Consumer Finance Association

IN ASSOCIATION WITH

EQUIFAX®

CREDIT 2.0

A COMMENTARY ON BORROWING AND SPENDING IN THE 21ST CENTURY

CREDIT 2.0

This report has been researched and written by the Consumer Finance Association, a trade association that represents short-term lenders in the UK. Insight has been provided by Equifax, a leading consumer and business credit intelligence agency, providing insight into the latest consumer borrowing and short-term credit market trends.

With the UK economy growing and new consumer credit regulations in place, this report draws on a wide range of data sources, reflecting the latest information that is available, to look at the challenges to household finances and changing use of short-term credit in 2015.

All data is cited throughout the report and further information is available online. Reference to this data does not imply endorsement by the originators.

Consumer Finance Association

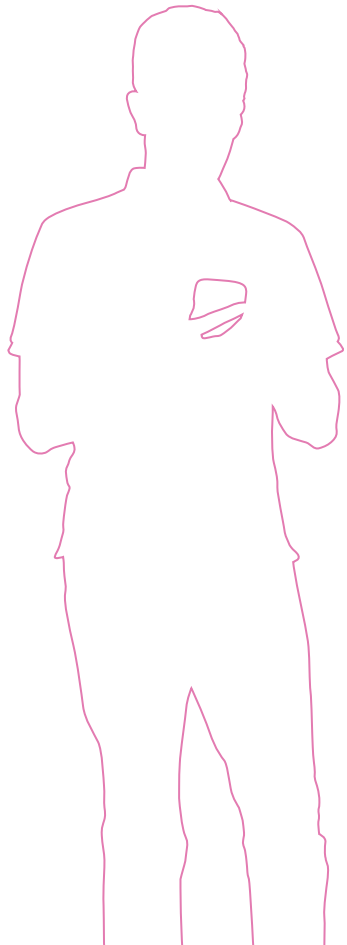
ABOUT THE CFA

The Consumer Finance Association (CFA) is the principal trade association representing the interests of major short-term lending businesses operating in the UK.

CFA members are committed to responsible lending and are keen to continue to improve the reputation of the industry through close engagement with the regulator. Indeed, by driving industry improvements and best practice through its voluntary Code of Practice, the CFA paved the way for the FCA's statutory regulation.

CONTENTS

	PAGE
EXECUTIVE SUMMARY	4
THE ECONOMY AND CONSUMERS I STATE OF THE NATION	6
How the country has changed	6
The economic outlook – what does the big picture look like?	6
Transport & Utilities	6
Housing	7
Earning power and employment trends	7
Employment	7
The rise of the self-employed	8
Part-time workers	8
Zero hours contracts	8
Wages	8
Access to credit	9
Debt – growing but evolving	9
Savings	10
Where does this leave household finances?	10
LIFESTYLE	12
Technological developments	13
Online banking	13
Where do short-term customers fit in?	14
Distinction between high-street and online customers	15
BEHAVIOUR	16
The Instant Society	16
What are they borrowing for?	16
Attitude to borrowing and debt	17
Why are people using short-term loans?	18
Other financial options	20
Banks	21
Credit Unions	22
Credit cards	22
Friends and family	23
Short-term loans are part of the financial tool kit	23
CUSTOMER PROFILES	24
Sarah – Online borrower	24
Chris – High street borrower	25
THE NEW LENDING LANDSCAPE	26
IMPACT OF THE CHANGES	29
What has happened to short-term loan customers?	29
The cost of missed payments	30
Are credit unions the alternative?	32
THE RISK OF OVER REGULATION	34
Offshore lending and loansharking in the UK	35
Price caps elsewhere	36
CONCLUSION	38



Executive Summary

The economic impact of the 2008 crash is well documented. It changed the UK economy dramatically and what followed was one of the longest and deepest recessions the UK has ever experienced.

As examined in our 2013 report, Credit Crunched*, the crash had a dramatic, immediate but also lasting effect on family finances and the ways in which people manage their financial affairs. During the recession, uncertainty meant that many people put big financial decisions on hold and their outlook was, by necessity, short-term.

Inevitably, there was a reluctance to take on longer-term debt in a volatile labour market. Short-term credit grew in popularity. It helped smooth peaks and troughs in income and expenditure quickly and easily without the temptation of further credit.

This short-termism coincided with a time when financial management became increasingly mobile, and working patterns shifted for a large group of people from full-time, salaried positions to multiple part-time and/or variable income jobs including self-employment. Short-term loans were accessible and, for some, provided a financial lifeline that couldn't be found elsewhere. Fast forward to 2015. The economic climate is improving and GDP has officially been growing since 2013. Employment figures are up, inflation remains low and wages are beginning to rise again. In spite of this improvement, families are still dealing with the financial hangover of the recession. Rising house prices against a backdrop of increasing utility bills and travel costs mean it is taking time for the recovery to reach the purse strings of the average family.

On top of this, memories of financial uncertainty are still fresh in the mind so there is a reluctance to make long-term financial commitments. People are focusing on their short-term future, but they are at least able to start looking beyond their next pay packet. However achieving long-term financial security, such as buying a house, remains, for many, out of reach.

Digital technologies have continued to evolve and become increasingly integrated into our lives with ubiquitous broadband access and high levels of smartphone ownership. This instant access to information, products and services has driven changes in attitudes to offline behaviours too. From

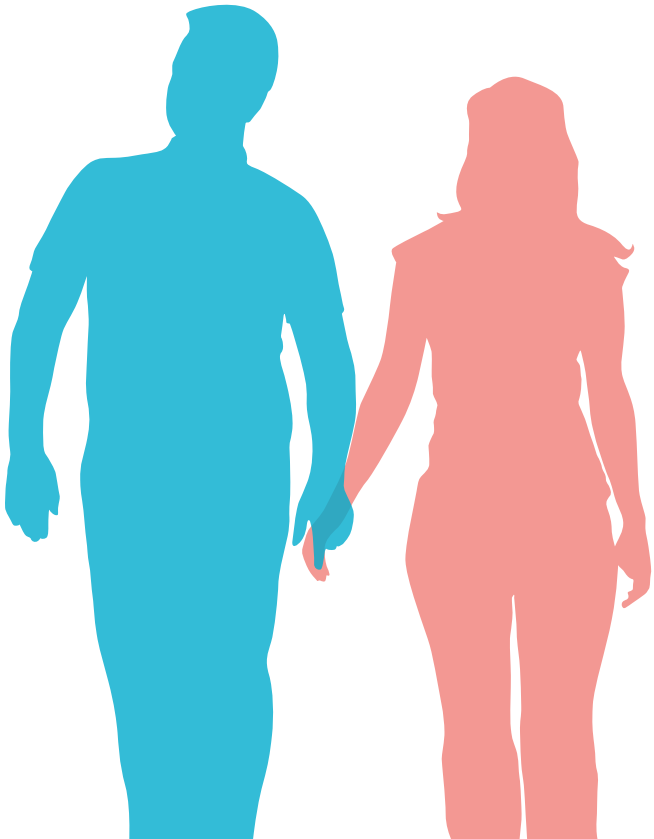
*www.cfa-uk.co.uk/creditcrunched

knowledge of stock levels to applications for services, consumers have high expectations of rapid response and customer service.

Alongside these developments the short-term loan industry has been subject to intense regulatory scrutiny that has radically altered the market place including restrictions on rollovers, warnings on advertisements and price controls. Many firms have already exited the market, and this is a trend that looks likely to continue.

Despite great regulatory pressure, the industry has continued to evolve. As households have broadened their economic outlook, the industry has adapted to offer loans over a period of months rather than days; a space also unfilled by traditional credit providers. Lenders have continued to innovate in how they make lending decisions, leading the wider credit market in the use of real time customer data to provide an up to date picture of a borrower's finances. Short-term loans remain appealing to consumers because of their speed and accessibility through online and offline channels; they fit with busy, modern lifestyles.

This report presses the pause button after a period of rapid and significant change for both lenders and customers. It allows for reflection on what today's short-term lenders and borrowers really look like. It examines why digital technologies and the data they generate have fundamentally changed the way consumer credit providers can make lending decisions and the way consumers engage with their finances. Finally, it looks at what future changes may mean for consumers that rely on these products to manage their money, at what continues to be an uncertain time for family finances.



The economy and consumers

STATE OF THE NATION

KEY FACTS

Inflation turned negative in April 2015 for the first time since 1960

2.6%

Economic growth in the UK was at its highest rate in 2014 since 2007

HOW THE COUNTRY HAS CHANGED

The economic fortunes of the country may be improving gradually, but this is taking longer than expected to filter through to reach the bank balances of individual people. Unemployment is falling and the cost of petrol has hit its lowest point since 2010. But scratch beneath the surface and another picture is revealed.

A rise in part-time roles, zero hours contracts with no guarantee of work and an increase in the self-employed workforce. What's more, wage rises continue to be slow. All this paints a far more complicated picture than the improving economic recovery suggests and people up and down the country are facing unique pressures on their finances.

THE ECONOMIC OUTLOOK- WHAT DOES THE BIG PICTURE LOOK LIKE?

Inflation turned negative in April 2015 for the first time since 1960 with the rate dropping to -0.1 %[1].

