COMPETITION AND MARKETS AUTHORITY

PAYDAY LENDING MARKET INVESTIGATION

RESPONSE OF WONGA GROUP

TO

THE PROVISIONAL DECISION ON REMEDIES

OF 9 OCTOBER 2014

30 OCTOBER 2014

1. EXECUTIVE SUMMARY

1.1 This submission sets out the response of Wonga Group (**"Wonga"**) to the Competition & Markets Authority's ("**CMA**") payday lending market investigation provisional decision on remedies (**"PDR"**) of 9 October 2014.

1.2 The CMA has reached the provisional conclusion that its proposed package of remedies represents a proportionate solution to the adverse effects on competition and resulting customer detriment identified in its provisional findings.[1] This conclusion is reached on the basis of the provisional conclusion that: (i) the proposed remedies would be effective,[2] and are no more onerous than necessary;[3] (ii) the benefits of the remedy package are likely to exceed the costs; and (iii) the risk of adverse effects is small.[4] The CMA reaches the view that the proposed price cap (which the Financial Conduct Authority (**''FCA''**) has a statutory duty to impose) is more likely to create additional risks to competition than to increase competitive pressure, and this increases, rather than reduces, the need for effective remedial action to stimulate competition.

1.3 Wonga does not agree that the remedies package, as specified in the PDR, represents an effective or proportionate solution. In particular, Wonga considers that there is a significant risk of adverse effects arising from the proposed remedies package which are inconsistent with the aims of the CMA. Amendments to the remedies package are therefore required in order to achieve a less onerous and more proportionate outcome.

There is no compelling evidence that the remedies package will be effective or that it will deliver significant benefits to customers

1.4 There is no compelling evidence that the CMA's proposed remedies package will be effective under the price cap regime or that it will deliver material benefits to customers. The CMA simply assumes that this will be the case (and that the package will be complementary to the price cap) rather than properly exploring the relevant interactions and, specifically, how the price cap itself, by fundamentally changing market dynamics, is likely to undermine the effectiveness of the CMA's proposed remedies package.

1.5 Wonga fundamentally disagrees that there will be scope for "substantive" price competition to take place within the framework of the proposed price cap, and considers that the CMA has no compelling evidence to support such a view. More specifically:

(a) any examples of lenders which currently price beneath the cap cannot be used as a reliable indicator of what will happen post price cap because: (i) these lenders may not survive; (ii) other parallel regulatory initiatives are simultaneously increasing lenders' costs and may therefore make these prices unsustainable; and (iii) it would be rational for such lenders to increase prices to the level of the cap given the reduction in competition from firms which will exit (indeed the FCA explores this scenario as a possible mitigation strategy);

(b) there is no compelling evidence that the remaining lenders in the segment will have the ability to offer price reductions on the basis of differences in their cost base. The price cap will force the exit of the least efficient firms such that those remaining in the segment can be expected to be similarly efficient; and

(c) finally, (and critically) the CMA has failed to appreciate the impact of the price cap itself on the incentives of lenders to compete in circumstances where the segment

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1 PDR, paragraph 8.38.

2 PDR, paragraph 8.3.

3 PDR, paragraph 8.10.

4 PDR, paragraph 8.37.

will become markedly more concentrated, less diverse, more transparent and less profitable. It cannot simply be assumed that greater customer engagement and pressure from supposed new entrants will drive a more competitive supply-side without properly assessing the range of factors which will influence behaviour following the fundamental changes to market structure and competitive dynamics which the price cap will bring.

Insufficient weight has been given to unintended consequences which will increase the cost burden on lenders significantly

1.6 The CMA has given insufficient weight to certain risks and unintended consequences which are likely to have the effect of significantly increasing the cost burden on lenders. In particular, there are a number of uncertainties facing commercial price comparison website (**''PCW''**) operators which will discourage entry and/or expansion to the payday segment, namely: (i) the accreditation regime which has not been market tested and will be finally determined by the FCA as opposed to the CMA; (ii) [CONFIDENTIAL]; and (iii) the impact of the price cap which will create uncertainty about the likely profitability of operating a PCW in the payday loan segment. As a consequence:

(a) the risk of PCW operators acquiring market power is much higher than suggested by the CMA.[5] [CONFIDENTIAL]; and

(b) there is a strong likelihood that no PCW operator will seek (or successfully obtain) accreditation, in which case lenders would face a significant cost burden in creating or commissioning an accredited website and funding its ongoing losses (where the principle of proportionality requires that the significance of these costs must be assessed against the low likelihood of the remedy yielding benefits).

Elements of the remedies package are more onerous than necessary and should be amended

1.7 Given the lack of compelling evidence supporting the effectiveness of the remedies package, and the high risk of unintended consequences, the CMA must be particularly careful to ensure that the package is no more onerous than necessary, and that the risk of adverse effects is properly addressed. In this regard, Wonga considers that the following elements of the package are more onerous than necessary to achieve the CMA's aim and accordingly should be amended:

(a) the fall-back option which requires lenders to create and commission an accredited website if no commercial PCW operators are interested in seeking accreditation and/or are capable of meeting the required standards, is disproportionate as it imposes an obligation to fund a commercially unviable, loss-making entity, and should not be required, if at all, until all possible options to stimulate commercial interest have been exhausted. More specifically:

(i) the accreditation scheme should be run (or at the very least devised) by the CMA in order to provide greater certainty at an earlier stage to PCW operators contemplating entry/expansion as to what the criteria will be;

(ii) the CMA should undertake a detailed survey of the large commercial PCWs operators to explore their commercial interest against specific parameters; and

(iii) the CMA/FCA should enter into discussions with [CONFIDENTIAL].

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5 PDR, paragraph 8.32(a).

Beyond this, the requirement on lenders in the Order should be specified as follows in order to provide a reasonable degree of protection from excessive costs:

(i) if no commercial PCW operator applies for accreditation within 6 months of making the Order, the CMA (if it is the accreditation authority or, otherwise the FCA) should be required to review the criteria to assess whether the scheme could be made more commercially attractive and then re-engage with commercial operators; and

(ii) if no commercial PCW operator applies for accreditation within 12 months of making the Order, lenders should have the option of deploying the infrastructure created for lenderscompared.co.uk to minimise the set-up costs involved in creating an entirely new PCW;

(b) the requirement on lenders to supply details of their prices and products to be published on at least one accredited PCW and for this requirement to become binding three months after the CMA issues a notice indicating the availability of at least one accredited PCW. This requirement should not become binding unless adequate protection from the exploitation of market power by PCW operators is available either through the availability of more than one accredited PCW operator or a regulatory mechanism for ensuring that commissions are fair, reasonable and non-discriminatory. More specifically, in the event that only one commercial PCW operator applies for accreditation within 12 months of making the Order, the obligation on lenders would be enforced three months after the earlier of the following dates:

(i) the date that the CMA establishes a mechanism for ensuring that commission fees charged by the PCW operator are fair, reasonable and non-discriminatory; or

(ii) the date that a third commercial PCW operator obtains accreditation; and

(c) lenders should not be required to include a link to one or more accredited PCWs as part of any summary of borrowing costs because this is duplicative and unnecessary given the requirement (as part of the PCW remedy) for lenders to provide such a link prominently on their website so that it would be clearly visible to a borrower prior to beginning an application.

