PAYDAY LENDING MARKET INVESTIGATION

Summary of a response hearing with Think Finance (UK) Limited held on Thursday 22 July 2014

1. Think Finance estimated that it had saved its customers around £3.2million since entering the market as a result of its no fee guarantee and progressive interest rate structure.

2. Think Finance were making changes to its risk model on a regular basis and were currently on the fourth generation of its model. This contrasted with its US parent's operations which operated on the 15th generation of its model. Because of differences between the US and UK markets and the availability of data Think Finance was unable to directly implement risk models from the US.

3. Think Finance's risk modelling had become more conservative in its risk appetite but in addition had developed its model from previous lending behaviour and was also targeting certain groups of customers.

4. The line of credit available under the Sunny product is five months. Customers have the ability to re-draw (i.e. take out a new loan) against their credit lines but only after demonstrating affordability via a solid repayment history. Because of the duration of the product and the length that Sunny had been active for, it was not yet clear what the level of repeat borrowing was.

5. Shortly after Sunny launched it experienced a large spike in applications of low quality. Think Finance believe that this was driven by customers, who were already active in the market becoming aware of a new lender and applying after they had been rejected by other lenders or as a potential new source of funding. Sunny were currently issuing around [✂] loans per month and at present the balance of new to repeat borrowers was skewed towards new borrowers as they sought to build up their customer base. Sunny was generating revenue of around £[✂].

6. While the Financial Conduct Authority (FCA) does not require existing customers to be moved to the new rate cap, Think Finance thought it likely that their highest price point even for existing customers would fall to the level of the cap. Think Finance thought that customers would become aware of the

price cap and would not consider anything above the cap to be a competitive rate, even before it was effective.

7. Think Finance considered Sunny to be different to other products in that all loans were structured as a series of instalment payments that required loan capital to be repaid such that the principle balance was zero at the end of the loan term selected by the customer. Spreading out the repayment term allowed each monthly repayment to be lower and thus more affordable to the borrower as opposed to payday loans which require many customers to re-borrow steadily over subsequent months as the one-month repayment amount is too high. This re-borrowing generates many unexpected fees and Think Finance believes its structure eliminates this.

8. Sunny had no plans to buy loanbooks from lenders exiting the market as they perceived that those exiting the market were likely to have the lowest quality customers and because there were more pressing matters it needed to attend to as it was still in start-up mode.

FCA proposals

9. Think Finance saw the FCA's cap on rollovers as being a positive development as it encouraged borrowers to shop around. It thought that the limit on continuous payment authority's (CPAs) reduced collection efficiency and increased costs. Think had never taken partial payments by CPA.

10. Think Finance had concerns with the way that the FCA was not treating running lines in the same way as instalment products. Because of the way the cap was proposed, the FCA rules would link any cap to the initial balance on a line of credit rather than the value of any drawn down balance. This would force any company offering a running line of credit to eliminate the product and turn the product structure into one of a pure instalment loan. Think Finance believes that not only would this result in less choice and flexibility for consumers, but it would also lead to worse decisions by consumers. Having a running account gives a consumer confidence that they have access to at least some form of credit while forcing them to look for a new instalment loan each time they need money may lead to them frantically searching for any loan at any price without looking for the best deal. It will also compel customers to take out more money than they otherwise would.

11. In the US, Think Finance had significant flexibility in its risk based pricing which allowed customers to be offered rates from between 3% and 30% per month. Think Finance thought the FCA's proposed price cap would impact its ability to operate this model in the UK; by charging higher rates for new customers whilst it gathered a better understanding of the credit risk of those

customers (and those that defaulted) it was able to charge lower risk customers a lower rate. By restricting the ability to charge higher rates for higher risk customers, Think Finance could no longer afford to offer the steep price progression it currently offers.

12. [✂]% of customers were borrowing at rates lower than the standard initial price point of 29%. [✂]% of customers were borrowing at Sunny's lowest price point of [✂]% and at present some [✂]% of those customers defaulted, but for repeat customers the default rate fell to around [✂]%. At present, around [✂]% of customers were offered a rate below 29% on their initial application.

13. Think Finance's risk model would not at present lend to a number of customers at the level of the cap that it would at its present rate of 29% for a month. However, those customers that it would have lent to at 29% might have demonstrated a lower risk profile through timely repayment that would have allowed them to be offered credit at a lower price. By being unable to initially offer those customers credit at 29% a month they would be excluded from demonstrating behaviour to obtain cheaper credit. Ultimately, this would reduce the number of marginal customers that Think Finance could learn from to finesse its credit models. Think Finance thought 27% per month would have been a more appropriate level to set the cap at as it would allow a much broader range of customers to be served.