On top of this the UK's economy grew by 2.6 % in 2014 - the fastest pace since 2007 and up from 1.7 % in 2013[2]. With key indicators showing improvement, it is only a matter of time before interest rates rise. 26 % of families are concerned about rising interest rates[3] and with good reason. If rates rise by 2 % then according to the Bank of England's assessment of the risk of financial distress, even if the income of all households increased by 10 %, the proportion of households with a high mortgage debt-servicing ratio would rise from 1.3 % to 1.8 % and 60 % of borrowers would cut spending in response[4].

TRANSPORT & UTILITIES

Despite petrol being at its lowest price in nearly five years, the cost of travel by public transport has risen steeply from £102 to £118 a month[5]. Train fares in particular continue to rise across the country. A season ticket from Reading into London now costs more than a fifth (22 per cent) of the average London salary. This is a rise of 25 percent since 2008[6]. In the UK as a whole, in January 2013, fares across all operators are 23 % higher than they were in January 1995.

Utility bills continue to be a big draw on household budgets. In 2014, the provisional average electricity bill across all payment

1 http://www.bbc.co.uk/news/10612209
2 http://www.bbc.co.uk/news/10613201
3 Aviva Family Finances- Dec 14
4 http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q405.pdf
5 Aviva Family Finances report- Dec 14
6 http://www.bettertransport.org.uk/sites/default/files/fair-fares-charter-april-2014.pdf

types rose by £15 compared with 2013, to £592[7].

In short, the prices of these essential purchases are still rising faster than wages.

HOUSING

The cost of putting a roof over our heads is also a complex influence on UK households' finances. It is impossible to avoid the constant debate about whether rising UK house prices can be sustained or if another crash is inevitable. As it stands, the average family home is now worth £244,100 – the largest figure ever recorded in Aviva's Family Finances Report. This is good news for those that bought a house in December 2013, when the average home was worth £222,280 - an increase in wealth of £21,720 in a year, or nearly 10 per cent[8]. However, for many, the dream of owning their own home is getting further out of reach. It would take 22 years for someone on the average salary, saving the average amount per household every year in an average instant access savings account, to afford the average first-time buyer deposit[9].

EARNING POWER AND EMPLOYMENT TRENDS

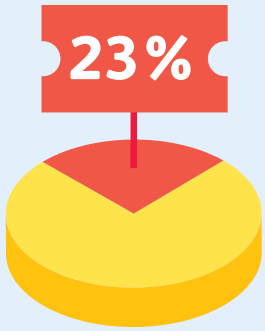
EMPLOYMENT

With improving economic circumstances, employment has been on the rise. From January to March 2015, 31.1 million people aged 16 and over were in work, a rise of 564,000 on the previous year[10]. Public sector workers make up 17.6 % (5.41 million) of all people in employment in the UK[11].

There is also more confidence in the employment market, a recent survey by PwC showed that only 13 % of respondents were worried about losing their jobs in the next 12 months, down from more than 20 % in 2011[12].

However, the figures do not reflect the reality of life in 'Working Britain'. The 9-5 society changed radically during the recession and the changes to working patterns have remained as the economy has started to grow again.

KEY FACTS



Rail fares across all operators are 23% higher than they were in 1995

The amount of time it takes on an average salary to save up for a first-time buyer deposit[9]

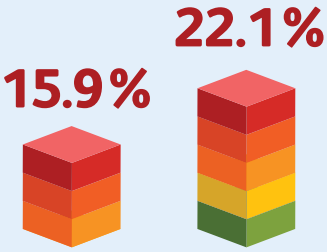
7 Department of Energy & Climate Change, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388140/qep_221.xls
8 Aviva Family Finances- Dec 14
9 http://themoneycharity.org.uk/media/May-2015-Money-Statistics-summary.pdf
10 ONS Labour Market Statistics, May 2015 release
11 http://www.ons.gov.uk/ons/rel/pse/public-sector-employment/q4-2014/stb-pse-2014-q4.html#tab-Total-UK-public-sector-employment
12 Precious Plastic Report 2015- PwC

KEY FACTS

15%

...of all workers are self-employed

Average self-employed person earnings are lower than they were five years ago



Underemployed rose from 2008 to 2014

THE RISE OF THE SELF-EMPLOYED

4.6 million people were self-employed in 2014, representing 15% of all workers, the highest figures since records began in 1971.

Worryingly, these individuals are earning less than they did previously – the average self-employed person earns 13% less than they did five years ago[13]. Overall in employment there has been a trend for those of pensionable age to remain in the workforce for longer as they are facing greater financial demands. This is also true for the self-employed. The number of self-employed people aged 65+ doubled between 2008 and 2014.[14]

PART-TIME WORKERS

The economic downturn also saw a rise in part-time working. For some this was a necessity; it was better to be working a small number of hours than none at all. The result of this rise in part-time working is that the UK has seen a rise in underemployment. Following the economic downturn, the percentage of part-time workers who were underemployed rose from 15.9% in 2008, to a peak of 24.4% in July to September 2012, before it started to decline from July to September 2013 to the current rate of 22.1% in 2014. With the rise in employment, this figure has improved, but it is still 6.2 percentage points, or 620,000 workers, higher than in 2008[15].

EMPLOYED BUT NO GUARANTEE OF EARNINGS – ZERO HOURS CONTRACTS

"Zero Hours Contracts" or contracts with no minimum hours are a controversial but unavoidable reality of the recession. In April 2014, the ONS estimated that there were 1.4 million[16] of these contracts in the UK. For some people Zero Hours Contracts provide them with the flexibility they need. Some students balance work with their studies, while many parents balance work with childcare. There is a clear trend towards people on these types of contracts being young (half are under 30[17]). The danger is that young people on these contracts become unable to secure adequate employment, leaving a difficult legacy for the UK economy.

WAGES

After a painful recession with a long period of wage stagnation, UK workers are finally seeing their earnings rise again. The average weekly earnings now stands at

13 http://www.jrf.org.uk/media-centre/young-working-and-renting-uk-poverty-65931
14 ONS, Self-employed workers in the UK, 2014 http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-371749
15 ONS Underemployment and Overemployment in the UK, 2014- Nov 14
16 http://www.ons.gov.uk/ons/dcp171776_361578.pdf
17 http://www.resolutionfoundation.org/publications/zero-hours-contracts-the-latest-figures-and-analysis/

£460 excluding bonuses. This is up by 2.2% on the previous year[18]. Between August and October 2014, average earnings excluding bonuses were up 1.6% from a year earlier. Including bonuses, earnings rose by 1.4%.

It is the first time for six years that both measures of earnings growth have been above the inflation rate. However, given the rising costs of living, this increase is, for many households, making little difference to their disposable income.

ACCESS TO CREDIT

The growth in unsecured borrowing is currently 3.8% annually, the highest rate since late 2008[19]. Indeed, consumer finance grew by 3% in November 2014, compared with the same month the previous year and increased by 10% in the twelve months to November 2014.[20]

Outstanding consumer credit lending was £170.2 billion at the end of March 2015. This is up from £160.0 billion at the end of March 2014, and is an increase of £203 for every adult in the UK[21].

DEBT – GROWING BUT EVOLVING

Despite the low levels of inflation and the rising household incomes, the level of personal debt in the UK is increasing rapidly. Figures may vary according to the sources but there is consensus that Britons are borrowing again.

According to PwC, while borrowers sought to reduce their debts in the years following the financial crisis, this period of retrenchment has now ended, with secured lending rising once again and unsecured debt bouncing back to an all-time high, in cash terms, of close to £9,000 per household by the end of 2014.[22]

At the end of March 2015, UK consumers owed £1.474 trillion. This compares to £1.445 trillion at the end of March 2014 – an extra £579 per UK adult[23].

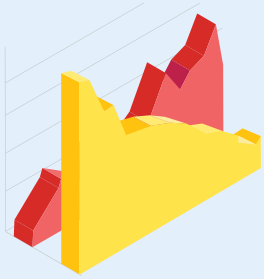
New analysis from The Money Charity found that overall, households in the UK took on an average of £395 of additional debt in 2014 – the biggest growth in any year since 2004.

Total credit card debt in March 2015 was £61.2 billion. This represents £2,292 of credit card debt per household in the UK. For a credit card bearing the average interest, it would take 25 years and 2 months to repay for consumers making the

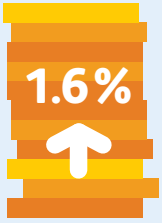
18 ONS Labour Market Statistics series.
19 BBA High Street Banking Statistics-Dec 14
20 http://www.fla.org.uk/index.php/consumer-finance-continues-to-grow-in-november/
21 http://themoneycharity.org.uk/media/May-2015-Money-Statistics-summary.pdf
22 Precious Plastic Report 2015- PwC
23 http://themoneycharity.org.uk/media/May-2015-Money-Statistics-summary.pdf

KEY FACTS

The estimated number of Zero Hours Contracts in the UK



- No. of people seeking advice for household bills
- No. of people seeking advice for personal debt



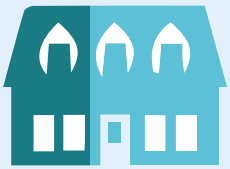
Between August and October 2014, average earnings excluding bonuses were up

KEY FACTS

£1,770

The average savings pot has increased from £636 during the credit crunch years[27]

35%



...of households in the UK have still have no savings[30]

minimum repayments each month[24].

However, the nature of debt is also evolving since the recession. Research by the Money Advice Trust revealed a change in the type of debts that people are seeking help with. The number of people seeking advice relating to credit card and overdraft debt has been declining, while more people are seeking debt advice regarding basic household bills (and the associated arrears) such as energy bills, water bills, telephone bills, and council tax[25].

