PAYDAY LENDING MARKET INVESTIGATION

Summary of a response hearing with Wonga held on Monday 21 July 2014

Provisional Findings

1. Wonga told us that the data the Competition and Markets Authority (CMA) had used was by necessity historical and not compelling. Further there was insufficient evidential support for many of the findings. Wonga believed that the CMA needed to have regard to the way the payday lending market, which was very dynamic, was evolving. The market now was markedly different from that of the last three to five years. The regulatory landscape had changed even before the proposed Financial Conduct Authority (FCA) price cap. There were also differences in the products now being offered, the pricing of products as well as the restructuring of some existing products including the removal of faster payment fees.

2. The approach the CMA had taken in concluding that the absence of price competition could be adding £5 to £10 to the cost of an average loan was misconceived. There was real price competition in the market and Wonga had seen a great deal of new entry (indeed much higher than other markets looked at over the last 25-30 years), new product launches with different headline prices (e.g. FlexCredit and Sunny) and competitive responses from lenders ([✄]). There had been interaction with other forms of short-term credit, for example, Provident Financial had launched Satsuma, which Wonga understood was intended to stem some of the loses in its traditional home credit business. There was also evidence of switching. There had been significant new entry in the market and Wonga was concerned that there was a real risk that this would be substantially reduced or eliminated following the introduction of the price cap.

3. Wonga expressed concerns about the CMA's profitability analysis. Wonga noted that the CMA had not provisionally found "excessive profitability". Further, the exceptional profits referred to by the CMA in the provisional findings had been generated by a small number of high performing companies. These profits were temporary and as the market was maturing the direction of travel had been down even before the FCA's announcement on its price cap proposal. Many lenders had not made high returns. Wonga was not surprised that the CMA had not sought to base an estimate of customer

detriment on the profitability analysis given the mixed results. However, it was surprised at the methodology that the CMA had used in relation to the customer detriment which it thought was incorrect.

4. Wonga considered that the CMA had used the incorrect methodology for its detriment analysis. The CMA’s benchmark suffered from the "Nirvana" fallacy as it assumed that all customers in the market could obtain the best price; Wonga did not consider this was a realistic assumption for a consumer detriment analysis. The CMA's analysis also omitted significant benefits, arising from non-price competition and, more fundamentally, the impact on volumes of lenders moving to those prices. This was a critical issue in looking at customer welfare analysis in credit markets; welfare was a function of price and access to credit and Wonga would need to tighten its lending at those prices. Lower prices stimulated demand from marginal customers whereas tightening credit choked off demand from both marginal and inframarginal customers and the potential welfare implications of that could be very significant. A proper consumer welfare analysis would need to take all of those factors into account.

5. Wonga thought that the FCA had looked at the impact of the proposed price cap in terms of marginal viability but did not think that they had considered the welfare analysis and the fact that the price cap could potentially reduce significant volumes of borrowing from customers who highly valued the payday loan product.

Pricing

6. Wonga did not consider that sufficient attention had been paid in the CMA’s provisional findings to pricing and the different approaches taken by various lenders (e.g. Wonga pioneered a daily interest rate). The focus on headline rates ignored the introduction of various competitive initiatives, for example, the removal of faster payment fees and early repayment at no cost, which had been a key feature of the Wonga product for a very long time. Wonga considered that the CMA’s finding that there was a clustering at £30 for the cost of a £100 loan ignored these points. Wonga also thought that there should have been some analysis of the value customers were getting. Wonga did not agree that pricing was clustered and had shown there were different models and levels of pricing and different service indicators. Wonga had witnessed a significant amount of competition on every aspect.

7. The FCA’s static analysis had indicated that if the proposed price cap was lower than 0.8% that would risk leaving just one lender in the market. This implied that there would only be very limited scope, if any, for price competition once the cap was in place.

8. Customers were well informed with regard to price and were not price insensitive. Wonga's own survey evidence indicated that price was one of the key reasons for using another provider. [✄]. The CMA's survey indicated that there was a high degree of price sensitivity with 55% of customers indicating that the total cost of the loan was either very (31%) or extremely important (24%) in their choice of loan, a further 30% said it was fairly important. In addition 91% were conscious about finding out how much it would cost to borrow the amount needed.