2. PRICE COMPARISON WEBSITE REMEDY

The CMA's proposed fall-back option imposes inappropriate and disproportionate costs on lenders

2.1 The CMA has provisionally concluded that commercial operators will be best placed to deliver accredited PCWs and that a number of such operators would be interested in doing so.[6]

2.2 If commercial PCW operators do not seek accreditation (as anticipated by the CMA) or are not granted it, then it is proposed that, as a fall back option, lenders will be required to work together to create or commission a website which complies with the accreditation scheme on the following basis:

(a) it is proposed that the fall-back option is stipulated as a requirement in the Order as follows "*The CMA remedy order would provide that in the event that no PCW applies for accreditation within a specified period – for example, six months of making the Order – lenders would be required to create or commission a PCW that satisfied the accreditation criteria within a further period (for example, 12 months), and the Notice would then relate to this PCW*";[7]

(b) as regards practical implementation, it is expected that a competitive tender would be used, "*the outcome of which would determine the costs to lenders of the remedy*";[8] and

(c) the total costs to lenders of establishing such a site are considered to "*be very unlikely to exceed £1 million and could be substantially less than this*".[9]

<u>The CMA has inadequately assessed and/or tested the likelihood of entry/expansion by commercial PCW operators</u>

2.3 The CMA considers the fall-back scenario to be unlikely but this appears to be a view based entirely on preliminary conversations with PCW operators.[10] It is not clear how much weight can reasonably be placed on these expressions of interest as it is unclear whether operators have been able to assess the commercial attractiveness of developing such products in the context of specific accreditation criteria, and there remains considerable uncertainty as to the impact of the FCA's price cap proposals as well as the implications of Google's Consumer Advisory Match (**"CAM"**) rules.

2.4 Moreover, the PCW operators themselves have indicated that a key criterion for successful operation in this segment is previous and "*considerable*" exposure to the short-term lending market and, in particular, prior experience of working with payday lenders.[11] It is not clear how many entities would meet such a criteria (it would rule out, for example, [CONFIDENTIAL]).

2.5 Without a more rigorous approach to testing the likelihood of entry/expansion by commercial PCW operators, the CMA cannot reasonably reach a view on the risk of commercial operators being unwilling or unable to seek accreditation. In these circumstances, it is inappropriate and disproportionate to expect the few lenders that may

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6 PDR, paragraph 3.70.

7 PDR, footnote 72.

8 PDR, footnote 217.

9 PDR, footnote 217.

10 PDR, paragraph 3.44.

11 PDR, Appendix 1.1, paragraph 43.

remain in the market following the introduction of the FCA's price cap to become the PCW provider of last resort.

2.6 The PDR indicates that commercial operators will "*seek accreditation only if they anticipate developing a website that would be profitable (ie the expected revenues were likely to outweigh the cost of developing and managing the payday loan comparison site).*"[12] Wonga considers that PCW operators will seek accreditation if they identify profitable opportunities (taking into account the opportunity cost of any investment) and this is deemed consistent with their strategic direction more generally. In this regard, there are a number of risks, namely:

(a) the accreditation criteria, to be set by the FCA, will have a significant influence on the level of commercial interest as acknowledged by the CMA which states that "*We noted, however, that over-specifying such criteria also carried significant risks, namely, making compliance with the accreditation onerous and burdensome, discouraging participation*".[13] Wonga has seen no evidence in the PDR that the interest of commercial operators has been tested in the context of a proposed set of criteria, allowing the CMA reasonably to conclude that its criteria are not "onerous and burdensome". Moreover, the proposal that the FCA should establish and administer the accreditation scheme (rather than the CMA) introduces further uncertainty, as the FCA will determine the precise criteria with the risk that these will be more onerous and burdensome that those contemplated by the CMA;

(b) Google's CAM rules restrict the ability of PCW operators to include payday loan comparison tables within the same domain as listings for other financial services.[14] [CONFIDENTIAL].[15] Google's response to the CMA suggesting that mainstream PCWs could comply with the CAM rules by creating a sub domain for websites and dynamically generating menus [CONFIDENTIAL][16] [CONFIDENTIAL].

[CONFIDENTIAL].[17] [CONFIDENTIAL]. Wonga also considers that a solution is required which specifically allows payday comparison tables to be provided alongside comparison tables for other personal credit products (even in circumstances where a customer has searched using non-payday loan terms) because, in many cases, a payday loan might offer a better deal than the credit product in question.[18] The CMA has acknowledged the benefits of a wider product set (albeit in the reverse scenario) as follows:

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12 PDR, paragraph 3.50.

13 PDR, paragraph 3.82.

14 A good example of the impact of these restriction is money.co.uk. Customers who reach the site by searching for non-payday loan financial products will not see a link to payday loan comparison tables in the menu structure. If, however, customers reach the site by searching for payday loans or directly entering the site's URL, payday loan comparison information is accessible.

15 [CONFIDENTIAL].

16 PDR paragraphs 3.97 to 3.102.

17 [CONFIDENTIAL]

18 Wonga has provided examples to the CMA of third parties providing comparisons, for example between payday loans and unauthorised overdrafts. The Chartered Institute for Securities and Investment, for example, has undertaken research which compares the cost of taking out £200 unauthorised short-term overdraft from Lloyds Bank and NatWest with a similar loan from a typical payday loan lender. See Annex 2 of Wonga's Response to the Competition Commission's Statement of Issues of 14 August 2013. The CMA's own comparison of payday loans with other forms of credit suggests that borrowing using a payday loan is typically cheaper than using an unauthorised overdraft, "*Competition between payday lenders and other credit providers*" Competition Commission Working paper Annex 1 – Price Comparison Method, paragraph 8.

"*We therefore see clear advantages in customers being able to compare a range of types of personal credit some of which may be more appropriate to the customer's needs than payday loans.*"[19]

(c) on the FCA's own analysis, the price cap will fundamentally change market structure and market dynamics and this will impact both prospective revenues and costs for commercial PCW operators. For example, revenues may be expected to be lower to the extent that loans are less profitable and this is reflected in lower referral fees which lenders are prepared to pay to PCW operators. However, PCW operators may benefit from lower bidding costs (for example in bidding for keyword traffic) because there may be less competition from fewer lenders (due to market exits). The net impact on margins is unclear, but it is likely that these risks will discourage some operators (at least until the impact of the price cap proposals is better understood).

2.7 In light of these risks, Wonga considers that it cannot be assumed that commercial PCW operators will seek (and obtain) accreditation and Wonga takes little comfort from the fact that "interest has been expressed" in conversations with the CMA, particularly as market and regulatory conditions are changing rapidly, and may have moved on since these conversations took place. A more rigorous assessment of likely entry/expansion by PCW operators is required, with the CMA seeking to minimise the risks over which it has control, in particular:

(a) the accreditation scheme should be run (or at the very least devised) by the CMA in order to provide greater certainty to PCW operators contemplating entry/expansion as to what the criteria will be. The CMA has relevant experience in adopting a PCW remedy following the Home Credit investigation and has detailed knowledge of the payday loan sector from this investigation. The CMA provides no compelling reason for preferring the scheme to be devised and run by the FCA, other than highlighting its focus on enhancing competition (which is clearly also the focus of the CMA);[20] and

(b) the CMA/FCA should enter into discussions with [CONFIDENTIAL].