Against this backdrop, people are also spending less money on servicing their debts. Aviva reveals that families are struggling with a new debt burden - household debt was at £7,840 six months ago, and is now back at nearly £16,300[26].

SAVINGS

The improving economic situation continues to have an effect on savings too. More people are now saving for the future. The average savings pot now stands at £1,770 compared to £636 during the credit crunch years[27]. However, with the UK base rate having been at a record low 0.5 % for 6 years[28] individuals are seeing very little return on their savings. For instance the average interest rate for an instant access savings account – not including bonus interest payments – was 0.38 % in March 2015. For a cash ISA, this was 0.82 %[29]. This can result in individuals spending money where they feel it might go further. Taking advantage of the relatively low cost of consumer goods, for example.

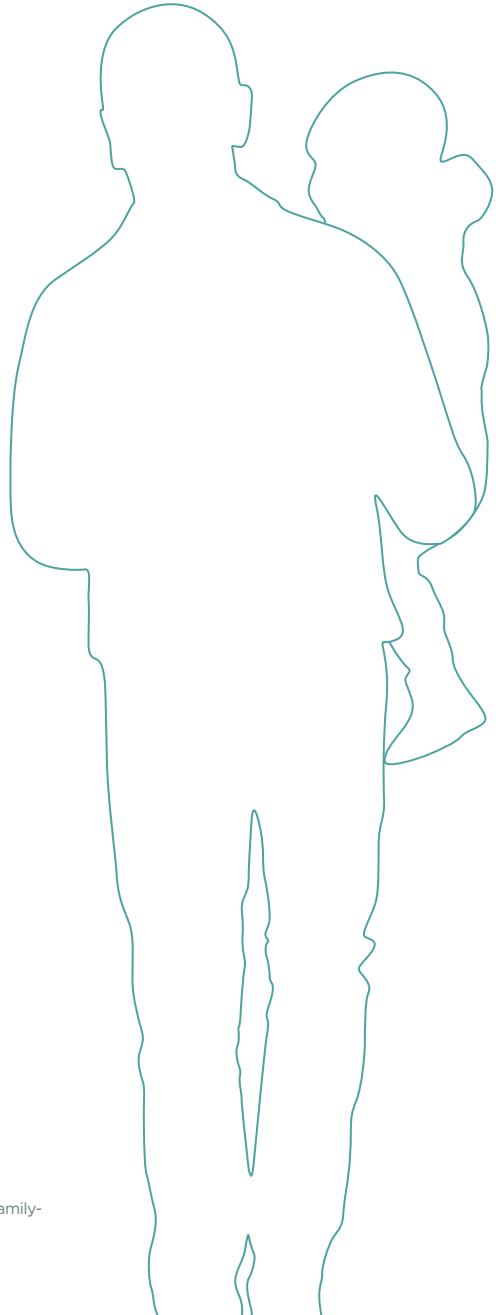
While more people are saving, the amount of money that they have as a buffer is still relatively small and around 9.24m (35 %) households in the UK have still have no savings[30]. For these people, access to small sum loans remains important in order to deal with even small financial shocks.

WHERE DOES THIS LEAVE HOUSEHOLD FINANCES?

Running a household continues to be expensive. The total average weekly household expenditure was £517.30[31] in 2013. Outgoings on housing (excluding mortgage payments), fuel and power reached their highest levels in the ONS family spending series since recording methods began at £74.40[32]. Transport, leisure and housing (excluding mortgages), fuel and power remained the three largest categories of expenditure.

24 http://themoneycharity.org.uk/media/May-2015-Money-Statistics-summary.pdf
25 http://www.moneyadvicetrust.org/media/news/Pages/Changing-Household-Budgets-report.aspx, http://www.stepchange.org/Mediacentre/Pressreleases/CouncilTaxarrears.aspx and http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_office-newpage-20140526.htm
26 Aviva Family Finances- Dec 14
27 Aviva Family Finances report
28 http://www.bbc.co.uk/news/business-31747859

The typical family now takes home £2,012 a month - £95 a month more than at the same time last year. Yet this is a recent rise, meaning that many families are still coping with the stagnant wages brought about by the recession[33]. At the same time, tax and benefit changes have reduced household incomes by £1,127 a year or 3.3 % on average, with low-income working-age households having lost the largest percentage of their income[34].



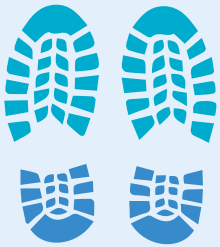
29 http://themoneycharity.org.uk/media/May-2015-Money-Statistics-summary.pdf
30 Money Charity Monthly statistics- February 2015
31,32 ONS, Family Spending Edition, 2014 http://www.ons.gov.uk/ons/rel/family-spending/family-spending/2014-edition/sty-the-headlines.html
33 Aviva Family Finances report- Dec 14
34 http://election2015.ifs.org.uk/uploads/publications/bns/BN159.pdf page.1

Lifestyle

KEY FACTS

44 Million

...contactless 'taps' this year. Up from 14 million in 2013 and 3.5 million in 2012



30%

...lower footfall in bank branches since 2009

People face different pressures on their household finances at different stages in life. For young adults, establishing themselves financially has never been more of a challenge with the twin pressures of getting a foot on both the job and housing ladders.

Increasingly, this means that people in this group focus on short horizons. They are reluctant to take on long-term credit commitments and to make plans too far into the future. A natural fit with this attitude is the reliance on technology. With its speed of response and easy integration in to every aspect of their life, it allows people to manage their affairs.

Graduates are planners. Half of young men and almost two thirds of women who achieved degrees want to be married by and starting a family within a decade[35]. However, in reality things often turn out differently. Many end up being drawn into the 'Boomerang generation', with nearly one in four aiming to live with their parents after university[36].

Those in their middle-ages are facing their own pressures. This group, sometimes referred to as the 'sandwich generation', is made up of those that are caring for elderly relatives while still having to financially support grown up children. They are usually forced to balance working full-time with spending an extra 19 hours each week caring for elderly relatives; all the while spending nearly £6,500 a year on children aged 22 and over[37].

Starting a family also has a big impact on family finances. On average, household income drops by 30% during maternity leave, driving three in five families into the red and forcing 50% of new mums to return to work early to make ends meet.[38]

Childcare also remains a massive cost for young families. The average cost of a child's first 11 years is £84,000, or £110,500 in London[39]. Most of the cost is due to childcare before children reach school age[40] but the financial pressures do not end when a child starts education.

Indeed, the cost of raising a child up to the age of 21 is £229,251. This is an increase of 63% since 2013[41].

These costs are having a wider impact on the extended family too. The second most popular form of childcare is provided by grandparents or another family

35,36 http://www.dailymail.co.uk/news/article-2846714/Girls-want-graduate-marriage-Majority-want-wed-start-family-ten-years-leaving-university.html
37 http://www.dailymail.co.uk/news/article-2809241/One-million-belong-new-sandwich-generation-forced-support-parents-adult-children.html
38 http://www.dailymail.co.uk/femail/article-2855763/Three-five-families-fall-debt-maternity-leave.html
39,40 http://www.telegraph.co.uk/finance/personalfinance/11152932/The-cost-of-a-child-is-84000-just-for-the-first-11-years.html

member with 35% relying on this option[41].

TECHNOLOGICAL DEVELOPMENTS

Against these challenges, people are also changing the ways in which they choose to manage their finances.

An increasing reliance on technology is core to this, with UK consumers embracing ecommerce services. 82% of households are now connected to the internet at home[43] and six in ten UK adults (62%) now use a smartphone; an increase from 54% in 2012[44].

Online banking continues to grow and the use of contactless payments (which allows for small sum purchases to be paid for without the need to enter a PIN) is now commonplace, with many using this method to pay for travel (buses, trams and the Underground), their morning coffee or even just a newspaper. This trend of managing money looks set to continue with RBS alone expecting to process payments from 44 million contactless 'taps' this year. This is a huge increase on the 14 million 'taps' it processed in 2013 and the 3.5 million in 2012[45].

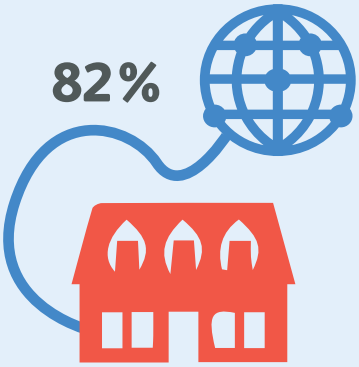
Other financial products continue to evolve. This can be seen with the introduction of cheque imaging, which now allows for cheques to be paid out on the basis of a digital image. This means that consumers no longer have to wait for the traditional cheque clearing process, which can take days to complete. They can now gain access to their funds quicker. Elsewhere, new payment systems are developing that allow for seamless transactions and the movement of money whatever the time of day, where ever you are.

ONLINE BANKING

People are also banking on the move. Apps offered by major banks have already been downloaded on more than 14.7 million occasions[46]. We are also making more purchases using portable technology, now more than 14 million mobile and internet transactions are processed each week[47]. We can shop and make payments wherever, whenever and people are integrating this into their busy lives.