9. Wonga thought that barriers to shopping around were overstated. There was a significant amount of customer engagement in the payday lending market. The CMA survey found that around 40% of customers said they were shopping around. A significant proportion of switching (45%) was attributable to active choice. Satisfaction was high with 61% saying that satisfaction was a reason for not shopping around. Wonga was concerned that customer engagement might fall following the introduction of the price cap because customers might think that they were protected by the FCA and so did not need to shop around. Research conducted by Bristol University indicated that 55% of customers would not have taken out a loan in response to a cost increase.

10. In terms of competitive pressure from broader short-term credit products, the CMA survey indicated that 61% of consumers had access to other forms of credit. The FCA believed that friends and family were a valid alternative taking this figure to 78%.

Entry

11. Wonga considered that the entry by 11 major lenders since 2010 and by around 8 to 20 lenders per year indicated, very clearly, the absence of any significant barriers to entry. Wonga believed that the alleged detriment set out in the provisional findings was overstated because brands could be built (or extended) quickly, costs could be scaled, a variety of channels existed to facilitate access to customers and some lenders were leveraging existing brands. In many ways it was easier to enter the market now than when Wonga entered the market; there was better access to capital, the sector was much better understood, there were off-the-shelf IT solutions and there was much better risk scoring data available.

Remedies

12. Wonga noted that there appeared to be some duplication between the approach of the CMA and FCA, certainly in terms of data sharing. In contemplating remedies Wonga believed it was absolutely crucial that the

CMA paid very close regard to the work being undertaken by the FCA. New regulation by the FCA (in particular. the limit to two unsuccessful continuous payment authority (CPA) attempts and two roll overs, the introduction of affordability assessments and the price cap) would have a profound impact on lenders in the market and inevitably, therefore, a very significant impact on price competition. Wonga thought that there was a conflict between what the CMA was trying to achieve in its remedies notice and what the FCA was doing. The CMA was trying to stimulate price competition by addressing a perceived insensitivity to price. The price cap would increase concentration and undermine price competition by creating a single price point in the market which was so low and restrictive that it would end up effectively becoming a uniform price. Wonga questioned whether any of the CMA's proposed remedies would be appropriate in light of the price cap and the effect it would have on the market. Wonga noted that the FCA had said that below the price cap (i.e. 0.8%) there might be room for one or no lenders in the sector.

13. Following the introduction of the price cap Wonga considered that a range of the short-term credit products that were currently available would either be unavailable or priced at the cap. Wonga thought that lenders would move to offering larger loans over a longer period as a result.

14. Wonga noted that the CMA's guidelines stated that its remedies needed to take account of laws and regulations either currently applicable or expected to come into force in the near future. Wonga also noted that the CMA guidelines indicated that it might make recommendations to the body responsible for the laws or regulations in question. If the CMA concluded that the FCA's price cap proposal was going to have a significant adverse effect on the dynamic nature of competition in the market, there was scope for the CMA to make those observations.

15. It appeared to Wonga that the price cap was a material change of circumstances within the meaning of section 138(3) of the Enterprise Act. Under the application of this provision the CMA's duty to remedy the adverse effects identified in the provisional findings would effectively be discharged if there was a material change of circumstances. Wonga thought that the price cap proposal by the FCA was more material than the entry of Netflix in the Competition Commission's (CC's) movies on pay TV market investigation, which had resulted in the CC issuing revised provisional findings. Wonga was not necessarily advocating that the CMA should issue revised provisional findings but, as a minimum, should pay very close regard to the likely operation of the price cap in framing and deciding which remedies to adopt.

Price cap

16. The announcement by the FCA on 15 July of its proposals for a price cap for payday lenders had had a significant impact on the market. Wonga was particularly struck by the FCA's observation that all but three online, payday lenders, and maybe a store front provider, might exit the market following the introduction of the price cap. The FCA also anticipated very low levels of new entry if any.

17. The price cap had been set so low that it would be difficult to innovate and there were reduced incentives to do so. It would also result in reduced profitability, market exit, increased barriers to entry and dampened incentives to reduce price. The majority of Wonga's products [✄]. One of the reasons the market had grown was that the Office of Fair Trading had been a different sort of regulator. Trying to innovate under the FCA regime would be far more difficult because of increased compliance costs. Wonga understood that the FCA was trying to guard against customer detriment but thought that the level and structure of the proposed price cap would restrict shorter-term lending (e.g. loans of 15 days or less), for which there was significant customer demand, because lenders would not be able to recover their costs. This might mean that customers might have to take out a loan for longer periods than required. The average length of Wonga's loans was [✄] days. Some lenders had already moved into longer term products. Wonga thought that the industry would move towards offering larger loans over a longer duration and had been doing so in any event.

