Competition Commission payday lending market investigation: Annotated issues statement, 31 January 2014

A response from Veritec Solutions

About Veritec Solutions

Veritec provides a data system that enables regulators to effectively enforce regulation of payday, doorstep and other short term consumer lending. Veritec does not provide any goods or services to the consumer credit industry, but provides regulatory services to regulators.

We have over a decade of experience working with US regulators in 14 different states, covering 88 million consumers. In addition to our work in the United States, we have also advised the Provincial Governments of Ontario and British Columbia in Canada, and the Federal Government of Australia.

Our experience has allowed us to build an unrivalled store of unfiltered data documenting borrowing in the high cost credit market. This has allowed us to provide empirical evidence to governments to ensure their policies are fit for purpose.

We have also many years experience of watching the market develop as US firms – in many senses the pioneers of payday lending – have diversified into other jurisdictions including the UK. In fact, 7 out of the 10 largest payday lenders operating in the UK are US-owned. Most of these companies use the same business model in the UK as they do in the US.

Response

Having submitted a response to the Competition Commission inquiry last year, it is with great interest that we noted the annotated issues statement published on 31 January.

We welcome the focus on payday lending use in the UK, a trend we believe is following a similar trajectory to historic US trends and would disagree with Dollar Financial's statement in its evidence to the inquiry that 'payday loans represent a relatively new business model.' We understand that, given the nature of the work the Competition Commission carries out, the focus is naturally on how competition in the sector operates with reference to conventional economic models.

However, Veritec has concerns that the Competition Commission's investigation is not looking carefully enough at the detrimental impact that payday use can have on those taking out loans in a sector unaffected by almost totally absent consumer-led competition. Given the knowledge and experience we have of this sector in US states we firmly believe the impact that irresponsible lending can have on customers should not be subsidiary to consideration of typical measures of market competition (such as number of firms, customer churn, differential pricing etc). The issues statement has raised several points that we feel require additional comment from Veritec. These points are explained in the submission below.

Multiple loans

The issues statement discusses simultaneous borrowing by customers and notes:

> "Repeat use of payday loans is likely to be even more widespread. Preliminary results from our analysis of CRA data suggest that a large proportion of payday loan customers take out more than five loans in the space of a year."

The issues statement also estimates that over half of payday loan customers are rolling over or taking out additional loans. The working paper on regulation of payday lending notes that:

> "more frequent or real-time sharing would, it is argued, enable to take other payday loans into account when carrying out affordability checks."

The use of a real time database was advocated by Peter Tutton of StepChange in the Competition Commission's oral evidence session last year. He said that real time data was a 'key part' in bringing about responsible lending practices. Martyn Saville from Which? also commented on this saying payday lenders should 'be sharing all credit data with all three credit reference agencies ideally on a live database'.

However, there are problems with using credit reference agencies (CRAs) for this purpose. CRAs do not record payday loan transactions in real-time, and therefore do not prevent consumer detriment at point of sale in such a fast moving market. Nor is one single agency able to provide 100% coverage of the market. Any attempts to mandate that all data be reported to one single agency, or all of them, would respectively give one firm an unassailable market position or destroy any competitive pressures.

The use of a regulatory database in this regard would remedy this issue as it would perform checks at the point-of-sale against any other loans already taken out, while ultimately giving regulators sight of detailed transaction data in real time. It would still allow lenders to undertake creditworthiness assessments using CRAs or any other means, but it would give regulators certainty that rules were being followed at point-of-sale.

Some argue that the database would bring about privacy problems by holding this level of information about customers. However, the data would be owned by the regulator, subject to rigorous data protection measures, and there have been no previous instances in the US of this ever causing a problem. It is worth noting that, unlike CRAs, the regulator does not have a profit incentive to use the data for anything other than its true purpose.

Credit reference agencies and loan verification

The issues statement notes that research has been undertaken on payday loan customers and that analysis of information held by credit reference agencies is taking place on a sample of over 3,000 payday loan customers to help demonstrate the extent to which those taking out payday loans have access to other forms of credit. We would caution relying on this information for the study, as we are yet to see what we would regard as completely accurate representations of the size of the UK payday lending market. Information held by credit reference agencies is not always up-to-date and often does not reflect instances where customers have rolled over their loans or where the original loan has morphed into another product. It should also be considered that not all payday lenders report loans to credit reference agencies.

There is also a genuine question about whether it is in consumers' interests for their data to be shared with CRAs as it is potentially problematic for two reasons. Firstly, an increasing number of mainstream lenders (particularly mortgage lenders) are refusing to lend to anyone with payday loan on their credit record. It is questionable whether a very short-term product should have such a bearing on consumers' attempts to take out a completely different and much longer-term product. Mortgage lenders' attitudes in this regard are symptomatic of the general lack of faith that payday products are lent and used as intended (i.e. very short-term, one-off credit smoothing facilities). Secondly, CRAs sell this data to other lenders and lead generators, thus allowing them to target potentially vulnerable consumers.

The issues statement notes that there is a variation in the way lenders approve loan applications and that high-street lenders review and verify income and expenditure using different forms of identification. However, this assessment rather misses the important point that such processes are only in place so that lenders feel confident they can recover monies from borrowers and not so they can fully underwrite the loans (as we would expect to see different pricing for different consumers applying to the same lender).