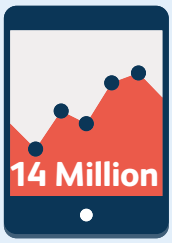
Around 167,000 RBS and NatWest customers use their mobile banking app between 7am and 8am on their morning commute[48]. There are now 2.7 million RBS and NatWest customers who are choosing to do all their banking digitally.[49]

KEY FACTS



...of households are now connected to the internet at home[43]

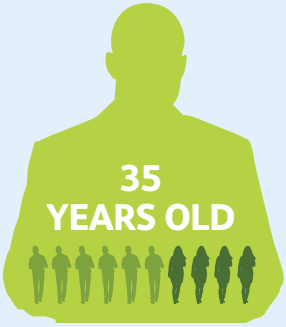
Six in ten UK adults (62%) now use a smartphone



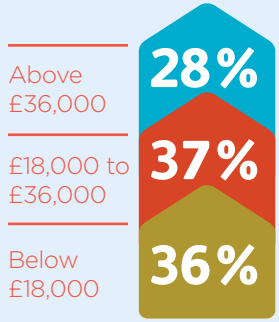
...mobile and internet transactions are processed each week[47]

41 http://www.lv.com/about-us/press/article/cost-of-raising-a-child-2015
42 Aviva family finances report- Dec 14
43 ONS, Family Spending Edition, 2014 http://www.ons.gov.uk/ons/dcp171766_385729.pdf
44 http://stakeholders.ofcom.org.uk/market-data-research/other/research-publications/adults/adults-media-lit-14/
45-49 BBA Report "How we bank now"

KEY FACTS



60% of short-term loan customers are male, and the mean age of all customers is 35



Net household income[52]

Alongside this, according to HSBC, footfall at their branches has fallen by 30% since 2009, with a 10% drop between 2012 and 2013.

There are also further technological developments in how people are choosing to send and receive money between their friends and family. In April 2014, Paym was launched. This is a payment service, which allows consumers to pay funds into a bank account by just using the associated mobile number. So now splitting the bill after a meal out or repaying a friend for a takeaway can be done instantly without the need for cash.

WHERE DO SHORT-TERM LOAN CUSTOMERS FIT IN?

Short-term loan customers are frequently stereotyped but in reality are average people facing some of the challenges of living and working in Britain outlined in this report. The debate in recent years has focused on whether these consumers are financially vulnerable or credit savvy.

The Competition and Markets Authority (CMA), which began a review of the short-term loan market in 2013, identified people's need to smooth out financial budgetary peaks and troughs over a short period of time[50] and as we have seen, with the economic recovery not yet reaching workers' pockets, there is a continuing demand for short-term loans.

The CMA research also provided new insight into short-term loan customers.

It found that customers were more likely to be male and were younger than the UK population as a whole (71% were aged 18 to 44 compared with 46% of the population). 60% of short-term loan customers are male, and the mean age of all customers is 35. There is a slight differentiation between online customers and high street customers, with 35 being the mean age for online customers and 38 for high street customers.

Short-term loan customers are also more likely to be working full-time than the population as a whole, and to live in larger households (as a result of having children). This reflects the fact that customers are predominantly working age[51].

In 2014, CMA findings showed that 36% of all payday customers had a net household income of less than £18,000, 37% of customers had a net household income of £18,000 to £36,000 and 28% of customers

50 CMA (2014) Payday Lending Market Investigation, Provisional Findings Report, Page 1.
51 CMA (2014) Payday Lending Market Investigation, Provisional Findings Report , Page 2-6

had a net household income of greater than £36,000[52]. This compares to a national average of £25,057[53].

Short-term loan customers come from all walks of life and as a result hold a variety of jobs across a wide range of industries. Extracts from lender data on the occupations of customers that had applied for a loan between March and May 2014, show that 52 company directors took out short-term loans. In addition, 577 customers were managers, 14 were police officers, 12 were legal secretaries, 11 were web developers, 12 were quantity surveyors and 144 were teachers. Lenders also provided credit to people on traditionally lower incomes such as sales assistants, restaurant staff, care assistants, cleaners and administrators[54].

DISTINCTION BETWEEN HIGH-STREET AND ONLINE CUSTOMERS

The CMA research revealed that there are differences in the demographics of short-term customers, dependent on whether they borrowed online or from a high-street loan store. High-street customers tend to be less affluent than their online counterparts and as result borrow a smaller amount of money on average (£180 vs £290).

12 % of customers have borrowed both online and on the high street. However there remains a core group of customers that will not move from the high street into the online market. Online customers are more likely to have a credit card, store card or savings account[55]. Customer groups that were significantly more likely to have used high street lenders included: women; older customers; social renters; those in part-time work; lone parents; those with no academic qualifications; and those on low incomes[56].

High street customers tend to have fewer credit options. Short-term loans provide a vital service to them.

However, many customers do have other options and have therefore chosen to use a short-term loan because it is the most suitable option for their needs. The next chapter explores why short-term loans match certain borrowers attitudes and assesses how they choose to manage their finances.

52 CMA (2014) Payday Lending Market Investigation, Provisional Findings Report , Page 2-6
53 2012-2013- http://www.ons.gov.uk/ons/rel/household-income/the-effects-of-taxes-and-benefits-on-household-income/historical-data--1977-2012-13/ref--table-14-oecd.xls
54 CFA response to CP14/10 Proposals for a price cap on high cost short-term credit
55 Development team
56 CMA https://assets.digital.cabinet-office.gov.uk/media/539b1d16e5274a103100000a/Main_report.pdf 2-22

KEY FACTS

Example of some customer types who applied for a short-term loan March - May 2014

Customer groups that were significantly more likely to have used high street lenders include[55]

Behaviour

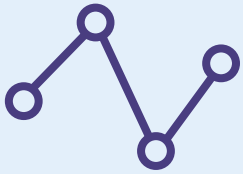
KEY FACTS

93%

of those who said their need was due to a change in financial circumstances thought this change was temporary

5%

expected the change to be permanent[59]



23%

of customers of short-term loans stated they have variable incomes

THE INSTANT SOCIETY

In today's 'instant' society, everything is geared towards the here and now.

Social media, 24-hour news channels and the facility to pay for anything and everything online, has created a demanding society. People are armed with smartphones and tablets and want things quite literally at their fingertips.

Short-term loans have a role to play in ecommerce. Consumers trying to buy the last available tickets for a gig, for the theatre or a football match are using short-term loans. People desperately trying to book a seat on a plane for a last minute holiday deal that has just been advertised, turn to a short-term loan provider. If they wait they will either miss out altogether or the deal will be gone and the price will have risen significantly. These are just some of the reasons why people are choosing to use short-term loans.

The shift to the 'instant society' has happened at a time when people are feeling pressure on their finances like never before. Managing the peaks and troughs of income and expenditure is a monthly headache for millions of people. Significantly, for many of these people, the ability to access short-term credit saves them from bigger debts in non-credit areas such as utility bills, council tax and other payments.

Short-term credit provides a valuable service for the consumers of the 'instant society', helping them to manage their finances in a way that suits them.

WHAT ARE THEY BORROWING FOR?

As part of the CMA's investigation customers were asked what they had used their most recent short-term loan for. 53% of those surveyed said that they had used the money for living expenses (such as groceries and utility bills), 10% of customers said the money related to a car or vehicle expense and 7% said general shopping such as clothes or household items[57]. Not surprisingly, short-term loan customers were often using the money to cover emergency expenditure or larger than average bills.

While it is concerning for some that people are using credit to pay for household essentials, this may not be entirely accurate. Further analysis reveals that unplanned expense, such as a school trip or a birthday gift, has a significant

57 CMA (2014) Payday Lending Market Investigation, Provisional Findings Report, Page 2-8

impact on a tightly-controlled budget. When asked how a short-term loan was used, people recall that they needed to pay bills or buy groceries at the end of the month, which is, in fact, a knock on effect of an unrelated expense earlier in the month.

It is also unsurprising that some users of short-term loans have variable incomes. 23 % of customers stated that this was case[58]. 93 % of those who said their need was due to a change in financial circumstances thought this change was temporary, whereas only 5 % expected the change to be permanent[59]. This challenges the assumption that these customers are vulnerable, may already be in financial difficulty and therefore are using short-term loans for the wrong reasons. In reality these consumers understand their finances and are borrowing to effectively manage a change in their circumstances.