2.8 More specifically, Wonga considers that the CMA should undertake a detailed and exhaustive survey of the large commercial PCWs operators to explore their commercial interest against specific parameters reflecting: (i) a proposed set of accreditation criteria; and (ii) likely market and regulatory outcomes, for example:

(a) "Best case" outcomes assuming: (i) exemptions from the Google rules are secured for accredited PCWs and (ii) keyword search costs [CONFIDENTIAL]; and

(b) "Worst case" outcomes assuming: (i) PCW operators must create a sub-domain for websites and generate menus dynamically in order to comply with the existing Google rules and (ii) keyword search costs remain stable.

2.9 Operators could also be questioned, in broad terms as to how these parameters are expected to influence their decisions to enter/expand, in particular, any thresholds in respect of keyword search costs beyond which profitable activity is expected to be difficult. Operators should also be asked to indicate the timescale over which they anticipate developing their products and obtaining accreditation.

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19 PDR, paragraph 3.95.

20 "*The identity of the accrediting body is also important: we would expect schemes run by an expert sectoral regulator, with a focus on enhancing competition, to be particularly likely to have a positive impact on the quality of PCWs operating in that sector*", PDR, paragraph 3.36.

Lenders should not be obliged to become the provider of last resort if the commercial PCW operators do not seek (and obtain) accreditation

2.10 Following the CMA's logic, if PCW commercial operators do not seek accreditation on a voluntary basis, then it can reasonably be assumed that they do not see a profitable opportunity in doing so. In these circumstances, Wonga considers that it would be disproportionate (and in all likelihood ineffective) to require lenders to step in to create and subsidise the provision of an uneconomic service. A competitive tender, in these circumstances, might minimise the subsidy required but would not address the fact that the entity created is not expected to be viable in its own right.

2.11 Nor would this deliver an effective and sustainable remedy because the benefits from commercially operated PCWs that are subject to competitive pressure (which the CMA has rightly identified) would not be available. More specifically, a PCW established by lenders would lack incentives to compete actively for lenders and for visitors, and competition, therefore, would not drive efficient operation and innovation.

2.12 Wonga does not have detailed information, but would expect that the stand-alone costs of creating a PCW (even where disciplined though a tendering process) may be expected to be significant, and ongoing costs would be incurred to cover operating losses (because referral revenue would be unlikely to cover the costs incurred to drive traffic to the site). Even if set-up costs were to be approximately £1 million, this could result in a significant burden for those few firms which are left in the market following implementation of the price cap which the FCA's own analysis indicates could be three online players (and possibly fewer based on Wonga's analysis). Equally, it is not clear how, in these circumstances, effective governance structures could be created to prevent conflicts of interest between the lenders and the PCW entity due to, for example, direct competition between them in seeking to attract website traffic.

2.13 Imposing such costs would be disproportionate particularly given that the expected benefits from price reductions below the price cap are highly speculative and uncertain as discussed in section 5 below.

2.14 The PDR confirms (and Wonga agrees) that a commercial solution involving several participants would be more effective and proportionate:

> "…*we took the view that, given the existing maturity of PCWs in general, the fact that some PCWs are already providing some details of payday loans and that PCWs operating in other sectors are also potentially interested in providing the payday loan comparison tables, it would be more effective and proportionate to seek to encourage several participants, including existing PCWs, to seek accreditation.*"[21]

2.15 If no commercial PCW operator applies for accreditation within a specified period of time (say six months) there should be no requirement on lenders to create or commission a site,[22] but rather the CMA (if it is the accreditation authority, or otherwise the FCA) should be required to reconsider the accreditation scheme in consultation with PCW operators to encourage profitable opportunities to be identified by commercial operators. In other words, the fall back option should not be a clearly sub-optimal solution which would, in all likelihood be ineffective and will impose unnecessary and disproportionate costs on lenders, but rather a process which emulates how markets actually behave – i.e. a dynamic process which tests, trial and learns. Such an approach will be much more likely to create a sustainable remedy which will deliver benefits to customers in the long run.

2.16 If, however, no PCW operator comes forward after further testing and review of the accreditation criteria (for example after 12 months), and the CMA nevertheless wishes to

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21 PDR, paragraph 3.46.

22 As outlined in Section 3 footnote 72 of the PDR.

retain a fall-back option, then every reasonable effort should be made to minimise the burden on lenders. One option in this regard would be to deploy the infrastructure created for lenderscompared.co.uk to minimise the set-up costs involved in creating an entirely new PCW.

The risks of distortion to the PCW sector have been understated

2.17 The CMA has rightly identified a risk of PCW operators acquiring market power in the distribution of payday loans which might lead to increased commissions for lenders and higher prices to customers.[23] The CMA considers this risk to be small "*given that we expect there to be a number of accredited PCWs and that barriers to entry for PCWs seeking accreditation in this sector are likely to be low.*"[24] As discussed above, Wonga considers that this view is based on insufficient evidence. Based on the risks identified above, Wonga considers that commercial operators can be expected to be very cautious in practice (despite what they might have indicated to the CMA). Moreover, to a large extent barriers to entry will be a function of the accreditation criteria and there is no indication in the PDR that the likely commercial reaction to the criteria has been gauged.

2.18 Wonga does not agree, therefore, that the CMA has designed its remedy "*to avoid putting either lenders or PCW operators in an unduly advantageous negotiating position*."[25] There is a material risk that lenders will be unduly disadvantaged in the likely event that few (if any) PCW operators seek accreditation and lenders (even those with strong brands) are exposed to the exploitation of market power. The exposure would arise because there will be a legal obligation to trade with at least one PCW operator, and it is difficult to exert competitive pressure in a highly concentrated market (potentially a monopoly in the event that only one commercial operator seeks and achieves accreditation). In this regard, Wonga notes the CMA's current thinking that the obligation on lenders would take effect "*around three months after the FCA has established its accreditation scheme and **at least one** PCW has been accredited*"[26] (emphasis added). In other words, trading with what might turn out to be a monopoly provider is mandated by the proposed remedy.

2.19 [CONFIDENTIAL].

2.20 Beyond this, if PCW operators are able to insist on excessive commissions, this will act as a barrier to entry and expansion for new or smaller lenders seeking to establish themselves, which would undermine the effectiveness of the remedy in assisting such entities[27] (notwithstanding the barriers which will be created by the price cap and which the CMA has given insufficient weight to – as discussed further below).

2.21 Although the risk of distortions arising from market power is deemed by the CMA to be small, the following protections are mentioned briefly in the PDR:

(a) the constraints on PCW operators as a consequence of competition law: "*we expect PCW operators to be aware of their obligations under Chapters I and II of the 1998 Act and Articles 101 and 102 TFEU and of the concurrent competition powers of the FCA and CMA, and to undertake such compliance audits as are appropriate*";[28] and

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23 PDR, paragraph 8.32(a).

