Response to the CMA's '*Provisional decision on remedies*' in its Payday Lending market investigation

on behalf of 118 118 Money

30 October 2014

Introduction and Overview

118 118 Money operates in the consumer credit market in the UK providing unsecured personal loans and are currently undertaking a major nationwide television advertising campaign which we expect to lead to a significant expansion of our business. We offer loans of between £1,000 and £5,000, with fixed repayments over 12 to 24 months with no arrangement or set up fees. Although we note that the Competition and Markets Authority (CMA) has slightly amended the scope of its inquiry which now just includes £1000 loans for 12 months, we would highlight that we do not offer any loans for less than £1000 or for periods shorter than 12 months, as that is not a market in which we are in any way focussed. As such, 118 118 Money does not operate within the traditional payday lending market and we fall outside of the FCA's definition of 'high-cost short-term credit providers.

We are therefore somewhat concerned that the definition of payday lending which the CMA appears to have adopted, might be interpreted as inadvertently encompassing £1000 12 month loans offered by 118 118 Money (and virtually all the major retail banks). We do not believe that the CMA intends to categorise these lenders as "payday" and therefore we would urge it to ensure that its regulation does not unintentionally do so.

However, we continue to have a strong interest in regulation of the sector because it is associated with the parallel market in which we operate. Many of our customers may have previously taken out payday loans and many of the issues identified by the CMA in its provisional findings are relevant to the wider consumer credit market.

The CMA will be aware that we have previously made detailed representations on the importance of real-time data-sharing in addressing an AEC. Whilst we are disappointed that the CMA is not proposing directly to impose regulation in this area, we welcome its proposal to make a recommendation to the FCA to do so. However, we would urge the CMA to recommend that the FCA does not merely continue with its current work (which we believe is worthwhile, but insufficient). Rather it should strongly recommend that the FCA impose regulation <u>requiring</u> the implementation of comprehensive real-time data-sharing, encompassing a number of issues which we highlight.

Terms of reference and definition of payday lending

118 118 Money would like to highlight an issue which we believe needs to be addressed, relating to the inter-relationship between the CMA's terms of reference and the separate definition of payday lending.

Existing definitions

The terms of reference describe (but perhaps do not 'define') payday lending as follows:-

> *"For the purposes of this reference, payday lending consists of the provision of small-sum cash loans marketed on a short-term basis, not secured against collateral, including (but not limited to) loans repayable on the consumer's next payday or at the end of the month and specifically excluding home credit loan agreements, credit cards, credit unions and overdrafts".*

That leaves significant room for uncertainty as to exactly what type of loans are included, particularly with reference to the meaning of "*small-sum cash loans*", "*short-term basis*" and "*including (but not limited to)*".

Previously, in the Appendices to its Provisional findings report[1] (13 June), the CMA included a more precise definition of payday loans as follows (with a similar reference in its Notice of possible remedies[2] (11 June)):-

> *"For the purposes of our investigation we define payday loans as short-term, unsecured credit products which are generally taken out for 12 months or less, and where the amount borrowed is generally £1,000 or less. Home credit loan agreements, credit cards, overdrafts, credit union loans and retail credit are all excluded."*

That definition previously appeared within the Competition Commission's Annotated issues statement[3] (31 January) and Payday loan products working paper[4] (31 January).

Both Appendix 2.1 of the Provisional findings report and the Payday loan products working paper similarly explain that the CMA amended its payday loan definition specifically to include 12 month loans of £1000 (where the previous definition included only loans <u>less than</u> 12 months and <u>less than</u> £1000). Nevertheless, this definition still leaves some ambiguity by use of the word "*generally*".

However, both documents acknowledge this difficulty and explain as follows:-

> *"For the purposes of our information requests we have needed to employ a more precise definition, without the use of ambiguous terms such as 'generally', in order to allow lenders and ourselves to establish whether products at the edges of our definition should be included or not. Accordingly, we have asked lenders to provide information on short-term, unsecured credit products which can be taken out for 12 months or less, and where the minimum amount that can be borrowed is £1,000 or less."*

Thus, the most precise definition appears to be included not within the inquiry's terms of reference or even in accompanying issues statements, working papers or notices, but rather only within information requests sent to a limited number of lenders. Indeed, the only reason that it was included there was to enable them to understand precisely what information was being requested. <u>118 118 Money believes that this situation is far from ideal and must be resolved as the CMA drafts its proposed Orders.</u>

It should also be noted that the CMA's definition of payday differs from the FCA's definition of '*high cost short-term credit*' principally because the FCA's definition includes reference to a minimum APR necessary to meet the definition. 118 118 Money is conscious that the CMA has previously addressed this point and commented that it is not bound to adopt the same definition as the FCA, which was created for a different

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[1] Para 9 of Appendix 2.1
[2] Footnote 5 on page 6
[3] Para 24
[4] Para 8

purpose. We understand that he CMA wanted to adopt a more flexible definition, in order that it could assess competition in the market more broadly.

