Global told us that Google changed its search algorithm in May 2013 which resulted in fewer visitors to Global's sites resulting in Global's peak new loan volumes falling by 50% between May 2013 and October 2013. This business was starting to pick up in December but the number of new applicants it was willing to lend to was still 35-40% lower than its peak in 2013.

3. As a result of the FCA's limit of two attempts of obtaining payment through continuous payment authority (CPA) (introduced on 1 July 2014) it had adjusted its underwriting model and was rejecting a further 30% of applicants that it previously would have lent to.

4. Global had been able to compensate for the reduction in new business through developing longer term relationships with repeat borrowers. The mix of new and repeat borrowers had changed significantly in the past year, with new borrowers accounting for 18% of loans issued compared to 40% at its peak. Global understood this trend to be consistent across the market.

5. Although its revenues were slightly down from 2013 (US $98 million in 2014 based on the first six months annualised compared to US $100 million in 2013) its profitability had increased because it had purchased less customers. However, Global told us that a reduction in purchase on leads in one year would reduce costs in that year and increase profitability, but would result in a reduction in revenue from repeat borrowing in subsequent years.

6. The customers Global had bought during the last two years were now becoming profitable, but continued profitability was dependent on these customers continuing to take out additional loans or Global identifying new customers. During the last four years Global had raised US $50 million of

institutional equity and had just broken even in terms of profitability. It was debatable as to whether Global would be able to generate enough customers to operate profitably under the price cap, and it would be challenging to break even from an EBITDA standpoint. Global had attempted to remove costs from the business by making its operations more efficient, improving customer service and lowering its overall operating costs. These measures have contributed to improved profitability. Zebit had been the smaller of Global's two brands. Global had hoped to make Zebit it its prominent brand but had decided to withdraw it from the market. Global had decided that seeking authorisation for two distinct products through the FCA authorisation process early in 2015 was the equivalent of bringing two different companies through the FCA authorisation process and Global did not have the management capacity at present to do so. Global was focussed on ensuring that its Lending Stream product was compliant with the FCA from 2 January 2015. It was in the process of putting together a longer term plan of what it would like to see in production.

7. Any future product development would be dictated by the FCA's rate cap guidance. Global thought that lenders' products would resemble five month instalment loans or open-ended line of credits. These were two very distinct sets of products. Open-ended line of credit products would be higher on the credit spectrum. Global currently had a six month instalment loan at Lending Stream. It might reduce the duration of this product but this would require a great deal of technical work (e.g. converting a monthly interest rate to a daily interest rate). [✄]. Global anticipates bringing new products to market in 2015.

8. [✄]

9. [✄][1]

10. It was argued in some quarters (politically) that those customers taking out payday loans would be worse off. Global performed the same essential analysis on the market and its customers as the FCA was conducing using advance econometric modelling. They found credit scores, which are proxy for credit health, generally improved for 90% of their customers.

11. Obtaining banking facilities or a merchant service provider in the UK and the FCA authorisation processes were significant barriers to entry.

12. Global was concerned about the effect of brand spend which it considered was essentially wasted value from a consumer standpoint. Global tested branding online and offline and found that customers would buy branded

[1] [✄]

loans even at a higher price (10 to 20% more than an unbranded product). When Global asked the consumers why they had purchased the more expensive product they explained that it was because they knew the brand. Global thought that increased regulation by the FCA would reduce the effect of brand value provided there was a budget to promote the fact that the industry was well regulated and that lenders must behave well.

13. There were other ways to compete other than price such as customer service. Global provided customer service 24 hours a day and seven days a week but thought it might have to consider areas that it might have to sacrifice as it looked to cut costs. If there were only four lenders left in the market they might compete in other areas, e.g. a better mobile app.

Price comparison websites

14. Global noted the creation of lenderscompared.org.uk and considered that the CMA could go further in payday lending and had the potential to create a high traffic price shopping portal with a common customer application that would enable better outcomes for borrowers, matching them with loan providers, competing on price charged to the customer, not price paid to the lead provider.

15. [✂]

16. Global thought the UK Government would be best suited to establishing a price comparison website (PCW) although it would be expensive and difficult to do so. A branded website, regulated by the FCA would give customers the confidence to use it knowing that they would be treated fairly. Lenders would also be supportive if the rules of the website included using quotation searches to provide a certain level of precision.