24 PDR, paragraph 8.32(a).

25 PDR, paragraph 3.60.

26 PDR, paragraph 3.111.

27 PDR, paragraph 7.14(a).

28 PDR, paragraph 8.32(a).

(b) further scrutiny (as part of accreditation) of commercial arrangements to ensure that PCWs are contracting with lenders on fair, reasonable and non-discriminatory (**"FRAND"**) terms.[29]

2.22 Wonga considers that these protections are insufficient. It is perverse for the CMA to suggest protections against market distortions caused by poor remedy design, particularly where these involve further burdensome regulatory interventions which aim to secure more competitive pricing, and/or time-consuming and costly investigations under Article 101/102 TFEU if compliance with *ex post* competition does not constrain market players as suggested.

2.23 Rather, the CMA should take all reasonable steps to establish a competitive outcome (including properly testing commercial PCW operators' interest) and should not impose the proposed obligations on lenders until there is a reasonable likelihood that competitive pressure will offer sufficient protection against unreasonable commercial arrangements between lenders and PCW operators.

2.24 If regulatory intervention is needed to secure FRAND terms, then this needs to be specified in greater detail. One option would be the establishment of a dispute resolution procedure including publication of guidance on the principles that will be applied in determining disputes relating to commissions and fees. This might include guidance on the costs which would be considered reasonable for a PCW operator to seek to recover.

Effective implementation requires competitive neutrality and transparency

2.25 Wonga strongly agrees that loan information should be presented to customers on a competitively neutral basis such that rankings are not affected by any commercial relationship the operator may have with lenders.[30] This is a problem at present where rankings can be ordered by how much commission a PCW will make if a user is directed to a lender, which will favour those lenders paying higher amounts on a cost per click (**"CPC"**) basis. This can have the perverse effect of giving prominence to less responsible lenders who can pay higher CPCs because they tend to accept more loan applications from which they gain some revenue without applying adequate affordability assessments. As indicated in the PDR, Wonga agrees that competitive neutrality should be enforced not only in relation to product rankings but also other devices for giving prominence, in particular advertising-funded sections at the top of web pages and banner placements.

2.26 Wonga also agrees with the proposal that customers should be invited to specify the value and duration of a loan before a comparison table is presented. Consideration should be given, however, to the presentation of results for lenders who offer risk-based pricing, in particular, it would be misleading for such a lender to gain prominence because prices are displayed on the assumption that the lowest risk price will apply. Wonga suggests that this is addressed by displaying average prices for loans of the specified value and duration (for example, at the 51st percentile). Equally, standard pricing should be displayed without factoring in the effect of any early repayment (for example if a customer queries a £100 loan for 15 days which falls beneath a lender's minimum duration criteria but could be achieved by taking a longer loan and repaying early). In short, the availability of early repayment and whether this will reduce the cost of the loan should be indicated as a feature but not factored into the total cost of credit.

Amendments to the proposed implementation of the PCW remedy are required

2.27 For the reasons outlined above, Wonga considers that amendments are required to the proposed design and implementation of the PCW remedy in order to ensure that it is

[29] PDR, paragraph 3.61.

[30] PDR, paragraphs 3.62 to 3.66.

proportionate and no more onerous or burdensome than is required to achieve the CMA's aim. More specifically, the following amendments are required:

(a) if no commercial PCW operator applies for accreditation within 6 months of making the Order, the CMA (if it is the accreditation authority or, otherwise the FCA) should be required to review the criteria to assess whether the scheme could be made more commercially attractive and then to re-engage with commercial operators;

(b) if no commercial PCW operator applies for accreditation within 12 months of making the Order, lenders would be required to create/commission a website (which would comply with the revised criteria) and would have a further 12 months to do so (i.e. 24 months from making the Order in total). As indicated above, the option should be available for lenders to deploy the infrastructure created for lenderscompared.co.uk in order to minimise set-up costs;

(c) if only one commercial PCW operator applies for accreditation within 12 months of making the Order, the obligation on lenders would be enforced three months after the earlier of the following dates:

    (i) the date that the CMA establishes a mechanism for ensuring that commission fees charged by the PCW operator are fair, reasonable and non-discriminatory; or

    (ii) the date that a third commercial PCW operator obtains accreditation.

3. A SUMMARY OF THE COST OF BORROWING

3.1 Wonga considers that, in principle, providing statements of borrowing costs to customers is a sensible approach to increase transparency and awareness of the total cost of borrowing. Wonga's comments on the CMA's specific proposals are provided below.

Method of distribution of the summary

3.2 Wonga agrees that using online lenders' existing customer account management tools (MyAccount in the case of Wonga) as a method for distributing the summary is a cost-effective and secure solution, which is consistent with how customers engage with lenders. Wonga agrees that informing its customers of the availability of a summary by email makes sense.[31] Wonga already contacts its customers soon after the completion of a loan to thank customers for repayment and one option would be to provide the notification as part of this communication.

The content of the summary

3.3 The PDR indicates that the summary should cover both the most recent loan that has been repaid, as well as the costs of borrowing with that lender over the preceding 12 months.

3.4 Wonga would propose to implement this remedy by [CONFIDENTIAL].

3.5 MyAccount provides a summary of a borrower's current loan (so long as that loan is not in arrears). This includes a summary of the original terms of the loan (including duration, principal, fees and projected interest) and the current balance which would need to be repaid if the borrower settled immediately. [CONFIDENTIAL]. [32]

3.6 The information on loans which is currently made available to customers can be accessed by clicking on "View Loan Details" which appears on the MyAccount landing page. This brings up a popup containing the summary information with the heading "My Loan Details".

The trigger point for the availability of the summary

3.7 Wonga considers that it is feasible for it to make available the summary [CONFIDENTIAL] within [CONFIDENTIAL] hours of finalising the repayment of a loan.

Ensuring borrowers receive and have the opportunity to review the summary

3.8 As described above, Wonga currently makes available specific information on current loans within MyAccount and [CONFIDENTIAL].

3.9 [CONFIDENTIAL][33] [CONFIDENTIAL].

3.10 [CONFIDENTIAL]

3.11 [CONFIDENTIAL].

Using the summary to encourage borrowers to shop around

3.12 Wonga considers that the provisional decision to include in the summary a reference to the existence of accredited PCWs and a hyperlink to one or more accredited PCWs (and/or

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31 PDR, paragraph 3.195.

32 [CONFIDENTIAL].

33 [CONFIDENTIAL].

the accrediting body's list of accredited sites) is duplicative and unnecessary given the requirement to provide such a link as part of the PCW remedy. If lenders are required (as part of the PCW remedy) to position such a link prominently (e.g. immediately adjacent to the sliders) in text of appropriate size, font and colour so that a borrower is aware of it, it is very unlikely that a new or returning customer would not be aware of the link. There is, therefore, no need to provide the link within the summary as well.

Costs and timescale for implementation

3.13 Wonga estimates that implementation of this remedy would require additional [CONFIDENTIAL] costing approximately [CONFIDENTIAL] in total (with additional ongoing costs).

3.14 Wonga notes that the CMA envisages putting in place an order within six months of publishing its final report with any additional transitional period granted to lenders not exceeding three months.[34] Wonga considers that implementation is feasible within this timeframe, assuming the requirement is as set out in the PDR.