However, as we discuss below, the CMA has now reached the point of defining its own regulation and must be precise as to whom it applies. In that context, it appears to make more sense to adopt the same (or at least a very similar) definition to the FCA, which would assist both compliance as well as consumer understanding. 118 118 Money does not believe that the imposition of two regulatory regimes potentially applying to two very slightly different categories of lender would be the best outcome.

The need for clarity

From our perspective, greater clarity is needed than merely confirming the definition used in the information requests (if that is what the CMA intends to do) in order to avoid some serious potential unintended consequences. The issue is particularly pertinent to 118 118 Money (and indeed to all retail banks) because our loans are for £1000 to £5000 and 12 to 24 months. At the lowest level, a £1000 loan for 12 months from 118 118 Money might be interpreted as being included within the CMA's definition and <u>would</u> therefore be subject to the Orders which it proposes to implement, but only a very small percentage of our loans fall into that category. Currently, our average loan is £1500 for 21 months and therefore, taken as a whole, most loans from 118 118 Money <u>would not</u> be subject to the Orders as they will be for longer than 12 months and/or more than £1000.

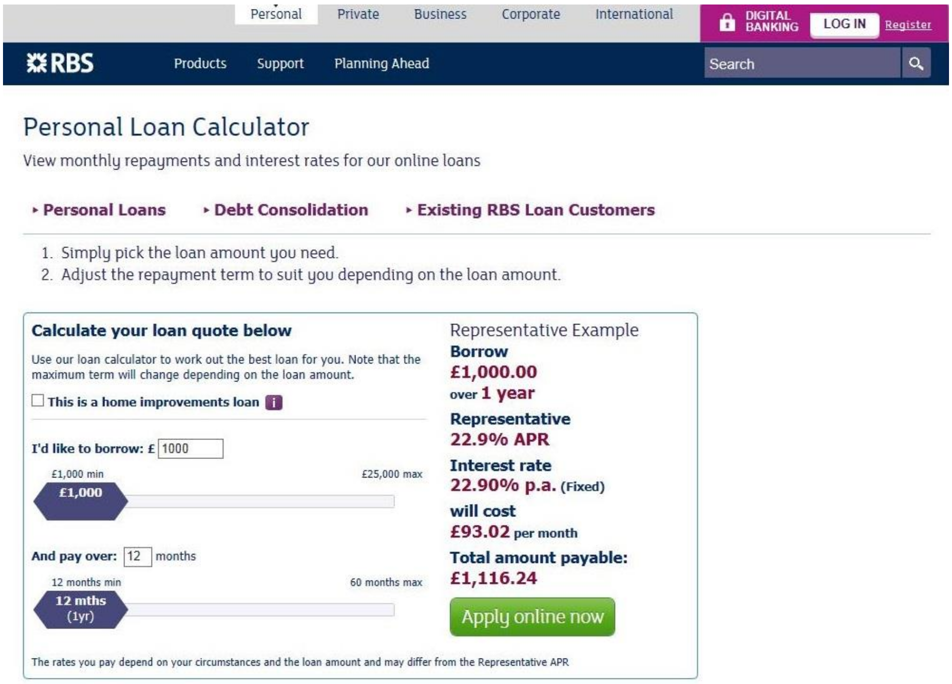
As mentioned above, both Appendix 2.1 of the Provisional findings report and the Payday loan products working paper similarly explain that the CMA amended its payday loan definition specifically to include 12 month loans of £1000. The explanation provided is as follows:-