18. Following the introduction of the limit to continuous payment authority (CPA) to two per loan Wonga had noted [✄].

19. During the last year Wonga had experienced [✄] in loans granted. [✄].

20. Under the price cap, if a customer repaid their loan early the lender would be required to refund the initial fee (unless it complied with the initial cost cap for the actual loan duration on repayment). Under the price cap (which did not include any fixed element) Wonga's revenue on a loan of £250, for example, would [✄]. Over the course of the financial year for 2013 this would result in [✄] of Wonga's EBITDA [✄]. Wonga already had a very low default rate. Wonga noted that the FCA had estimated that about 160,000 customers would lose access to short-term credit. Wonga [✄] believed that a lot of companies were looking at withdrawing from the market, including some reasonably large players.

21. Wonga could not imagine that lenders would want to spend £50 million or £100 million on above the line television advertising to enter the market at these prices.

22. Based on a preliminary consideration of the impact of the FCA's price cap proposal and subject to detailed review, Wonga did not yet have a strong view regarding the number of competitors that might remain in the market as a result of the price cap but thought that [✂] lenders could do so. Wonga also noted that the fixed costs in the industry were rising with the FCA's regulations. If only three competitors remained (and maybe a retail lender) as the FCA had suggested, then acquisition costs could potentially fall changing lenders' marketing strategies. There was room in the market for new products which would enable lenders to spread their fixed FCA costs across a wider product set although it was not a market for new entry. Lenders were going to have to become leaner while negotiating a busy regulatory period at the same time.

23. [✂].

24. The pricing of the price cap was very much "back loaded" on late fees and other charges incurred if a customer did not repay in full and on time. This was very unattractive for customers, and, the £15 fee for the cost of default [✂]. A report by AlixPartners in 2013 indicated that Wonga's default fee should be set in the region of £[✂]. Wonga had set its default fee at £30 but had lowered this to £20. The FCA's proposed initial price cap was not quite as bad as the situation in Australia, which had a lower cap up front and providers therefore focussed on revenue from arrears.

25. The FCA had not set a limit on the period for which interest could be charged after default. Around [✂]% of Wonga loans ended up in arrears, and Wonga collected about [✂] as it took the view it was better to charge customers upfront and then deal with customers who were able to repay their loan as opposed to those could not. Overselling a loan (i.e. suggesting a customer take out a loan for longer than they needed) was not appropriate and had implications for its balance sheet.

Price comparison website

26. In light of the FCA's proposed price cap, which would in all likeliness lead to price uniformity and very few providers, Wonga thought that a price comparison website (PCW) would serve no useful function. Subject to that overriding concern, Wonga was open to the idea of a PCW remedy but had identified a number of issues that needed addressing. Wonga raised a

number of areas of concern the biggest of which was that the site had to be commercially viable.

27. There was no point in investing money in a not-for-profit PCW because it would not be run effectively and competitively. It would make a lot more sense to put out a tender to the existing operators of comparison services who knew what they were doing, had the operations in place to do it properly, the marketing ability and pre-existing reputation as a credible PCW operator to make the site a viable proposition. That way the site would stand a chance of becoming a relatively well known, sustainable, long-term-service.

28. [✂] thought that MoneySuperMarket or Gocompare, for example, might be more comfortable entering what is now a heavily regulated sector. However, the main challenge would be [✂] to enable the site to run a viable service. This [✂] meant that companies [✂]. MoneySuperMarket, which had previously operated a relatively effective PCW, providing customers of a reasonable quality (i.e. their ability to pay their loan) for payday lenders, and which also advertised other services (e.g. for credit cards and car loans), [✂]. The PCW would need [✂] in order to be commercially viable. It would not be viable for a PCW such as MoneySuperMarket to [✂].

29. Wonga had worked with a lot of the smaller specialist payday loan PCWs [✂]. Lenders spent millions of pounds every month advertising their services so it was important that the PCW had the ability to attract sufficient customers. Customer acquisition was an expensive business and so PCWs such as MoneySuperMarket, which had a large customer base, could actually make the process more cost effective.