34 PDR, paragraph 7.23(b)

4. RECOMMENDATIONS TO THE FCA

4.1 In this section Wonga sets out its representations on the proposed recommendations to the FCA to take steps to:

(a) improve the disclosure of late fees and other additional charges;

(b) help customers shop around without unduly affecting their ability to access credit;

(c) promote real-time data sharing between lenders; and

(d) increase transparency regarding the role of lead generators.

4.2 As a preliminary observation, Wonga notes that its ability to comment substantively on each of these recommendations (and their respective potential impacts on Wonga) is limited by the fact that there is an inherent uncertainty as to whether and how the FCA would implement the proposed recommendations.

Disclosure of fees and charges

4.3 The CMA has provisionally found that "*customer demand is particularly insensitive to the fees and charges incurred if customers do not repay their loans in full and on time*."[35] To address this concern, the CMA has provisionally decided to recommend that the FCA:

> "*Take the steps necessary to ensure that payday lenders and relevant intermediaries are fully aware of their obligations to disclose to customers prominently and on a timely basis details of late fees and other charges payable if a loan is not repaid in full and on time.*
>
> *Review proposals by payday loan PCWs for complying with these obligations as part of the accreditation process.*
>
> *Monitor actively both the presentation by payday lenders and relevant intermediaries of information about late fees and other charges payable if a loan is not repaid in full and on time and the accessibility of this information to customers, and to take enforcement action where necessary*."[36]

4.4 The CMA notes that it has received "*broad support*" that fees and charges should be presented transparently.[37] Wonga agrees that fees and charges should be presented transparently. However, as explained in Wonga's Response to the Remedies Notice, the CMA's conclusion that customers are less informed about back-end charges than about upfront charges is unsupported by evidence.[38] On this basis, the CMA (and indeed the FCA) should be cautious about over-stating the need for additional regulation or enforcement.

4.5 Further, and in any event, Wonga considers that it already meets the CMA's desired level of disclosure as its website currently provides substantial information upfront on the additional charges and fees payable if a customer fails to repay the loan in full on time.[39]

4.6 If, notwithstanding the above, the CMA intends to make the proposed recommendation to the FCA, Wonga would urge the CMA to draw to the FCA's attention the following:

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35 PDR, paragraph 3.115.

36 PDR, Figure 3.2 (page 50).

37 PDR, paragraph 3.123.

38 Response of Wonga Group to Remedies Notice of 11 June 2014, paragraphs 4.4.

39 Response of Wonga Group to Remedies Notice of 11 June 2014, paragraph 4.5.

(a) some lenders (such as Wonga) already provide the relevant information upfront to customers and therefore the FCA's focus should be on ensuring that lenders with less transparent practices are required to be equally transparent as regards information on back-end fees and charges. This is acknowledged in the PDR which states "…*the widespread adoption of the best practices present in the market would go some way towards remedying the problems we have identified*";[40]

(b) only indicative charges and fees associated with late repayment could be disclosed to customers upfront as the actual interest charged depends on the parameters of the original loan and how late repayment is (and to the extent the original loan principal is increased by way of a "top-up");

(c) the FCA should consider carefully the interaction between any additional regulation/enforcements and its price cap proposals (which is likely to have the effect of standardising late fees and charges across the sector). In this regard, the CMA expects lenders to offer different late fee structures within the constraints of the price cap but does not explain their incentives for doing so;[41] and

(d) caution is required in seeking to raise the prominence of late fees to avoid customers choosing loans by reference to the competitiveness of late charges rather than the competitiveness of the costs of the original loan (bearing in mind that, in Wonga's experience, most customers pay their loan in full on time).

Helping customers shop around without unduly affecting their ability to access credit

4.7 The CMA has provisionally found that borrowers face difficulties in shopping around and identifying the best offer. Further, the inability of borrowers to establish prior to application whether a lender would be willing to lend to then "…*may result in borrowers either choosing their loan primarily on the basis of which lender they think will approve their application or which gave them a loan before…*".[42]

4.8 In order to address this, the CMA has provisionally decided to recommend that the FCA "…*work closely with lenders, CRAs and operators of accredited PCWs to encourage initiatives including greater use of quotation searches, to enable customers to search the market without adversely affecting their access to credit*" (i.e. without leaving a footprint on borrowers' credit records).[43] The CMA then identifies two broad issues which the FCA might wish to consider, namely:

(a) whether the disclosures made to borrowers by lenders are sufficient; and

(b) whether FCA guidance on the use of quotation searches should be revised to the status of a rule in situations where lenders introduce variable or risk-based pricing.

4.9 As an initial observation, and as is clear from Wonga's Response to the Remedies Notice (paragraphs 5.2 to 5.5) and Wonga's PFs Response (paragraphs 5.17 to 5.19), there is no compelling evidence that customers are choosing lenders based on whether they believe a lender will offer a loan. The PDR provides no new evidence as to the lack of information on eligibility preventing shopping around.[44] On this basis, Wonga submits that there is no

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40 PDR, paragraph 3.126

41 PDR, paragraph 3.130.

42 PDR, paragraph 3.137.

43 PDR, Figure 3.3 (page 55).

44 The TNS BMRB report *Research with Payday Lending customers* August 2014 (**"TNS Report"**) simply observes that "[t]*here were varying levels of interest among customers about there should be [on a price comparison website inter alia] an indication of how eligible they would be for a payday loan*". Although the report observes that customers "*with lower credit scores or experience of being turned down for loans in the past spontaneously raised*

objective need for CMA and/or the FCA to adopt measures to ensure that customers are better able to establish their likelihood of acceptance by a lender.

4.10 If, notwithstanding the above, the CMA were to make the proposed recommendation to the FCA, Wonga would draw the CMA's attention to the following factors, which the CMA should bring to the attention of the FCA.

4.11 First, the FCA should be very wary about requiring lenders to provide any indication of eligibility prior to application. As is clear from Wonga's previous submissions, other submissions to the CMA and the CMA's own analysis in the PDR, there are a number of significant practical considerations associated with providing an indication of eligibility, namely:

(a) credit search results are only a limited indicator of the likelihood of loan approval and therefore any eligibility assessment based on credit searches alone gives rise to considerable customer relationship issues (i.e. turning away potentially eligible borrowers who would ultimately have been approved and giving other borrowers an inaccurate impression that their application is likely to be accepted when it is later declined);

(b) in order to provide a meaningful indication of eligibility, a credit search will need to be supplemented with other checks, which will require borrowers to provide more detailed information. Borrowers might be reluctant to provide the necessary information at the "shopping around" stage;

(c) eligibility checks are bespoke to each lender and therefore need to be undertaken by the lenders. This cannot, in Wonga's view, be centralised through service providers such as PCWs;

(d) providing an indication of eligibility will be more difficult for lenders with variable and/or risk-based pricing; and

(e) the requirement to provide a compulsory pre-application eligibility assessment or an indication of creditworthiness will give rise to a number of direct and indirect costs, including significant development costs and increased CRA search costs. Wonga considers these costs would be disproportionate given the lack of evidence supporting the CMA's assertion that borrowers choose a loan based on whether they believe the lender will approve their application (rather than the merits of a particular lender's product).