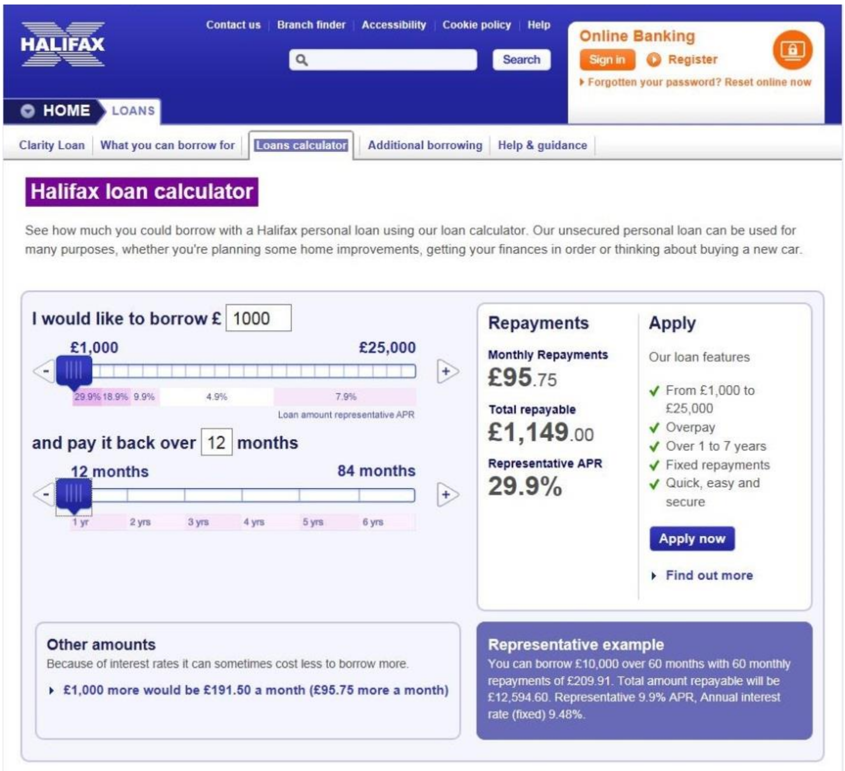
> *"It should be noted that this definition differs from (and is slightly broader than) that used in our issues statement, which referred to products which are generally taken out for less than a year and which are generally of value less than £1,000. The revised definition is to capture products at the edge of what might be considered a payday loan, such as 12-month loans or loans where the amount borrowed may in some instances be £1,000 or more (eg some QuickQuid Pounds to Pocket loans) but which nonetheless are very similar in concept to other payday products within our terms of reference. It will also allow us to take into account ongoing product innovation, the trend of which appears to be towards products which allow borrowers increased flexibility over loan term and amount."*

It seems clear from this statement that the CMA's intention is not to capture businesses such as 118 118 Money (or the major retail banks) where £1000 is the smallest loan we offer and 12 months is the shortest period. <u>The reference to loans "*which nonetheless are very similar in concept to other payday products within our terms of reference"* strongly suggests that the CMA envisages £1000 being at the top end of the loan amounts and 12 months being the longest period. That is supported by the reference contained in the final sentence which suggests that the CMA is trying to take account of situations where a loan of less than £1000 or shorter than 12 months may subsequently be converted or extended into that category.</u>

118 118 Money certainly does not believe that our loans are "*very similar in concept to other payday products*". Indeed, our loans are identical in concept to the major retail banks, virtually all of whom appear

to offer loans starting at £1000 for 12 months. We include below a couple of screenshots taken from the websites of RBS and Halifax in order to illustrate the point.





Nevertheless, if the CMA was to impose regulation according to the strict definition which it used in information requests to lenders, <u>it would appear that it will inadvertently include some of the loans offered by 118 118 Money and the major retail banks</u>. If this situation was allowed to occur, it would present all of these lenders with very obvious compliance difficulties having to adhere to the CMA's regulation for just one small category of loan, but not for the vast majority.

The CMA will understand that a £1000, 12 month loan is not (and cannot readily be) presented or treated any differently from a £1500 or a 13 month loan. Our business currently operates products within a very limited range and this type of differentiation (which has no associated commercial or operational logic) is simply not practical. Most obviously, it would create confusion as to whether the product needed to be included on an accredited PCW because it would only be relevant/required if the borrower chose a loan amount at the bottom end of the scale, but that would not be known in advance of them making that choice. It would be impossible for lenders to know whether or not they needed to comply. It would also be most confusing for borrowers who would not recognise these types of loans as being 'payday'.