30. Wonga was uncertain of the value in having a PCW if price was no longer an area in which it was going to be able to compete in the short-term lending market because price was the main determining factor when customers were shopping around on comparison websites. Wonga thought customers would stop visiting the site if all the lenders charged the same price. The other issue was who was going to pay for the website. Given that there were going to be a limited number of lenders in the market (and the need for a site has changed), it was unreasonable to expect the industry to bear significant costs. If the CMA put the operation of the PCW out to tender and did not receive any interest, it would be disproportionate to require the remaining lenders to create something.

31. If the PCW was accredited it could apply for its accreditation in much the same way as Wonga applied for its FCA licence. The accredited PCW would need to operate under certain principles, a key one being that it displayed its information in a transparent way enabling customers to make effective

comparisons. Wonga believed that all lenders should be required to participate in the site so that customers could obtain a view of the entire market and it would also be useful to enable users to compare with other short term credit products. Wonga thought that a PCW might facilitate new entry.

32. It could be difficult to promote non-price issues on the website. It was not obvious what the comparisons would be and Wonga was concerned about the basis for competition following the introduction of the price cap. Although it would not be straightforward, Wonga thought the few remaining lenders in the market would be able to work together.

33. Wonga did not tend to work with many of the PCWs because they were focussed on comparing APR which Wonga considered was an irrelevant measure for the industry. Quite often Wonga was quoted as having the highest APR despite having the lowest price.

Late fees and other additional charges

34. Wonga supported the broad principle that fees and charges should be transparent and customers should be able to view these as early as possible. Customers could see all of Wonga’s charges on its website. However, Wonga questioned the relevance and the value of this following the introduction of the price cap because lenders would be charging similar pricing and there would only be one default fee of the set amount. As part of Wonga's customer journey, before customers could accept, a loan they received a summary of all the terms and conditions on the screen which showed all the prices and charges. Details of the default fee could be made be available to customers earlier in the application process, including an illustration of the cost depending upon customer behaviour.

35. Lenders should be able to make money out of customers who wanted to borrow for a period and repay their loan. Wonga was concerned at how default fees were structured as there was an incentive to make money out of customers who could not repay their loan (whereas it was Wonga's strategy to earn revenue from upfront charges/interest). Wonga noted that lenders rarely received all their money back so this was not a particularly satisfactory model. Wonga had always tried to freeze its default rates.

Assessing credit worthiness

36. The results of the CMA survey, Bristol University research and Wonga’s own internal customer research did not support the CMA’s belief that loan providers were selected by customers based on whether or not the lender

was likely to accept that application for credit. The evidence demonstrated that customers were actively shopping around.

37. The loan approval process was not dependent on creditworthiness (around [✂]% of declined applications were as the result of credit information, the remaining proportion were declined on other criteria). There were a number of reasons why Wonga declined customers such as the debit card or bank account used for their application. Customers were informed of the reasons why their application had been declined. Before issuing a loan Wonga first conducted a number of policy checks ([✂]). Wonga then obtained credit reference agency (CRA) data enabling it to run its credit risk model and its affordability checks. If an individual passed these checks Wonga would conduct final checks [✂].

38. Wonga told us that using a quotation search as the CMA's remedy envisaged, would not provide it with a definitive answer in terms of issuing a loan as Wonga conducted a number of other checks and would still have to conduct an application search, which would have cost implications. If Wonga did not conduct an application search it would not show up on the individuals' credit file. Wonga had not discussed with CRAs what the marginal cost of an application search in addition to a quotation search would be.

39. Requiring all lenders to conduct a quotation search would also make the process of an individual obtaining an indication of them being accepted for a loan more onerous. There would also be implementation costs [✂]. The CMA needed to consider the proportionality of the costs of redesigning the system, regardless of whether it was going to mislead customers or not because they might receive a positive credit score and still be rejected.

40. Wonga considered that being unable to see credit searches performed by other lenders (and with each additional search indicating customer had been rejected) would affect its ability to assess credit risk.

41. The cost of data searches, for the new real-time data products, varied from [✂] depending on the volume and the lender. Wonga spent [✂] on quotation and follow up searches over the course of a year. Wonga declined about [✂]% of customers on the basis of credit and affordability checks and so was concerned that it might provide a customer with misleading information before having the ability to run the full application process.

42. Wonga did not think it would be feasible technologically to operate an application process through the ping tree because lenders application processes were not consistent. Wonga also expressed a preference for seeing the customer's data which would assist it in terms of making

affordability assessments. Lenders would also want to see whether a customer had applied for a loan and been declined by other lenders as part of their decision making process.