Competition

From Veritec's experience in the US, retaining customers is a financial imperative for lenders. They view rollovers as a method to generate additional revenue from the existing customer base without having to innovate or improve services to obtain new customers. Customers are more likely to roll over their loan with the original lender before taking out a loan with another lender because of the convenience of remaining with the original lender.

Payday loan customers are not price sensitive (or sufficiently price sensitive to drive competition) but choose lenders on speed and convenience, a point supported by Peter Tutton of StepChange in the oral evidence session, and also in the TNS payday lending survey. Of those surveyed 74% said speed was extremely or very important. Speed was a particularly important factor for those with multiple loans. In response to being asked why speed was such a high consideration, some stated the speed of obtaining the money was more important than the value of the deal, with customers in some cases saying that they paid more for a speedy 'peace of mind'. Therefore it is in the interest of lenders to 'acquire' the customer by saying 'yes' to a loan with minimal underwriting and credit assessment, even when the balance of risk might be against the customer being able to repay the loan on time. Additionally, the TNS survey suggests that customers are unlikely to review roll-over or penalty charges when taking out their first loan, and they only become aware of rollover charges when they incur them.

In our opinion, competition in the UK market is strong, but only in the sense that lenders are competing to be the first to offer the loan as opposed to being the lender to offer the loan at the lowest price. The low level of regulation in place, alongside the retreat of banks from offering comparable products, has allowed the industry to flourish in the UK.

Veritec is encouraged that the Competition Commission is going to look further at the actual repayments made by customers that do and do not rollover their loan. We believe that there are differences between lenders on fees charged, and this is an area in which many lenders make significant sums of money. However, and this is very important to note, as the market becomes more saturated in the absence of firm enforcement of rules on multiple loans, the performance of lenders' portfolios will deteriorate. Lenders will be forced to make up revenues by increasing fees and more aggressively targeting consumers, thus exacerbating current problems in the sector.

Point 103 notes that the Competition Commission is taking into account the impact of more effective regulation on market forces. Veritec strongly advocates better regulation complete with effective enforcement of rules. Industry claims that real-time enforcement would force borrowers to go to illegal lenders are false as the following example will show.

One of the larger lenders operating in the UK and US recently stated in its quarterly results that it had seen below expected revenues (a decrease of 9.6%) due to the deteriorating performance of its loan book as its customers are targeted by other lenders offering them loans in addition to the payday loans they current hold. ongoing in the UK. It added that regulatory transition in the UK continues to affect its overall results because some competitors are currently getting away with not meeting minimum standards. However, it remains optimistic for the market in the long-term, especially if effective enforcement of rules is introduced. Based on this optimism, in the last quarter it has acquired 15 stores in the UK, predominantly in the form of pawnbroking, pawn exchange, cheque cashing, money transfer and gold buying stores. It added that these stores are an opportunity for it to "bolt-on" unsecured short-term loan products.

This lender believes that UK regulation and enforcement should establish an equal playing field amongst all competitors, as well as removing lenders who operate well outside the boundaries of what it believes to be appropriate treatment of consumers.

In the question and answer session which followed the announcement of the results, the lender was quizzed on various items. One question examined what impact the FCA will have when it comes into effect in April, and what the result of taking out the 'wrong players' in the industry will have on other lenders. The lender responded that in every jurisdiction in which they operate, consumer demand exceeds the supply, and the reduction in the revenue pool is not something they are concerned about.

Access to credit

Point 93 of the statement notes that the Competition Commission is examining the potential barriers to customers switching lender, adding that research suggests a substantial proportion of loans issued by lenders are to borrowers that have previously used their payday products. The statement also adds that the Competition Commission will continue to assess the extent to which the use of multiple lenders is being driven by a lack of availability, rather than changing lender in order to obtain a better deal on a loan. This is something we welcome but we reiterate the comments made in our original submission, particularly:

> "Payday loans, when used appropriately, are not revolving forms of credit and so are unlike credit cards or bank account overdrafts. When coupled with price insensitive customers, this poses challenges to the traditional concept of consumers creating beneficial outcomes and driving competition by switching between providers."

Ultimately, consumers will be in a much better position to make choices if they are not constrained with problem debt. The key to achieving that position is to ensure short-term, high-cost loans remain short term and are not compounded by multiple, simultaneous loans.

Point 100 comments on the levels of consumers rejected for loans and the difficulties a new entrant would face on entering the market. To reinforce this point you note that lenders rely on their own databases and the use of credit reference agency data. We have already noted some consumer protection concerns on CRAs and we would reiterate the points we made in our original submission about lead generators who, as Linda Isted from the Debt Advice Foundation noted in the commission's evidence session, often play a role in exacerbating aggressive marketing to indebted consumers. Most online operators have relied more heavily on purchased leads as a means of accumulating customers and building loan portfolios. Lead aggregators are a valuable but expensive source of customers to many lenders. On average, online lenders can expect to convert 40% of mid to high quality purchased leads to convert into borrowers.

Conclusion

Following our submission to the inquiry, we would like to reiterate our offer to meet with the Competition Commission to discuss some of the comments made in our response to the issues statement, prior to the publication of the provisional findings later this year.