In order to avoid such difficulties occurring, in reality the automatic inclusion of <u>all</u> £1000, 12 month loans within the CMA's regulation (regardless of any other criteria) is highly likely to prompt lender behaviour designed to avoid regulation applying to a very limited percentage of its products. Most obviously that would involve no longer offering loans which are just caught by the definition i.e. the removal of £1000 12 month loans, where they are the smallest and shortest loans offered (as is the case for 118 118 Money and the retail banks). This in turn would be highly likely to lead to loans beginning at £1001, £1050 or £1100 for periods from perhaps 53 weeks or 13 months.

As consumers are used to loans being offered for regular amounts and commonly used periods of time, these changes will appear to be visibly odd and out of place, with no rational explanation which they can easily understand. Depending on the loan amounts offered by providers, consumers may also be forced to borrow larger sums than they really want or need. If a minimum £1000 loan is replaced by a minimum £1100 loan, it would obviously equate to an additional 10% of borrowing above the desired amount. All of this would represent an unnecessary distortion of the market, which is entirely avoidable.

118 118 Money therefore urges the CMA to address this issue in its drafting of the Orders with the purpose of ensuring that its intentions are accurately reflected and that these type of loans are not inadvertently caught by its regulation. **The most obvious means by which to do so would appear to be a return to the original definition of payday loans being for sums <u>less</u> than £1000 and <u>shorter</u> than 12 months.**

Alternatively, it could simply choose to adopt the FCA definition including a requirement that the APR must be at least 100%. Whilst we note that this would be a different approach to that which the CMA has adopted to date, it would be an effective means of achieving the CMA's objective of identifying loans "*very similar in concept to other payday products*". One might reasonably conclude that any loan with an APR of below 100% (such as those offered by all of the retail banks) does not have the characteristics of a payday loan and therefore should not be subject to regulation which the CMA intends to impose on that sector. Although we understand why the CMA did not want to adopt the FCA criteria during its market definition phase, now may be the appropriate time to do so, as it drafts its regulation.

If the CMA does not wish to adopt either approach, it must somehow still find a way of distinguishing these loans by their nature, as compared to a traditional 118 118 Money type bank loan. Once again this would appear to turn on the meaning of the words "*very similar in concept to other payday products*". Whilst one may inherently know what is meant by that phrase, the CMA must define it in its Orders in a far more exact and precise manner, if lenders are to have confidence that they understand clearly which of their products are and are not subject to the regulation and what they must do in order to comply. The CMA will also be mindful of the need to take account of a borrower's perception of what they are likely to consider to be a payday loan.

It should of course be noted that the scope of its inquiry has been intentionally limited as a result of which the CMA's terms of reference and definition of payday lending have been drafted explicitly to exclude "*home credit loan agreements, credit cards, credit unions and overdrafts*". In that context, 118 118 Money believes that the inquiry (and resulting regulation) must not inadvertently capture personal loans, which would clearly not be objectively regarded as payday loans. Similarly, providers of those loans should not be required to take steps to alter their product mix in order to avoid being included within regulation, which was never intended to apply to them.

Measures to encourage development of real-time data sharing

Supporting the CMA's recommendation

118 118 Money strongly welcomes the CMA's proposal to recommend to the FCA to develop real-time data-sharing. In particular, we welcome and endorse the CMA's view that real-time data-sharing will make a significant contribution to addressing the AEC which it has identified.

It is clear that the lack of real-time data-sharing is a significant barrier to entry and expansion not only in the traditional payday lending market (in which 118 118 Money does not participate) but also in the wider consumer credit market (in which we do). In their different ways, both the larger established/incumbent consumer credit/payday lenders and retail banks utilise their proprietary information about their existing customers in order to make risk-based lending and pricing decisions. Without knowing what they know, it is impossible for newer and smaller lenders (with far fewer existing customers) to compete on equal terms. As a result, their risk and therefore their costs and prices inevitably increase, weakening their position in the market. The fact that lenders must rely to a large degree on repeat borrowing from existing customers in order to operate profitably further exacerbates the position.

In addition, the CMA has correctly identified that the development of real-time data sharing will make a critical contribution towards allowing (and thereby encouraging) consumers to shop around without adversely affecting their credit record. Although the CMA itself makes this point, it is not clear that it fully recognises its fundamental importance and wide-ranging potential benefits.

As we explained in our previous submissions, the review of the number of recent application searches undertaken on a prospective borrower is merely a (somewhat poor) proxy for reliable and up to date credit information in relation to that borrower's actual liabilities (rather than possible, but unknown liabilities). It is what lenders are forced to do because they are unable to access the data which they really want. The availability of comprehensive real-time data would remove entirely the need for (and benefits from) using application searches in this way.