43. Around [✂]% of the leads Wonga thought it might accept (and indeed had purchased) dropped out of the application process. There were a multitude of reasons for this, the biggest one probably being customer boredom (due to the length of the bidding process) and inertia. The data Wonga used when deciding to [✂]. Wonga always conducted an application search before deciding whether or not to accept the application. [✂]. If Wonga declined a loan it would inform the customer of its decision. It did not sell the lead on and did not refer them back to the ping tree. Wonga was currently not buying leads.

Real time data sharing

44. Wonga was submitting data to Callcredit on a daily basis and had been doing so for just under a month and was just starting to receive performance data. Wonga paid for this product on the basis of its usage. [✂].

45. [✂]. Equifax were also looking at the feasibility of providing real-time data sharing.

46. Wonga considered that it was disadvantaged by real-time data sharing. It was contributing around [✂]% of the data on MODA, the Callcredit initiative, so was providing [✂] than it was receiving. However, it felt incredibly positive about the benefits real-time data sharing would bring to customers and lenders decision making. One of the short comings of the real-time initiative was that other credit products were not being seen in real time (e.g. defaults on mortgages). Wonga thought there was scope for it to be extended.

47. A large number of the smaller lenders were not doing credit checking properly or at all. Most of these companies would not have the systems to enable them to submit this data.

48. When Wonga first entered the market, credit files effectively contained bank data. During the last seven years this data had evolved into bespoke, high-cost, short-term data products such as affordability checks and a real-time data base which were a significant advantage to new entrants from a data point of view. These combined with the fact that there were a great deal of ancillary and supplementary products provided by some of the CRA's meant that entry was more feasible and the learning curve a lot shorter.

Periodic statements on the cost borrowing

49. Wonga' had no problem in principle with providing its customers information on a regular basis. Its customers could currently review the status of their loan and repay their loan early by accessing the My Account function on Wonga's website. It did not post statements to its customers, all of which were online, because of the cost implications.

50. Wonga thought that all lenders should provide the same information, including the costs of the loan, the duration and the amount they had spent and considered that it would also be helpful to have a link to a debt advice organisation or at least some risk warning. Wonga did not think that providing its customers with regular statements would have a great impact on their behaviour given that they could already log on to My Account and see what they had borrowed. My Account, from which customers could access other functions, was one of the most used functions on Wonga's website. Wonga was trying to encourage more of its customers to use My Account more frequently. With regard to issuing periodic statements, Wonga said it could email its customers at the allotted time asking them to go to My Account.

Lead generators

51. [✂]

52. Wonga considered that borrowers using lead generators were generally those more likely to be over-indebted. Wonga noted that customers reaching its site by [✂].

53. Wonga told us that many lead generators' websites closely resembled those of lenders and did not operate in a transparent manner; their function was unclear to customers and they were not hugely customer focussed. Wonga saw the same customers being recycled through pingtrees. Customers were not aware that there was a bidding process taking place behind the scenes and ultimately received a lender that did not necessarily provide the best price or the best terms; it was just the lender that had decided it wanted to pay the most for that customer at that time.

54. Wonga told us that it should be made clear that lead generators were not lenders themselves, rather that they were searching a panel of lenders. Clearly the intention of the new FCA guidelines was that lead generators should be regulated as lenders, which Wonga fully supported. The lead generator process could be made more transparent if customers submitted data to some form of comparison service that allowed the customer to select the lender of their choice.

55. Wonga has previously paid between £[✂] for a lead depending on the quality of a customer. Wonga typically had affiliate relationships with the smaller lead generators whereby it paid them a [✂] which was around £[✂]. This was quite low but the volume of business Wonga received from them was very small. [✂]. Lead generators were one of the more expensive customer acquisition channels and the performance of the customer returns and their ability to repay was poorer than the general population.

56. Wonga tried to encourage the lead generators it used to enter into formal agreements. It thought that there should be some minimum requirements for payday lenders using regulated lead generators along the lines of creating contractual terms and regular representations. However, Wonga thought that putting the cost of policing lead generators on lenders would not be particularly helpful for the industry.

57. Lead generators would still be one of the main customer acquisition channels following the introduction of the price cap but would probably be less profitable. If lenders had to be accredited and all had to pay the same amount that might force lead generators out of the market. Regardless, Wonga would not do business with any party that was not reputable.