ATTITUDE TO BORROWING AND DEBT

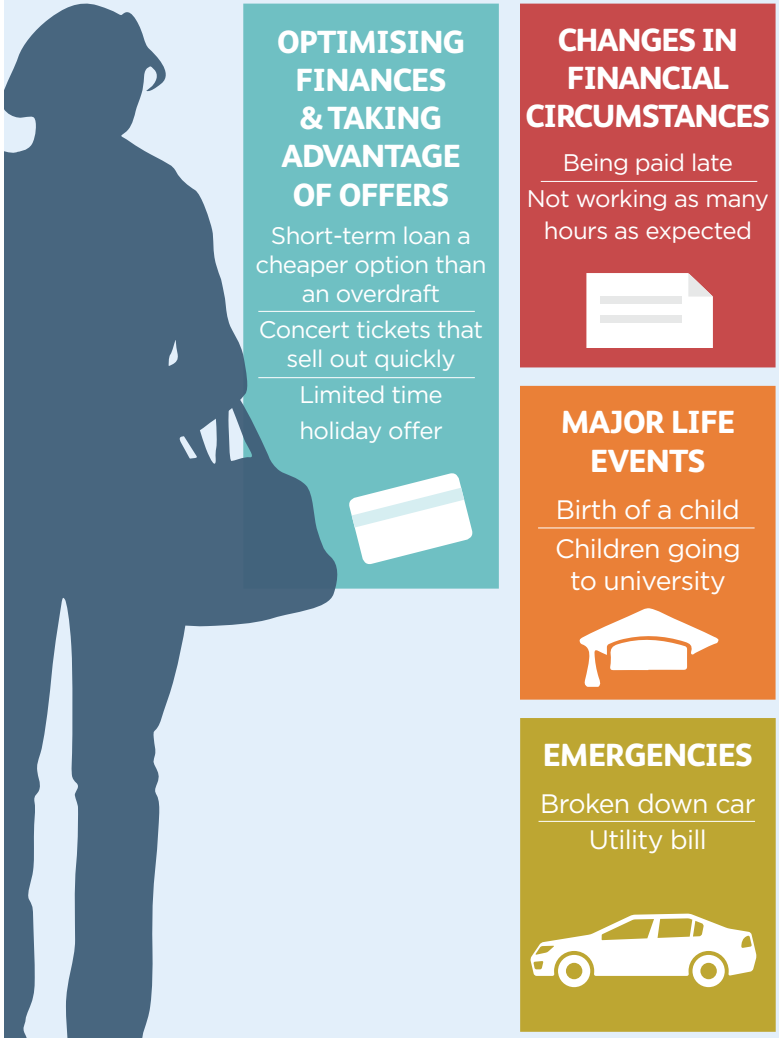
According to research carried out by one CFA member, 40 % of short-term loan customers described themselves as not always being as in control of their finances as they want to be. However 39 % said they are careful with money and try and avoid going into debt.

Some would argue that the UK is now a nation built on credit. Credit is now

58 CMA (2014) Payday Lending Market Investigation, Provisional Findings Report, Page 2-6

59 C MA (2014) Payday Lending Market Investigation, Provisional Findings Report, Page 2-9

THERE IS A RANGE OF REASONS PEOPLE USE SHORT-TERM LOANS



a part of our everyday lives and the government is encouraging households to spend in order to reboot the economy.

However, at a time when the economic outlook is still uncertain and little return is offered on savings, people prefer to spend rather than save. This does not mean that they cannot have a cautious attitude to spending. People are still focusing on the short term, rather than being tied to long-term financial decisions.

It is important to bear in mind that consumers have been under significant financial pressure for a considerable period of time. As the UK's economic indicators are now improving at pace, and as people's personal circumstances begin to improve, they are now more open to borrowing to fund expenses that they may have avoided in the last few years.

WHY ARE PEOPLE USING SHORT-TERM LOANS?

There are a variety reasons why people choose to use short-term loans to manage their finances. They offer flexibility to borrowers. Accessibility is also an important factor. Customers require access to cash and in particular like the ability to be able to borrow online at any time of day, wherever they might be. Even high street loan stores offer late evening and weekend openings, unlike some banks.

This was corroborated by research undertaken by TNS BMRB on behalf of the CMA[60], which was published in January 2014. In particular, three typologies emerged in relation to access to and perceptions of other mainstream credit alternatives:

- The first group of consumers had tried mainstream credit alternatives and had been turned down because of a poor credit rating.
- The second group had assumed they would not be approved for mainstream credit without checking. This was based on having a poor credit rating, or an assumption of this, or that they were at the maximum credit limit with the existing credit available to them.
- The third group of consumers had actively decided not to use other mainstream credit alternatives. This decision was made either because of the practical benefits associated with short-term credit, or

60 https://assets.digital.cabinet-office.gov.uk/media/5329df8aed915d0e5d000339/140131_payday_lending_tns_survey_report_.pdf

because they disliked or distrusted the other credit options available.

As outlined above, each consumer assesses their personal circumstances differently. However, what is clear is that a large proportion of consumers prefer to borrow from short-term lenders, rather than from other credit providers. Mistrust of the mainstream financial institutions is prevalent, with 33 % of those surveyed by TNS saying they "try to avoid banks as much as possible".

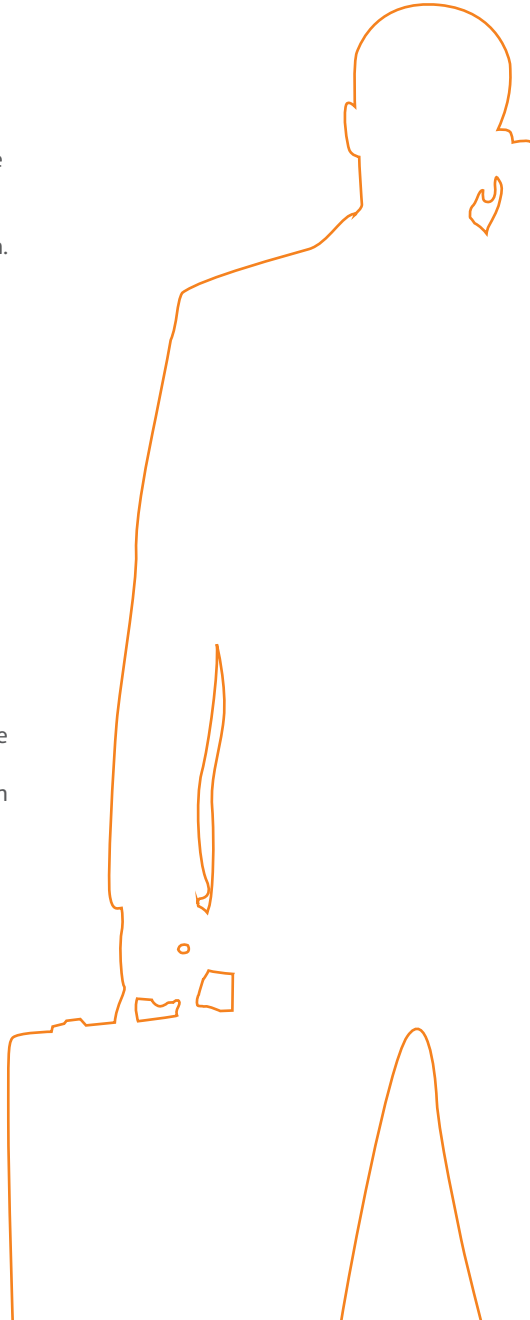
Compared to mainstream financial institutions, short-term lenders are more willing to consider a wider range of financial circumstances when people apply for credit. This is hugely appealing especially to customers who have had difficulties accessing mainstream finance and as a result have a distrust or fear of banks and building societies.

High-street customers in particular value being able to call into a local branch of a short-term lender. These customers are often more reluctant to carry out financial transactions online and have built relationships with store staff from previous visits so have built up a level of trust that does not exist with web-based services.

For online customers, the decision to use short-term loans often has different motivations. Many online customers value the relative anonymity that comes with taking out a loan online. For others it is the clear and transparent way they can borrow. They find websites easy to use and that is what works for them.

The speed of the transaction goes hand in hand with accessibility. In the past, short-term lenders have been accused of irresponsible lending because of the speed at which decisions are made. Lending decisions in this market, although complex, can often be made in a matter of minutes. However regulatory intervention has lengthened the process. It is important to note that the speed of the transaction does not equate to a lack of rigour in application process. Lenders can check a number of databases and multitude of data points instantaneously and this process continues to evolve with the sharing of real-time data.

The speed at which customers can access funds from a short-term lender is not a reflection of a lack of checks, but rather is a response to consumer demand. Short-term credit providers undertake the same checks as the largest financial institutions when



KEY FACTS

Within a year of Barclays launching a lending page within their banking app, half of all the unsecured borrowing from the bank was being completed without the customer visiting a branch

7.5 minutes

The typical time it takes Lloyds Banking Group customers to complete their online loan applications within 7.5 minutes[61]

offering a loan, including rigorous affordability checks. This ensures that lenders do not give credit to those who cannot afford it, while offering customers a quick and convenient service.

The time involved in applying for a loan continues to be an important consideration for consumers.

Consequently other credit providers, which do not operate in the short-term credit industry, are adapting to reflect the changing needs of consumers.

In 2013, Barclays launched an unsecured lending page within its mobile banking app. This provided customers with a pre-approved credit limit. Within a year of this being launched, half of all the unsecured borrowing from the bank was being completed without the customer visiting a branch. In addition, Lloyds Banking Group says that customers applying for a loan online, typically complete their applications within 7.5 minutes, with approval often instantaneous.[61]

A payday lending pilot run by London Mutual Credit Union offered customers credit at £2 per £100 for 30 days. They issued almost £700,000 of these loans in the year-long pilot through almost 3,000 loans. For an additional £11 the borrower could receive their loan funds on the same day – 86 % of customers took up this option[62].

East Lancashire-based social lender (or Community Development Finance Institution (CDFI), Moneyline, introduced a 'same day' transfer option in April 2014, for a cost of £7. To date 75 % of borrowers have chosen this option.

Speed is a defining feature of short-term lending, but this is because customers demand it. In reality, despite other financial institutions seeking to adapt to accommodate this, very few other finance providers can supply access to money this quickly.

OTHER FINANCIAL OPTIONS

A large number of consumers choose to borrow from a short-term lender, rather than from other mainstream lenders. However some short-term borrowers still struggle to access finance from other providers such as mainstream banks or credit unions.

According to research undertaken on behalf of the CMA[63], 39 % of short-term loan customers do not have access to any other form of credit and 60 % of customers believe they

61 BBA Report, The Way We Bank Now: It's in your hands, p.29 – June 2014
62 http://inclusioncentre.co.uk/wordpress29/wp-content/uploads/2013/09/Can-payday-loan-alternatives-be-affordable-and-viable-Summary-Report.pdf
63 TNS BMRB survey report, January 2014

could not have managed without the item/bill they spent their loan on.