Aside from its recommendation to the FCA to develop real-time data-sharing, the CMA proposes to make a separate recommendation that the FCA "*help borrowers shop around without unduly affecting their access to credit*". The basis of that recommendation is that the FCA should encourage lenders to use quotation searches rather than application searches because it is the existence of those multiple application searches which might adversely affect a borrower's access to credit. <u>However, as we explained in our previous submission, that is merely addressing the symptom rather than the cause of the problem.</u>

If real-time data-sharing existed, lenders would have no need or interest in using the second rate method of relying upon the number of recent application searches as a means of deciding whether or not to grant a borrower credit – they would derive no benefit from doing so, but would simply increase their costs by undertaking additional searches. Therefore the problem which the CMA has identified i.e. consumers being denied credit (and discouraged from shopping around) due to the existence of multiple application searches, simply disappears because no-one will be making lending decisions on that basis and borrowers will not suffer from multiple applications.

The CMA will therefore recognise that if real-time data-sharing is effectively implemented, there would be no need for this separate recommendation to the FCA. Specifically, it would not have to be concerned with the detail or difficulties related to the disclosures made by lenders about their use of credit checks or the revision of FCA guidance on the use of quotation searches.

118 118 Money recognises that as the CMA is addressing both of these issues through recommendations to the FCA, it may not feel in control of how they will be progressed and therefore it may wish to maintain them as separate recommendations. However, for reasons explained, the introduction of real-time data-sharing will clearly make a critical contribution towards addressing the problem of borrowers access to credit being restricted as a result of shopping around, to the extent that no additional measures may be required at all.

We therefore believe that in making its recommendation to the FCA, the CMA should make this link far more explicit, thereby emphasising why the introduction of real-time data-sharing is so fundamentally important. Although we consider that the benefits of real-time data-sharing are strong enough on their own merits to warrant implementation, the additional benefit of encouraging shopping around makes the case even more compelling. The FCA must recognise that they would therefore be 'killing two birds/CMA recommendations with one stone' by ensuring that it is made available.

Strengthening the CMA's recommendation

In view of the importance of real-time data-sharing which we have outlined above, 118 118 Money believes that there should be a <u>regulatory obligation on all CRAs to make real-time data products available and a regulatory obligation on all consumer credit lenders (or for the CMA's purposes all payday lenders) to provide data on a real-time basis.</u> We believe that regulation must be both detailed and prescriptive in order to ensure that the solutions developed by the CRAs are comprehensive and do not allow for loopholes to emerge which would reduce their effectiveness. We outline below the points which the regulation must cover. Whilst we would have liked the CMA to have imposed those regulatory obligations directly, we recognise why it proposes instead to make a recommendation to the FCA, in view of its ongoing work in that area.

Nevertheless, we are disappointed that the recommendation as currently framed by the CMA will not progress matters, as it does not extend the scope of what the FCA is already doing. As we have outlined above, 118 118 Money strongly endorses the CMA's analysis of the importance of real-time data-sharing which is both comprehensive and compelling. In particular, its assessment of why data-sharing is so critical to addressing the AEC which it has identified goes beyond the work which the FCA has done in this area. Yet, despite its additional analysis and understanding of why real-time data-sharing is fundamental to increasing competition, it recommends only that the FCA should "*continue to work closely with lenders and CRAs to encourage the development and use of real-time data-sharing systems ….*"

The CMA does identify three specific issues on which it believes that the FCA should focus, and in particular we welcome its reference to "*the terms of access to real-time data-sharing schemes to ensure that these do not act as a barrier to entry or expansion for new lenders*". However, we now briefly outline the ways in which we believe the recommendation may be made more precise in order that they provide a greater focus to the FCA's work.

Timescale for implementation

In discussing the time taken to implement its recommendation on real-time data-sharing, the CMA states that it "*expects the FCA to be able to make significant further progress …. within 12 months of publication of our final report*". In fact, this is broadly in line with its proposed timescales on all of its remedies and takes no account of the specifics of this particular issue. That is, that the industry has already been prevaricating on the adoption of real-time data-sharing for several years and now is the time finally to bring the matter to a conclusion.