17. In order to be successful, the PCW would need to ensure better outcomes for borrowers matching them with loan providers based on the price charged to the customer and not price paid to the lead generator and facilitate new entry. It would also enable customers the flexibility to tailor the duration and price of the loan. The key factor in making the website a success would be whether the price shown was a true price reflective of a best offer or just reflective of the average price given to previous borrowers on the website. The results displayed as a result of a user's search should be neutral and not dependent on the commission paid by the lender or whatever payments the lender made to the operator of the site. The website would also need to provide the user with an experience that was compelling. It would be expensive to set up the site and Global was sceptical that the site could be done well. Removing the cost of using search engines such as Google would mean that lenders would

be able to pass on the savings to the borrower. Acquisition costs were Global Analytics second biggest cost, for every £200 that it generated it cost £[✂] to acquire that customer.

18. The introduction of a PCW would have a negative impact on lead generators. Global was more reliant on lead generators than any of its larger competitors and was concerned at impact on its business if the lead generator market disappeared too quickly. It would prefer to see the exit of lead generators occur over time as it would take it 12 to 18 months to build a brand.

19. Global thought that it should be a privilege for lenders to participate on a PCW rather than a requirement. Global noted that some low cost providers may not choose to participate. For instance, Southwest Airlines, which is the most efficient and profitable airline in the US, does not participate in any of the airlines PCW because there is a cost attached. Southwest operated its own site. Global thought it would be very difficult for lenders to set up their own PCWs because the savings with the rate cap were above and beyond those of a PCW. Global did not believe that there would be any lenders that would not want to participate in an industry accredited PCW.

The FCA price cap

20. Global thought that the price cap would result in a market with few lenders and very little price competition with lenders pricing to the cap. A large number of customers, which the FCA recognised, would not have access to credit because lenders would not be able to provide loans at the mandated interest rates. Global noted that in US states which did not permit payday loans the demand for credit did not fall away with them being replaced by substitutes or illegal lending. When Global entered the market it tested one and two month products which some customers failed to repay. Global experimented and found that if it gave its customers a longer time period to repay a loan with smaller payments its customers tended to be more successful in repaying the loan. The market was a difficult and expensive one to serve because the population was not as stable in terms of income as customers with bank accounts.

21. The monthly interest rate for Global's core six month offering is set at 34% per month, with straight-line principal amortization of 20% from month two to month six. Its initial default fee was £12 which would be followed by a further fee of £10 and then, in sent to a debt collection agency, a £40 collection fee. Under the price cap the return on credit would be capped at 100% with the interest rate falling to 0.8% a day or 24% a month. [✂].

22. Global wanted to be one of the three lenders the FCA had suggested would remain in the market following the introduction of the price cap. The surviving lenders would need to be well capitalised. Several smaller lenders with large capital backing had recently entered the UK (e.g. Think Finance) had the potential to be one of the remaining lenders provided they could negotiate the FCA authorisation process. Global was extremely efficient in terms of product development and support and ran a very good low cost operation which enabled it to offer competitive products. However, it had not had the opportunity to make the large brand investment required to insulate it in the event of a rapid market exit by lead generators. Global was in the process of making dramatic changes to its business and was planning on opening a branch in the UK before the end of 2014. It was also looking at serving less risky, less volatile market segments.

23. Global believed that 2015 would be a year of transition and that many lenders would more than likely contract and all but a handful would go out of business. However, 2016 would likely be a more positive year for the remaining lenders. The barriers to entry post FCA authorisation would be significant with the new regulatory regime resembling a bank-like compliance structure. The industry would be a very different business. Global felt it was conceivable that top lenders such as [✄] might consider buying a bank in the future to monetize the significant investment in compliance infrastructure.

Additional fees and charges

24. Customers should be made aware of the costs and additional fees associated with taking out a loan upfront. It was not in a position to comment on whether these were displayed prominently on other lenders websites but did so on its own website and made these clear to the customer at the point of application. Global thought that the FCA would require lenders to explain the total cost of credit cap, on their websites. Global's customers had a very sophisticated knowledge of its products and knew when their repayments were due. Global Analytics thought that if the regulators were too prescriptive lenders websites would become a poor and confusing experience for consumers.