4.12 Secondly, the FCA should be cautious about mandating greater use of quotation searches, and any increased use of quotation searches should not be at the expense of robust affordability checks. The footprint left on a credit record by an application search is an important indicator in determining the risk profile of a borrower and the loss of this indicator (or a reduction in its effectiveness as an indicator) could affect the robustness of affordability checks.

4.13 In addition, there are potentially considerable costs associated with increasing the use of quotation searches (especially in circumstances where an applicant makes a formal loan application and an application search would need to be undertaken as well). These costs (as well as implementation costs and costs arising from less robust affordability checks) need to be weighed against the magnitude of any AEC which the intervention seeks to address (as discussed at paragraph 4.9 above).

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eligibility as a useful feature", no information is provided on how many customers considered eligibility relevant to, or whether the inclusion of such information would promote, shopping around. Indeed, the report also states that customers with good credit scores thought that eligibility was irrelevant and other respondents considered that the "*total cost was the only information deemed worth including*".

4.14 Thirdly, in terms of disclosure to borrowers, Wonga notes that it already informs customers that it will undertake a credit search prior to submission of an application and customers are required to confirm (via a tick box) that they understand that Wonga will use their personal information to carry out a credit search. Wonga's privacy policy also states that "[l]*arge numbers of applications within a short time period may affect your ability to obtain credit, this is applicable whether you have been accepted or declined*."[45] Although Wonga would support moves by the CMA/FCA to ensure that other payday lenders also make similar disclosures to their customers, Wonga is not convinced that such intervention by the CMA/FCA would address any AEC identified by the CMA relating to shopping around.

Promotion of real-time data-sharing

4.15 In order to facilitate new entry and expansion, and also to assist in ensuring that the credit ratings of borrowers are not negatively affected by shopping around, the CMA has provisionally decided to recommend to the FCA to continue to work closely with lenders and CRAs to encourage the development and use of real-time data sharing systems that are open to all payday lenders and other credit providers.[46] In this regard, Wonga observes that the FCA is already working with lenders and CRAs to improve real-time data sharing and it is therefore unclear what the purpose of the CMA's proposed recommendation would be, and whether it will have any additional effect.

4.16 More generally, Wonga is fully supportive of moves to improve real-time data sharing between CRAs and payday lenders and considers it beneficial for all payday lenders to be required to share data on a real-time basis. The initiative will enable payday lenders to conduct more accurate credit risk and affordability assessments, thereby promoting responsible lending to the benefit of consumers. This obligation should relate not only to details of any new credit facility, but also to details on defaults and late payments. Further, Wonga observes that the quality of the CRA data could be further improved if other credit providers (credit card, overdraft, mortgage, personal loan providers) were subject to similar requirements. Wonga would urge the CMA to consider recommending that the FCA consider the extent to which real-time data sharing initiatives should be extended beyond payday lenders.

4.17 Wonga is already working closely with CallCredit and Experian to establish and improve real-time data sharing. Wonga is contributing data to CallCredit on a daily basis. Wonga is also monitoring Experian's real-time data initiative which was recently launched in July/August 2014. Wonga agrees that the "*CRAs and the payday lending industry have made significant progress towards developing and using real-time data sharing*".[47]

4.18 The CMA has observed that it "*saw benefits to competition in encouraging the greater sharing of data (in real time) with multiple CRAs.*"[48] As noted above, Wonga is already working with multiple CRAs in relation to the provision and receipt of data in real-time. Wonga shares the CMA's concern that requiring data to be shared with all CRAs could reduce the competitive dynamic between CRAs and unnecessarily increase costs for lenders. Wonga considers that the FCA's position, as stated in the PDR (i.e. that it would like to see lenders sharing with at least two CRAs)[49] and the CMA's proposed recommendation (that the FCA should promote "*the sharing of credit information by*

45 https://www.wonga.com/privacy-policy

46 PDR, Figure 3.5 (page 63) and paragraphs 3.170 and 3.171.

47 PDR, Appendix 3(1), paragraph 53.

48 PDR, paragraph 3.177.

49 PDR, Appendix 3(1), paragraph 48.

payday lenders with more than one CRA")[50] strikes the right balance (if, contrary to Wonga's view, this recommendation is deemed necessary) .

Lead generators

4.19 In order to address the lack of transparency in how the services provided by lead generators are described on their websites, the CMA has provisionally decided to recommend to the FCA that it should take steps to ensure greater transparency about the services they provide and the extent to which customers might not be offered the cheapest loan that is available to meet the customer's needs.[51] Specifically, the CMA considers that the FCA should take the steps necessary to ensure that lead generators:

(a) disclose clearly, prominently and concisely that they are "not a lender"; and

(b) state explicitly that the sale of customer details collected may not result in an offer of the cheapest loan that is available to meet the customer's need.[52]

4.20 The CMA also considers that there is a case for the FCA to undertake a broader review of the activities of lead generators, possibly during the authorisation process for lead generators.[53]

4.21 Wonga shares the CMA's concerns about the lack of transparency in relation to the way in which some lead generators operate [CONFIDENTIAL]:

(a) [CONFIDENTIAL];

(b) [CONFIDENTIAL];

(c) [CONFIDENTIAL]

(d) [CONFIDENTIAL].[54]

4.22 Wonga strongly supports efforts by the CMA to address the lack of transparency in how lead generators operate and broadly supports the proposed recommendation to the FCA. In particular Wonga agrees that lead generators should be required to disclose clearly and prominently that they are not a lender and that the use of their services may not result in an offer of the cheapest loan that is available.

4.23 In addition, however, Wonga considers that the CMA should also recommend to the FCA that:

(a) lead generators should publish the same financial "risk warnings" that payday lenders must provide on their websites and in other promotional material;

(b) lead generators should publish prominently that they receive a "commission"/"fee" from lenders in payment for the borrower's contact details;

(c) lead generators should be required to publish details on the extent to which customer details will be on-sold after the initial "ping tree" auction (i.e. to unsuccessful bidders and other third parties); and

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50 PDR, Appendix 3(1), paragraph 56(b).

51 PDR, Figure 3.8 (page 79).

52 PDR, paragraph 3.248.

53 PDR paragraphs 3.245 and 3.249

54 Response of Wonga Group to Remedies Notice of 11 June 2014, paragraph 7.1.

(d) given the customer detriment arising from the conduct of certain lead generators, it is important that the recommendation to the FCA is acted upon without undue delay.