Whilst welcome recent progress which has certainly been made, for all of the reasons outlined in our previous response, we still believe that there is some way to go before all CRAs and lenders are participating in an effective real-time data-sharing process, despite the months and years of prior discussion. In that context, we do not believe that "*significant further progress … within 12 months"* is sufficient not least because it is obviously unclear as to what would be regarded as "*significant further progress*" . Rather, we believe that the FCA should impose an absolute deadline for the total implementation and adoption of real-time data-sharing of 6 months. In view of how matters currently stand and the time which has so far been afforded, we believe this to be an entirely realistic (and arguably generous) timescale.

We would therefore urge the CMA to recommend to the FCA that it imposes such a deadline. Although the FCA has announced that it expects to see 90% adoption by November, we have highlighted the dangers both of the 10% of loans which apparently do not have to be subject to real-time data-sharing, as well as the lack of detail in what the FCA actually requires. It is now time to state when we will see full implementation and adoption of real-time data-sharing.

What is 'real-time data-sharing'?

In order for any real-time data-sharing to be effective, it is necessary to be precise about exactly what is required. The flaw in the approach which the FCA has adopted is that it allows significant room for interpretation by different CRAs, with the result that none of them have adopted or propose to adopt what might objectively be regarded as a fully comprehensive solution. Only prescriptive regulation will overcome that hurdle by ensuring consistency and effectiveness. We highlight the following issues by way of example:

- Real-time should be mean real-time, which in practical terms should mean that lenders have visibility of a relevant transaction or event no more than 30 minutes after it occurred.

- The data shared should extend beyond simply the opening and closing of a loan account and should include: product type; amount or credit limit; term; recurring repayment; payment due date; amount of arrears; number of payments overdue; total amount overdue; date when arrears were paid etc.

- The triggers for making a report to a CRA should include: an application being made; an offer of lending being made; a loan being opened; an account falling into arrears; an account deteriorating in arrears; a repayment arrangement being agreed; an account being cured or closed.

- Regulation must be clear as to exactly which CRAs and lenders are required to participate. If it is anything less than 100%, the criteria for excluding any must be precise and a timescale adopted for when they will be required to participate.

- What happens if any CRAs or lenders subsequently withdraw participation in real-time data-sharing? Any unregulated solution creates this significant risk and therefore there must be a plan for what will occur in the scenario.

Whilst 118 118 Money obviously does not expect the CMA to include this level of detail within its recommendation to the FCA, we do believe that it should recommend that the FCA itself address it. In simple terms, it should therefore recommend that in the course of implementing its solution, the FCA specify precisely what it means by real-time data-sharing with reference to the issues above. Regrettably, the FCA has not engaged in this level of detail to date, with the result that the solutions which have been developed will not provide sufficient protection to consumers or benefits for competition.

Terms of access to real-time data-sharing

118 118 Money strongly welcomes the CMA's proposal to recommend to the FCA that it conduct further work on "*the terms of access to real-time data-sharing schemes, to ensure that these do not act as a barrier to entry*", which we believe is of critical importance.

Again, however, we believe that it would be preferable for the CMA to specify in some greater and more specific detail, the issues which the FCA should be considering (and subsequently including in prescriptive regulation). Those issues are as follows:-

- Who should be entitled to participate? If (as currently happens) some CRAs only make real-time data-sharing available to a closed user-group, it will both deny the benefits entirely to those who are excluded and reduce the benefits even to those who are included (as they will not obtain data from those who are not).

- Who should be required to participate? If either significant CRAs or lenders choose not to participate it will notably reduce the benefits to everyone else, because in order for any solution to be effective, it must be comprehensive. The FCA's target of 90% take-up will inevitably lead to a significant number of loans not being reported in real-time, but without knowing to whom they were made, other lenders will never have confidence that they're seeing a full credit history

- What are the costs of participation? Whilst all CRAs operate within a commercial environment, the FCA should be mindful that if they set the charges for utilising real-time data-sharing too high, it is likely to prevent smaller and new entrant lenders from participation. Clearly, that in itself will create an AEC by allowing only those who have greater financial resources to benefit from the best data.

- What are the timescales or other barriers to participation? Even if a CRA is providing a real-time data-sharing solution, individual lenders may still encounter difficulties and delays in being able to agree terms with the CRA and actually access the data. The CRAs also currently possess the freedom to impose other restrictions or requirements that might delay or otherwise obstruct a lender who wants to obtain real-time data. The FCA should be mindful that in a highly competitive market, such delays could cause significant difficulties.

118 118 Money would again reiterate that although we recognise that it would not be practical for the CMA's recommendation to address all of these points, we would urge the CMA at least to be specific in recommending that the FCA do so.