When asked what they would have done if a short-term loan had not been available, 31 % of those questioned said they would borrow from family or friends. Unfortunately, this is not an option for everyone. 11 % of those questioned admitted that they did not know what they would do instead. This chimes with YouGov research commissioned by the CFA which found that only a quarter (25 %) of people turned down by short-term lenders were able to turn to friends and family and of those 69 % of said that they can only do so infrequently.[64]

BANKS

Short-term loan customers cite many reasons for not using traditional banks. Banks are not approachable in the same way; appointments and limited opening hours do not always fit around people's working life or other commitments. On top of this there is often a lot of paperwork to fill out and a decision can take days.

They can often find banks impersonal with lending decisions coming from a central clearing point without access to detailed knowledge of the applicant's individual and immediate circumstances. Aside from this, banks do not currently offer the kind of product that short-term loan customers demand – a small sum loan over a relatively short period of time. Banks instead often offer longer term loans over a greater duration, but customers often do not want to be exposed to the levels of debt associated with longer-term and higher-value loans.

Not surprisingly the legacy of the financial crash and the exposure of further mis-selling and interest rate fixing scandals continues to paint mainstream banks in a negative light. 80 % of people agree that banks put profit before people[65].

A recent survey of retail payday borrowers undertaken by a CFA member found that 72 % of people agreed or strongly agreed that borrowing money from banks or building societies is very difficult for people in their financial situation[66].

"You've got no choice, you have to have a bank account. If you didn't I wouldn't have one. They prioritise taking their money. It's £25 if you go over, they charged my son a few times because he's got no overdraft"[67].

64 CFA/YouGov research http://www.cfa-uk.co.uk/media-centre/press-releases/press-releases-2014/out-of-credit-survey-reveals-cost-for-borrowers-who-are-denied-credit-under-new-lending-rules.html
65 http://cdn.yougov.com/cumulus_uploads/document/ylf7gpof19/Public_Trust_in_Banking_Final.pdf p.20
66 Development team p. 151
67 Development team

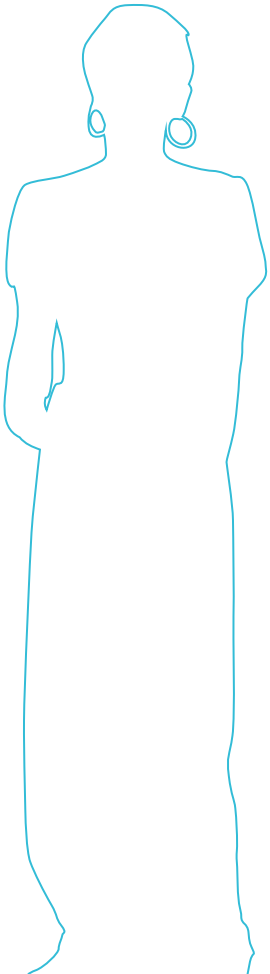
KEY FACTS

86%

of London Mutual Credit Union borrowers chose to pay an additional **£11** to receive their loan funds on the same day

75% of Moneyline customers chose the same day delivery option too

80% of people agree that banks put profit before people[64]



CREDIT UNIONS

Credit unions are sometimes described as an affordable alternative to short-term loans. Credit unions are not-for-profit mutual organisations run for the benefit of their members. Members have a common bond, such as living in the same geographical area or working for the same company.

While credit unions provide a valuable service, their members are often required to save money with them for a period of time before being able to borrow. In addition, like mainstream banks it can take days for a loan application to be approved unless borrowers pay a premium for faster payment. This makes it an unrealistic option for most of those who wish to take out short-term credit.

Many credit unions and other not-for-profit lenders are unable to access capital funds to lend to their customers at times of high demand. Banks adopt a low risk approach and require credit unions to demonstrate a sustainable business plan before they will approve new funds.

Most credit unions do not have the infrastructure or business model to service the demand for short-term loans. The London Mutual Credit Union (LMCU) recently ran a pilot offering short-term loans, however, given the current restrictions on the rates that credit unions can charge, LMCU made an average loss of £2.30 for each loan[68].

Credit Unions are evolving but are not a viable option for many borrowers.

CREDIT CARDS

61 % of the adult population in the UK has a credit card[69], and around a third of short-term loan customers have access to a credit card[70].

However, short-term credit customers often choose a short-term loan over a credit card. Some of these customers admit that a credit card can be tempting. Often borrowing limits are higher, but there is a risk that borrowing for a temporary change in circumstances leads to longer term borrowing.

The cost of a short-term loan is also much more transparent than a credit card with the exact fee displayed when taking out a loan. Credit cards cannot provide this visibility. In addition, terminology surrounding balance transfers, minimum payments, rewards, and annual fees can be confusing.

68 http://inclusioncentre.co.uk/wordpress29/wp-content/uploads/2013/09/Can-payday-loan-alternatives-be-affordable-and-viable-Final-Report.pdf p.5
69 http://www.theukcardsassociation.org.uk/wm_documents/01072013%20UK%20Plastics%20Cards%20Report%202013%20media%20alert%20FINAL%20for%20UKCA%20website.pdf
70 Development team p. 58

Many consumers, who have a good understanding of their finances, would prefer not to have access to the levels of credit offered by credit cards, opting instead for the more transparent costs and repayment discipline of a short-term loan.

FRIENDS AND FAMILY

The Financial Conduct Authority[71] expects 25-30 % of short-term loan customers to borrow from family and friends if they were unable to obtain a loan under the new regulations that were introduced in April 2014. As has been previously referenced, the CMA[72] found that 31 % of short-term loan customers could borrow from family or friends.

However, even most of those who can choose this route say this would be a one-off measure for most and is not a guaranteed solution to wider financial problems.

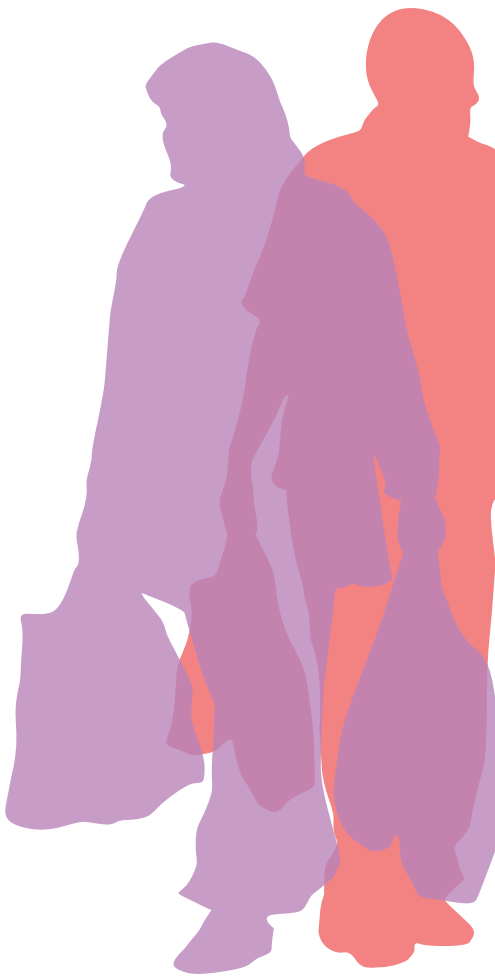
There is evidence from Japan[73] that consumers, who initially turn to friends and family for help when they have difficulty accessing credit, are unable to do so repeatedly and revert to the illegal and unregulated credit market.

In the UK, some people have the option to borrow money from friends and family should they need to. However 69 % of short-term loan customers thought they could only rely on this rarely, on an infrequent basis[74].

SHORT-TERMS LOANS ARE PART OF THE FINANCIAL TOOL KIT

Customers often state that they intend to use their short-term loan to pay utility bills or housing costs, and this is backed up by CMA analysis. Many critics of the industry interpret this to mean that customers using the loans to cover everyday living expenses are financially vulnerable. But it is important to look at a customer's entire financial situation when assessing their decision to use a short-term loan.

When a short-term loan is used towards the end of the month, it is not always possible to know all the other financial decisions made by the customer. The customer may state that the loan is to repay the gas bill, but in reality the car may have broken down earlier in the month (an emergency expense) or payment for a school trip was due, which has resulted in the subsequent budget deficit. It is this unexpected expenditure earlier in the month that has caused the need for a short-term loan to cover other usual outgoings.



71 FCA, Page 28, https://www.fca.org.uk/static/documents/consultation-papers/cp14-10.pdf
72 TNS BMRB survey report, January 2014
73 Domoto (2012), The rise of Yamikin (illegal lenders) market, which is spreading quietly in Japan (Institute for Research on Credit Business, Waseda University)
74 CFA/YouGov – Declined Applicants 2014

CUSTOMER PROFILES

ONLINE BORROWER

SARAH

Sarah is one of over 75% of customers who earns in excess of £15,000 a year. She is 32, is paid monthly, and has an income of between £1,000 and £2,000 after tax, each month.

Sarah works as a personal assistant – it's a busy job and as a young mother she has significant demands on her time.
Sarah takes out a loan two to three times a year, and usually borrows around £290. She always pays the loans back on time and uses them for living and household expenses. Her most recent loan was to pay for the washing machine to be repaired.