5. **THE NEED FOR REMEDIAL ACTION AND THE EFFECTIVENESS OF THE PROPOSED PACKAGE**

5.1 The CMA's justification for its remedies package in the face of fundamental market changes (in particular those resulting from the implementation of the FCA's price cap) may be summarised as follows:

(a) the proposed price cap is unlikely to address the underlying features of the market identified by the CMA as giving rise to the AEC; and

(b) absent remedies to promote effective price competition, the price cap may further dampen competition (in particular if the cap became a focal point for payday loan pricing).[55]

The PDR identifies the risk of anti-competitive effects attributable to the price cap

5.2 The CMA appears to agree with Wonga that the price cap could have anti-competitive effects. The PDR states, for example, that the "*longer-term dynamic effects of competition, are very difficult to replicate through measures to control outcomes such as the price cap*".[56] More specifically, the PDR states:

(a) referring to characteristics of the payday loan segment which might limit the constraint on lenders from entry and expansion, "*The cap may even weaken the constraint further, if by reducing expected post-entry profitability the cap reduces the incentive for new lenders to enter, and increases the resources and time a new entrant requires to overcome its initial disadvantages and establish itself in the market.*"[57]

(b) "*a further potential effect of the proposed cap on competition is that it may further dampen price competition between lenders by providing a 'focal point' or 'going rate' for payday loan pricing*";[58]

(c) "*in the absence of effective price competition, there will be no incentive for lenders to compete below the cap, keeping their prices low and reflecting their costs in the prices they charge in the future. Absent effective competition, prices are unlikely to respond to changes in market conditions, such as technological developments, evolution in the products on offer, or changes in market structure.*"[59]

The need for remedial action by the CMA has not been established

5.3 Wonga disagrees, however, with the CMA's provisional conclusion on the potential scope for customer benefits under the price cap regime and, more particularly, the justification for the CMA's remedies package on the basis that it will deliver effective price competition, thereby ensuring that these benefits are passed on to customers, through the stimulation of customer engagement and the facilitation of entry and expansion, for example:

"*We consider that in the presence of the proposed price cap, which might otherwise risk reducing price competition between lenders (eg by making entry more difficult*

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[55] PDR, paragraph 6.28.

[56] PDR, paragraph 6.27.

[57] PDR, paragraph 6.16.

[58] PDR, paragraph 6.17. See also paragraph 6.21 "*The proposed price cap might also give rise to a risk that price competition between payday lenders is further dampened (albeit around a lower interest rate than is currently observed in the market), for example if entry were discouraged or if the cap were to become a focal point for the price of payday loans.*"

[59] PDR, paragraph 6.29.

and/or facilitating coordination), there will be increased importance attached to measures designed to enhance price competition between lenders."[60]

<u>The CMA's position is not consistent with reasonable administrative policy</u>

5.4 If the CMA has identified that the price cap could have anti-competitive effects (which it has), it would be consistent with its role as a competition authority to undertake a detailed assessment of those effects and to communicate its views to the FCA. The role of the FCA would then be to weigh up whether these anti-competitive effects (and the potential detriment to customers) are outweighed by consumer protection benefits. Wonga's detailed analysis suggests that this is not the case, [CONFIDENTIAL].[61]

5.5 It is not reasonable for the CMA to justify its regulatory intervention on the basis that it addresses the failures of other regulatory intervention. In short, Wonga agrees that dynamic competition is difficult to replicate through a price cap (as noted above); what the CMA has failed to appreciate, however, is that dynamic competition is also difficult to replicate using the kind of demand-side measures which the CMA is proposing in circumstances where a diverse segment which has been evolving dynamically is rendered markedly more concentrated, less diverse, more transparent and less profitable by the price cap.

<u>The CMA assumes, without compelling evidence, that its remedial package will have a greater impact on lenders' incentives than the price cap</u>

5.6 Remedial action is justified in the PDR by assuming that the CMA's interventions will be effective in stimulating competition by making customers more responsive and price sensitive and by encouraging entry. More specifically:

(a) the remedies are designed to increase customer awareness and facilitate searching and switching which, in turn, is expected to increase pressure on lenders to compete. This relationship between greater demand-side pressure and strong competition between lenders is at the heart of all of the CMA's remedy proposals;[62] and

(b) the remedies are also expected to increase the constraint on established lenders by the prospect of new entry or expansion by better allowing new and/or smaller entities to raise awareness of their products, reduce disadvantages in assessing credit risk and address reputation concerns.[63]

5.7 The CMA, however, simply assumes that there will be gains (in particular price reductions) available to customers from greater awareness, greater searching and greater switching, and that lenders will have incentives to provide such gains to retain existing customers and attract new customers.[64] Under the price cap regime, this simple dynamic cannot be assumed. Equally, there is an assumption that entry and expansion will become attractive as a result of the remedies package without proper consideration of the significant costs and risks suggesting otherwise in the post price cap world.

5.8 Post price cap, lenders will focus, in the first instance, on restoring margins through stricter lending criteria. Beyond this, lenders will focus on margin protection. The CMA

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60 PDR, paragraph 7.42.

61 [CONFIDENTIAL].

62 As outlined at paragraphs 7.7 to 7.12 of the PDR.

63 PDR, paragraph 7.13 to 7.15.

64 The PDR states "*we expect that the proposed package of remedies will increase the extent to which customers are responsive to price and choose the best loan for their requirements. This will in turn increase pressure on lenders to keep their prices low, rather than simply pricing at the level of the FCA's proposed price cap, in order to attract new customers and/or retain the existing ones*", (paragraph 7.12).

postulates that the remaining lenders will be stimulated to protect their positions through competition. This might have been a reasonable hypothesis under the market conditions which prevailed at the start of the CMA's investigation (i.e. many market players, diverse business models, high levels of entry, and the prospect of reasonable profits). It is not, however, a reasonable hypothesis under the vastly different market conditions which will prevail post price cap, the main features of which, may be summarised as follows:

(a) <u>increase in market concentration</u>: this is due to a contraction from a sector estimated by the CMA to have over 100 operators to a sector with three online players and possibly a high street operator (according to the FCA), with a material risk that the number of competitors would be lower. When all regulatory impacts are properly taken into account (in particular stricter affordability assessments), AlixPartners estimates that [CONFIDENTIAL]would actually be at the margins of profitability at the level of the price cap proposed by the FCA in July;[65]

(b) <u>high risk of the high street operators ceasing to operate entirely</u>: the FCA states "*at caps below 1%, there is a risk that HCSTC will not be distributed through the high street*";[66]

(c) <u>entry is unattractive</u>: the FCA states "[o]*n balance, we consider the likelihood of entry to the market to be low*";[67]

(d) <u>significantly lower profitability</u>: the proposed price cap will put significant pressure on margins. The FCA estimates that aggregate revenue will fall by 42 per cent[68] with a 21 per cent reduction in customers[69]. According to analysis by AlixPartners which considers the cumulative impact of all relevant FCA interventions, these figures are [CONFIDENTIAL] per cent and [CONFIDENTIAL]per cent respectively;[70] and

(e) <u>less diversity</u>: Wonga considers that lenders who may be able to remain viable post-cap are likely to be less diverse than the range of entities in the market at present. All of the remaining lenders, for example, are expected to be online players with similar cost structures and similar business models based on data-driven affordability assessments and sophisticated online customer interfaces.

5.9 When considering the likely impact of this market re-engineering on the ability and incentives of the remaining lenders to compete, a range of factors are relevant in addition to the degree of demand-side pressure and the ability of new entrants to exert pressure (which the CMA's remedy package is seeking to influence), namely:

(a) the likely impact of lower prices on profitability; and

(b) the likely response of competitors to pricing initiatives (i.e. competitive dynamics, with the impact of a more concentrated market structure being relevant in this regard).