14. Think Finance identified a number of barriers to entry and expansion in the market, principally the marketing expenditure required to develop brand awareness, and the multiple years of lending experience that established market participants held. Industry data on the level of advertising expenditure in the market showed that Wonga accounted for some 60% of all advertising expenditure. Sunny forecast it would spend some £[✂] on advertising in 2014.

15. Sunny had undertaken market research that found that 60-70% of customers named Wonga as a supplier of short term loans and 20-30% named QuickQuid. In contrast Sunny had only achieved a 10% level of awareness. As customers were only able to name a small number of lenders unprompted Think Finance took this to be evidence that customers were unlikely to shop around because there were not perceived to be multiple alternatives.

16. Although real-time data-sharing offered improvements on the availability of data on a more timely basis, there was still uncertainty over whether credit agreements on a customer's file were still open or not. It was also not clear if this would in any way lower the costs as the Credit Reference Agencies were charging for access to this real time data and so likely negating any cost

benefit from better underwriting. This remains to be seen and will only be able to be analysed over the 6-12 months following the implementation of real time data into the risk models.

17. The cost of acquiring customers was significant and varied by channel, but was in excess of £[✄] per customer. Ultimately Think Finance would hope this cost to reduce to £[✄].

Channel	Cost per funded lead (£)
Lead Generators	[✄]
Affiliates	[✄]
PPC Unbranded (generic search terms)	[✄]
TV View	[✄]
Direct	[✄]
Overall	[✄]

18. Think Finance said that speed of payment by a lender was more important to many customers than the offer of no fees, flexibility of duration and repayment of a loan and lower interest rates.

19. Think Finance thought that there might be some validation of the market as a result of regulatory interventions that might lead to some growth in the market however because of barriers to expansion it was likely that this growth would be concentrated amongst the three largest lenders.

20. Think Finance supported the cap on default charges as a good thing for consumers. It noted that at present some lenders were levying late/default fees in the order of £140.

21. New entrants to the market faced the constraint of existing large lenders spending large amounts of money on advertising and brand awareness that new entrants could not match. Achieving any significant form of brand awareness was a long process and very costly, thereby raising the cost to the new entrant and limiting price innovation.

Price comparison website

22. Sunny is listed on money.co.uk and lovemoney.com's comparison site. However, Love Money has had development issues of around six months and the pricing information was not fully accurate for loans over 30 days.

23. To distinguish itself on price comparison websites (PCWs), it had added the tagline 'no fee guarantee' to its logo that appeared on the money.co.uk comparison site.

24. Think Finance did not know why the price comparison sector was relatively under developed in respect of number of sites and functionality.

25. Think Finance thought that a PCW would improve customers' awareness of lenders in the market and would reduce barriers to entry by decreasing reliance on advertising. Operation by an existing well-established site would aid familiarity and trust. It might be necessary to liaise with search engine operators to ensure the site wasn't demoted in search rankings. It was also important that a PCW be robust and enable a consumer to compare the true cost of borrowing under multiple scenarios.

26. Think Finance supported the use of customer ratings on a PCW.

27. A link to the PCW could be included on a pop-up when a customer repaid their loan or prior to taking a loan out. This would be one way in which to level the playing field for new entrants and enable them to raise brand awareness without huge and costly TV efforts, and thus lowering the cost of acquisition of new customers. Lowering this cost is essential to enabling price competition.

Fees and charges

28. Think Finance supported the use of scenario-based examples of all categories of fees and charges, including upfront fees, late fees and all others fees as well such as loan extension fees. As the Bristol report demonstrated that lenders make up to 45% of their revenue off these other fees, it shows that it is a key component of the cost to a consumer and so should be modelled in the scenarios so the consumer sees the true cost of borrowing.

Creditworthiness and eligibility

29. Think Finance thought eligibility could possibly be incorporated into a comparison site but were not certain.

30. Think Finance thought CRA data needed visibility of live loans. This was essential to improving the underwriting for new entrants and would help again to lower the cost of lending and so enable greater price competition.

31. [✂]

Periodic Statement

32. Think Finance customers were able to access their borrowing history from their account page.

Lead generator

33. Think Finance believed that lead generators and brokers should clearly state their true nature and the services provided. Think Finance believed that providing customers with a list of lenders and the choice to decide which lender to apply to would always be the best solution.

34. One remedy might be to require brokers and intermediaries to be required to include a flag of their status in the metadata used to generate site descriptions on search engines.