Sarah has only ever taken a loan out online and has used a few different providers. She is careful with her money, and for her it's about using the options available to her. She has an overdraft and a credit card, and chooses to use short-term credit as one of the ways to manage the peaks and troughs in her income and outgoings.

Sarah finds short-term credit is a convenient alternative source of credit. She wants a simple, quick service that is there when she needs it, and that she can trust. She likes borrowing online because it's a controlled, efficient environment that she understands and which works for her.

She has thought about borrowing from friends, or increasing her overdraft limit, but she finds short-term credit is the best option for her, enabling her to keep on top of her finances, without them getting out of control.

These profiles illustrate the ways customers borrow and manage their finances. One is based on a typical retail customer, the other on an online customer. This demonstrates the different ways customers decide to borrow and spend their money.

HIGH STREET BORROWER

CHRIS

For Chris, access to short-term credit is absolutely vital. He is 45 years old, is a sole trader, working as a handyman.

Due to his job, Chris, doesn't have a regular monthly income but usually earns around £1,000 a month, after tax.

He would only ever borrow from a high street short-term credit provider. He doesn't trust the banks, and prefers to take out a loan in person, rather than putting all his personal information online.

Chris has been using short-term credit for years and always goes back to the same loan store, where he knows the staff. He usually borrows around £180 and uses the money to pay his bills, when big ones come through. His used his last loan to pay the gas bill which was higher than usual due to the cold winter.

Chris rents his house and doesn't have any children. He doesn't have a credit card or overdraft as he prefers to only take out credit when he really needs it. This way he has more control over his finances.

However, he has in the past gone into his unauthorised overdraft, and this has resulted in fees that exceed the ones he incurs when taking out a loan on the high street.

Chris isn't always as in control of his finances as he would like, but he is fully aware of his financial situation, and being able to access short-term credit enables him to manage his finances in a way that works for him, without getting in to trouble.

Chris is one of the 54% of customers who feel that access to a loan makes it easier to pay bills on time. Without having this access to credit, Chris admits life would be more difficult and he might be tempted to turn to his local loan shark.

Earns around £1,000 a month

Typically borrows around £180

Does not have other forms of credit

The new Lending Landscape

KEY FACTS

Cap on the cost of credit

0.8%
per day

When loans are taken out or rolled over, the interest and fees charged must not exceed 0.8% per day of the amount borrowed.

£15
default fees

If borrowers default, fees must not exceed £15. Firms can continue to charge interest after default but not above the initial rate.

TOTAL COST CAP
100%
of amount borrowed
(applying to all interest, fees and charges)

Borrowers must never have to pay more in fees and interest than 100% of what they borrowed.

In April 2014 the Financial Conduct Authority (FCA) took over regulation of consumer credit, prompting dramatic changes in the short-term loan industry.

A range of measures was introduced to tighten regulation of the industry. As a result the short-term credit market now looks dramatically different to how it appeared as little as two years ago.

Lenders have made significant changes to the way they promote their loans, such as displaying risk warnings on all financial promotions and running strict enhanced affordability checks. Collection processes are as transparent as possible and are highly regulated with a limit on the number of times a loan can be extended (two 'rollovers') and a limit of two unsuccessful attempts at collections using Continuous Payment Authority (a payment method where funds are deducted from a borrower's bank account).

Since April 2014 Equifax has witnessed a significant increase in lender interest in developing robust affordability procedures. Lenders want to be able to accurately verify income via electronic means and use real-time data to ensure they are not placing borrowers into a position where they will become over-indebted by taking out a loan. The number of approved loans has decreased as a result in some cases by up to 40 %, however repayment rates have improved as lenders only accept those applicants that can afford the loan.

The regulations have also been overlaid with the introduction of a price cap that has been applied to the industry from the 2nd of Jan 2015. The cap covers the initial cost of the loan, a cap on the total amount of interest and a cap on the default fees that can be charged.

The changes the FCA has introduced since taking control of the regulatory regime have had a significant impact. Some lenders decided they could not operate under the new rules and have already left the market. This is a trend that is likely to continue over the next year as lenders opt out of full authorisation from the FCA.

The FCA has not been afraid to show its teeth in policing the industry. The lenders that have remained in the market are taking remedial action to address historic practices viewed as unacceptable in the new regulatory environment.

In February 2015 the CMA published the final report of its market investigation into the sector. This included further measures that will be applied to the industry. Online lenders will need to list their loans on a price comparison site authorised by the FCA.

All lenders will be required to provide existing customers with a summary of their cost of borrowing. This tells customers the cost of their most recent loan as well as all borrowing from the lender over the last 12 months and how late repayment affected the cost of credit.

With so many requirements placed on the industry within such a small amount of time, it has been difficult to identify the drivers of the change. However it is clear that the industry today is markedly different from its headline grabbing peak of 2013.

Data collected from CFA members shows that lending in March 2014 was down 54% on the previous year. A year later, lending had dropped by 68% on the peak of the market in 2013[75]. Equifax has also noted similar reductions in short term lending during this time period and in the last year the market has continued to shrink. The new regulations, such as the rollover cap and the price restrictions, will undoubtedly lead to further restrictions on loan approval rates.

By its own admission the FCA predicts that only three online and potentially one high street lender will be left offering a single payment loan within the price cap. The question remains of what impact this will have on consumers and competition within the market. In 2013 there were 240 firms offering a single payment loan. There are currently around 30-40 firms offering a short-term loan within the price cap.

The short-term loan industry is still relatively young and is continuing to mature. Alongside regulatory intervention in the market, lenders have evolved their products to continue to appeal to consumers' needs. Most of the larger players in the market now offer slightly larger installment loans over a number of months and early customer feedback has been positive.

Lenders have also embraced new technology to continue to offer loans that meet the expectations of modern consumers. Short-term loan companies are now leading the credit industry in the development of real-time data sharing to allow

75 CFA member data independently aggregated by Shelley Stock Hutter

for smarter, more robust lending decisions that provide a better picture of a borrower's entire financial situation quickly.

Real time systems have been developed by the major credit reference agencies including the Real-Time Exchange by Equifax and Moda by Call Credit. These solutions can provide much more up to date information than traditional credit files that are usually only updated every 30 days. All CFA members are signed up to at least two of the real time data solutions. Equifax has seen a shift in the market toward much wider sharing of data as the industry now recognises the importance that data sharing provides in helping all lenders lend responsibly. As ecommerce grows and consumers expect instant decisions, this is an area that the wider consumer credit industry should seek to embrace. The more lenders that supply customer transactional data, the more sophisticated and intelligent the lending decisions become for the entire industry.

Impact of the changes

The implementation of the new regulatory regime has had a huge impact not just for lenders but for borrowers too.

The consumers who suffer the most are those who are no longer able to access credit, but whose need has not diminished.

Information supplied to the FCA[76] as part of the research surrounding the development of the cost of credit cap, revealed an overall 20 % increase in applications for short-term loans between September 2013 and August 2014. In the same period, there was a significant reduction in the volume and value of loans (approximately 40 % and 35 % respectively), reflecting a 50 % reduction in firms' acceptance rates. In 2015 CFA members are rejecting approximately 80 % of applications and loan volumes are down by 70 % on 2013.

This demonstrates a clear increase in demand, while supply is being severely restricted as lenders either leave the market or tighten their affordability checks so that only those with the best credit records are granted loans. The demand for short-term credit does not go away with a reduction in supply; consumers still require access to small sum short-term loans to manage their finances effectively.

As identified earlier[77], 39 % of short-term loan customers do not have access to any other form of credit and 60 % of short-term loan customers believe they could not have managed without whatever they spent their loan on.

When asked what they would have done if a payday loan had not been available, 31 % of those questioned said they would borrow from family or friends. Unfortunately, this is not an option for everyone. 11 % of those questioned admitted that they did not know what they would do instead.

CFA members have seen this impact first hand. Some consumers are suffering as a direct result of regulatory action.

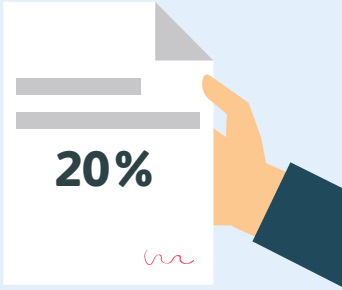
WHAT HAS HAPPENED TO SHORT-TERM LOAN CUSTOMERS?

Since the regulations were implemented, there are two distinct groups of consumers emerging:

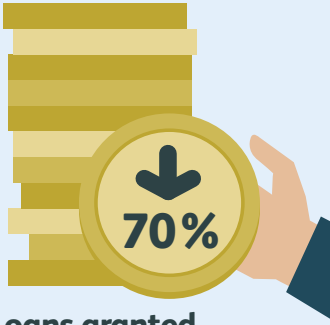
- The first group are those who were able to get approval on their loans prior to the implementation of the regulations, and are still able to do so. The impact on these borrowers has been limited, though they may only be

76 FCA PS14/16 p.13
77 TNS BMRB survey report, January 2014

KEY FACTS



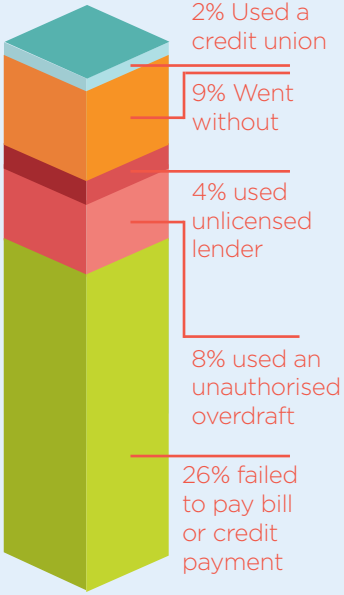
Applications accepted in 2015



Loans granted each month in 2015 vs 2013

KEY FACTS

When denied a short-term loan...