5.10 When all of these factors are properly considered, Wonga considers that the CMA remedial actions are unjustified and are very likely to be ineffective in the post-price cap world because: (i) lenders will have little ability to offer price reductions to customers which are required to stimulate customer engagement; (ii) even if customers were to become more

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65 [CONFIDENTIAL]

66 FCA's Consultation Paper CP14/10, September 2014, paragraph 5.20.

67 FCA's Consultation Paper CP14/10, September 2014, Technical Annex 2, page 123.

68 FCA's Consultation Paper CP14/10, September 2014, Annex 1, Box 1, page 61.

69 FCA's Consultation Paper CP14/10, September 2014, Technical Annex 1, Box 7, page 68

70 [CONFIDENTIAL]

aware and engaged, it is unclear that this would exert competitive pressure on lenders given other factors affecting incentives to compete; and (iii) the segment will become unattractive to new entrants and smaller players because returns will not be sufficient to justify significant upfront and ongoing costs.

Little scope to generate customer gains, in particular further price reductions

5.11 There is a strong likelihood that, in the post-price cap world, lenders will have little scope to offer price reductions to customers beyond those already delivered by the price cap (even the CMA accepts that the scope for further reductions is reduced).[71] In this regard, little weight can be given to the fact that some lenders charge around or beneath the cap (or have done so historically).[72] The FCA has established that most loans are priced between 1 per cent and 2 per cent equivalent daily rate (i.e. above the proposed upfront cost cap of 0.8 per cent).[73] Moreover, any such low-price lenders may respond to the price cap by increasing their prices, and this is precisely one of the mitigation strategies considered by the FCA as part of its analysis of possible dynamic responses. This would be a rational strategy in circumstances where margins are under pressure and firms face less competition from firms that have left the market.

5.12 In its provisional findings, the CMA estimated customer detriment on the basis of how much lower prices might be in the payday lending market if price competition were more effective. The primary competitive benchmark used by the CMA (which Wonga challenged) was **£25 per £100** for a one-month loan and was based on "*the price paid by some customers for some of the cheaper products.*"[74] This benchmark for a competitive price is above the level of the FCA's proposed price cap (which corresponds to a monthly interest rate of 24 per cent or **£24 per £100**).

5.13 In order to re-establish some headroom within which the CMA can claim its remedies will deliver benefits to customers beyond those already delivered by the price cap, the CMA is now arbitrarily changing the relevant benchmark to the lower bound estimate in its initial analysis (on which it previously placed no weight in reaching a view on customer detriment), namely **£22.50 per £100**.[75] This price reflected the "*lowest prices on offer in the market – for instance, those offered by Speedy Cash or those offered by CashEuroNet to customers using money.co.uk.*"[76] No reliance can be placed on these specific (and now historic) prices as an indicator of what might be offered by the remaining lenders post cap: [CONFIDENTIAL]. Moreover, the analysis points strongly towards ex-post rationalisation of the CMA's proposed intervention which no longer delivers incremental benefits beyond the price cap for the obvious reason that the FCA has proposed a very tough cap which the remaining lenders will struggle to beat.

5.14 Price competition under the price cap is envisaged by the CMA to arise in light of "*the differences in the efficiency of different lenders (and so the significant potential for differences in costs to be reflected in lenders' prices)*"[77]. No evidence is presented in the PDR to support this view, in particular, there is no indication that the CMA has identified significant differences in efficiency between the small number of firms which will remain in the segment post price cap. As only the efficient players will remain viable post price cap, Wonga considers that any cost differences are unlikely to be significant.

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71 The PDR states "*…the proposed price cap will reduce the extent to which customer are overpaying for their loans, and so reduce the scope for further price reductions*", (paragraph 8.19).

72 PDR, paragraph 6.25(a).

73 FCA's Consultation Paper CP14/10, September 2014, paragraph 1.12.

74 CMA Provisional Findings Report, 11 June 2014, Appendix 8.1, paragraph 8.

75 PDR, Section 8 footnote 207.

76 CMA Provisional Findings Report, 11 June 2014, Appendix 8.1, paragraph 10.

77 PDR, paragraph 8.20(c)(i).

5.15 A greater degree of competition for lower cost customers (for example customers with lower credit risk) through targeted price reductions is also envisaged by the CMA under the price cap.[78] The CMA has not, however, fully assessed the customer implications of this pricing strategy, and whether it is reasonable to expect it to be more common in a market subject to greater competitive pressures (assuming, contrary to Wonga's view, that such pressures will exist in the post price cap world). There are good reasons why risk based pricing may not be adopted widely (even in a well-functioning market) particularly by lenders that use risk pooling to support a proposition which extends credit as widely as possible (subject to creditworthiness assessments) to the benefit of customers.[79]

Incentives to compete are unclear and have not been properly assessed by the CMA

5.16 Even if gains could be generated (for example through cost reductions) it is not clear that lenders would pass these gains on to customers. As previously stated by Wonga, a standard economic analysis (of the type routinely used in merger reviews) would suggest that there is upwards pricing pressure in circumstances where the remaining firms may potentially benefit from the diverted volumes of firms that exit, and there is a positive gross margin on these sales.[80]

5.17 Wonga notes, moreover, that the CMA has not undertaken any detailed analysis of whether the price cap will make it more likely that firms in the segment will start to coordinate (although the risk is acknowledged), given the characteristics of the segment post price cap, in particular by applying the standard tests, namely the ability of firms to reach and monitor the terms of coordination and the internal and external sustainability of coordination.

5.18 The CMA cannot, therefore, reasonably conclude that the effects of the PCW remedy (namely facilitating entry/expansion and rewarding lenders for offering customer a good deal) will "*significantly increase incentives on lenders to compete with each other rather than coordinate*".[81] Incentives to coordinate as opposed to compete will be affected by a range of factors, but in particular the likely pay-offs under different scenarios of coordination and deviation. This has not been explored and the important question of lender incentives cannot be short-cut by assuming a fully effective PCW remedy.[82]

Barriers to entry will be high

5.19 Barriers to entry and expansion will be high in the post price-cap world because the segment will offer insufficient returns to justify the significant regulatory and commercial costs and risks associated with entry/expansion (a conclusion which the FCA, itself, has reached). The CMA justifies its intervention by confidently predicting that its measures, by helping new and smaller players to raise customers' awareness of their products and more accurately assess risk, will restore incentives to enter/expand without, it seems, undertaking any market testing or analysis, or otherwise exploring the views of the potential entrants themselves.

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78 PDR, paragraph 6.25(b).

79 See Wonga response to the PFs, paragraph 1.19.

80 Submission of Wonga Group following 21 July 2014 hearing, paragraph 2.23(a).

81 PDR, paragraph 6.18.

82 For example, the PDR states "*By stimulating customers' responsiveness to prices and by facilitating entry and expansion our proposed remedies would increase incentives to compete with each other, therefore undermining the sustainability of coordination*" (paragraph 6.26). The mechanism by which coordination would be destabilised, however, is not explained. Arguably, a more responsive customer base increases the costs to deviation (because competition, when it resumes, could be intense) thereby increasing the sustainability of coordination. Equally, entry and expansion may or may not undermine coordination depending on whether the new players have incentives to compete or align with the coordinated position.