25. Global's fee income was less than two per cent of overall revenue. It did not make much money from fees or customers who did not repay their loan. Its collection rates were pretty low once a borrower had reached the point of incurring its second arrears fee. The FCA's total cost of credit cap would ensure that lenders could not charge more than 100% removing the ability to differentiate between sites.

Assessing credit worthiness

26. Global told us that credit card issuers in the US had started to list (i.e. on their statements) how much a customer would repay if they only paid the minimum every month. This had had an impact on how customers' looked at the money they were borrowing.

27. [✂]

28. Global believed that it had the most efficient fraud control system in the market which saved it a lot of money. [✂]. Global suggested that a quotation search could conducted by the site and shared with all the lenders on the site. The lenders could then conduct their own additional data checks including an application search. Global said it would want the ability to record the fact that a consumer had missed a payment on their credit file.

29. Global also suggested letting lenders share credit reporting data for one loan on the PCW. This would avoid lenders creating unnecessary footprints on a customer's credit file.

30. Many of the approved but not booked applications were instances where a customer had decided not to proceed with the loan following approval. Global had a conversion rate of [✂]%. Global thought this might be due to the fact that the loan process might be taking too long for them, that the experience was confusing (i.e. being redirected from the lead generator website to Global's website) or that the customer night have taken out a loan with another lender.

Real time data sharing

31. Real-time data was, in actuality and practicality, not real-time and there was scope for fraud in the period of time between the credit search and the final delivery of the loan. The incentives were not in place to make the payday lending industry truly real-time. Global was in discussion with vendors ([✂]) regarding real-time data sharing and was scheduled to go live with one of those vendors ([✂]) in November 2014.

32. Real-time data sharing would enable lenders to make better informed decisions. Although lenders should not be required to participate in such initiatives Global thought that all lenders would wish to do so because it was for everyone's benefit.

33. Credit reference agencies (CRAs) worked better when they shared data but typically did not do so because this would impact on their competitive advantage. Data sharing typically occurred in instances where a financial

institution had signed up with multiple CRA's. Global bought more data from [✂] because it had more of the data Global was interested in.

Periodic statements on cost borrowing

34. Periodic statements on the cost of borrowing could be helpful to customers, allowing them to manage their finances better. Global currently did not provide periodic statements but had considered having that information (e.g. loan balance, payment date and next payment amount) on the home page of its mobile App.

35. Global had designed its product to respond to customer need and had, for example, made the first repayment the lowest one because consumers felt that they needed more time before they started repaying the loan. However, this also created a situation where every payment was different and caused the customers confusion so Global was looking at moving to equal monthly payments.

Lead generators

36. Global thought that requiring lead generators to identify themselves as such would benefit customers for two reasons. First, because customers felt tricked when they were redirected to a lenders website and second, they would know that there were not necessarily being referred to the cheapest lender. Global saw a great deal of non-conversion because of the latter reason. However, these concerns would fall away with the rate cap because customers would be able to obtain the same type of loan from all lenders. Global had a team which audited lead generator websites and so could see the source of each lead.

37. Global had not seen any reduction in the cost of leads. It paid around £[✂] for leads from its top tier (of the ping tree). Global had thought six months ago that it would benefit from a reduction in the cost of leads because the demand for, and volume of, loans issued had fallen. It attributed this to the fact that supply and demand were coming down at the same time. Lead generators business was under strain because volumes were falling but the price had remained the same.

38. There were differences in the value of the leads supplied by PCWs and lead generators. [✂]. The quality of the leads from lead generators were not consistent. When Global had been building its lead generator channel it had black listed lead providers which it felt were not conducting themselves ethically. Global had retained a core of probably half a dozen of the most reliable and honest lead providers. Global said it did not want to see lead generators that charged fees to borrowers operating in the market.

39. It was in lenders best interests to ensure that the lead providers they were dealing with were compliant with FCA regulations because the lenders wanted to ensure that they were compliant. Global believed that lenders were already taking these into consideration in their selection of lead providers.

Other remedies considerations

40. Global noted that any remedies package needed to consider the FCA’s changes and that changes in lead generation should be managed gradually to allow firms dependent on lead generators to develop brand awareness.