As a result:

Only a quarter

27%

were better off than they would have been with a short-term loan.

And a third

33%

considered using an illegal or unlicensed lender when they were declined.

able to access smaller amounts of money.

- The second group are those who were previously able to borrow, the vast majority of whom did so responsibly, and always repaid their loans on time. However, this group is now finding that they are being turned down for loans, and are no longer able to access credit. This has left some consumers angered and distressed as they do not understand why, when their circumstances are the same, they are no longer able to access this form of credit.

With a 70% reduction in firms' acceptance rates[78] the second group is a large and expanding group of consumers.

In the summer of 2014, the CFA carried out consumer research in partnership with polling company YouGov. This research focused customers who, having previously been approved for loans, had been declined as a direct result of the new affordability checks.[79]

All of the respondents had applied for a loan between 1 April and 5 August 2014. They were polled during the summer of 2014.

The research found that a large proportion of borrowers who are now denied short-term credit, are facing financial plight as a result.

Of those surveyed:

- 26% said they failed to pay some form of bill or credit repayment;
- 8% had used an unauthorised overdraft on a personal bank account;
- and 4% had borrowed from an unlicensed lender.

Only 9% said they chose to do without whatever they intended to pay for with a loan, with just 2% turning to a credit union.

THE COST OF MISSED PAYMENTS

The cost of missing a payment or using an unauthorised overdraft can be significant. Of those surveyed, 44% said they had incurred a

78 CFA member data independently aggregated by Shelley Stock Hutter
79 CFA/YouGov – Declined Applicants 2014

bank account overdraft fee, and 51 % had incurred a late or missed payment fee for a credit card, utility bill, rent payments, or other penalty.

This is a clear indication of the impact of the regulations on those borrowers in the second group. Unauthorised overdraft fees and fines for missed payments can often be higher than the fees charged by short-term credit providers.

For example, research undertaken by Which?[80] found that some banks charge up to £30 for borrowing £100 through an authorised overdraft for 31 days – a higher rate than the cap on short-term credit.

The fees for unauthorised overdrafts can far exceed this. Which? found that some unauthorised overdraft fees on an overdraft of £100 can be as high as £100.

Late or missed payments, and the associated fines and administration fees can also be high, resulting in these customers paying more than if they were able to access credit from a short-term lender.

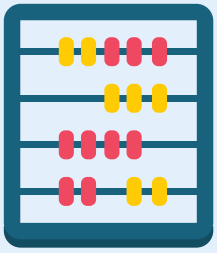
Indeed, 26 % of those surveyed said they had incurred fees or fines that were more than the cost would have been if they had been approved for the loan. It is clear that these customers would have been better off if they had been approved for a loan.

In addition, when customers were asked what alternative they used when their loan application was rejected, 40 % said they used another short-term credit provider. These are likely to have been firms, who at that point, were not adhering to the FCA's regulatory regime. It is unlikely that these borrowers would be able to do the same today, or will be able to do so in the future due to the requirements placed on the industry as a whole.

Furthermore, it is important to remember that this research was undertaken prior to the implementation of the price cap, which has further restricted firms' ability to lend.

It is therefore likely that more consumers are being impacted by this than was reflected in the research.

KEY FACTS



Which found that **26%** of those who took part in their survey had incurred fees or fines that were greater than the cost if they had been approved for a short-term loan

Which also found that **40%** used an alternative short-term credit provider

80 Which? says it time to clean up credit – Which?, October 2013

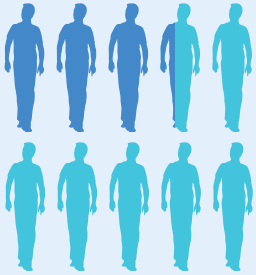
ARE CREDIT UNIONS THE ALTERNATIVE?

The reality is that while credit unions do provide a valuable service, they are simply not an option for many of those who have been turned down by a short-term credit provider. Just 2% of those asked what they did when they were turned down by a short-term credit provider, said they turned to a credit union for assistance.

As has been outlined, credit unions have a completely different model from short-term credit providers and often cannot meet consumer requirements.

The risk of over regulation

KEY FACTS



33% of those turned down by a short-term credit provider, under the new regulatory regime, had considered using an illegal lender

The comparatively small illegal lending market in the UK in 2010 was...

"in a large part due to a regulatory environment that permits high cost credit and does not prevent those with adverse credit history from borrowing in the legitimate market."[81]

Department for Business, Innovation and Skills

It goes without saying that any market should be properly regulated to protect consumers and ensure it is vibrant and competitive. But it is essential that regulatory action does not have an adverse impact on consumers.

While many consumers will incur a fine, or some other financial penalty, as a result of no longer being able to borrow from a short-term credit provider, there are some – perhaps more vulnerable consumers – who will be more significantly impacted.

CFA members operate in a number of different markets around the world and from this experience know that without viable alternatives in place for many consumers, over-regulation and cutting off access to credit drives customers towards unregulated lenders.

The requirement for credit does not go away. While a large number of customers are able to access other forms of credit (through long-term loans, credit cards, and overdrafts) for the most vulnerable this isn't an option – according to the CMA[81], 39 % of payday loan customers do not have access to any other form of credit.

The polling undertaken by YouGov[82] last year, which was referenced in Chapter 5, found that 33 % of those who had been turned down by a short-term credit provider, following the implementation of the new regulatory regime, had considered turning to an illegal lender. What is extremely concerning is that 4 % of people had actually used an illegal lender.

According to the Department for Business, Innovation and Skills, in a report published in 2010, the illegal lending market in the UK was, at the time, comparatively small by international standards. This was: "*in a large part due to a regulatory environment that permits high cost credit and does not prevent those with adverse credit history from borrowing in the legitimate market.*" [83]

Using examples in Asia, the Milken Institute also argues that one of the key ways in which to prevent and reduce the level of illegal lending is to reduce regulatory restrictions, to: "*make cost recovery on smaller, unsecured, short-term or high-risk loans possible for formal lenders, increasing competition for underground lenders.*"[84]

In order to ensure unregulated lenders do not monopolise the credit market for certain sections

81 TNS BMRB survey report, January 2014
82 CFA/YouGov – Declined Applicants 2014
83 Department for Business, Innovation and Skills - Interim Evaluation of the National Illegal Money Lending Projects, October 2010
84 The Milken Institute - Underground Lending: Submerging Emerging Asia?, April 2014

of society, regulated short-term credit providers must be able to lend to a variety of borrowers – regulations must not be too restrictive, they must be balanced and reasonable.

OFFSHORE LENDING AND LOANSHARKING IN THE UK

The traditional image of a loan shark coming to your door demanding payment with menaces still exists, but in reality many illegal lenders are found online. These lenders have not obtained the relevant licence required to lend into the specific territory and often do not adhere to the required regulatory regime. This is sometimes referred to as 'offshore lending'.

This form of illegal lending is prevalent in the US where it can be argued that overly restrictive regulation on short-term lending has driven the illegal market online.

In the US six in ten online lenders are illegal, with no licence to lend in the state in which the borrower lives. This equates to 21 million illegal loans a year, representing $9.7 billion.[85]

Regulation in the US varies by state but, for instance in Oregon, illegal lenders represent 74% of all online small sum lending.[86]

There is the potential for a similar regime to operate within the European Economic Area (EEA). Unmet demand may be served by firms operating in EEA countries, where the FCA does not have regulatory jurisdiction.

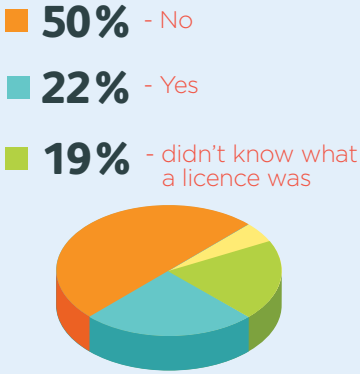
When YouGov asked payday loan customers if they had checked to see if the provider had a UK credit licence when they last borrowed from a short-term lender, 50% said no, and 19% said they did not know what a credit licence was. Only 22% said they had checked.[87] There is nothing to stop firms who are not licenced in the UK from operating online. Consumers are very unlikely to check the lender is licenced and will therefore not be aware they are borrowing from an unregulated lender.

Restrictions on interest rates, the use of continuous payment authority, rollovers, affordability assessments, collections and any other aspect of the regulation may not be adhered to by such lenders. While the most significant impact of overzealous regulation in terms of volume of loans is likely to be 'offshore lending', the issue which will have the greatest impact on

85 https://www.policis.com/pdf/Illegal_Lending_presentation_171214.pdf
86 https://www.policis.com/pdf/Illegal_Lending_presentation_171214.pdf
87 CFA/YouGov – Declined Applicants 2014

KEY FACTS

...online lenders are illegal in the US



...percentage of people who checked to see if the provider had a UK credit licence

KEY FACTS

> While the supply of that lending has disappeared the demand doesn't. The demand keeps on growing. And it's in that respect that the illegal loan sharks are getting into a feeding frenzy.[86]

Chris Pond, vice-chairman of the Financial Inclusion Commission

individual consumers is likely to be loan sharking.

Chris Pond, vice-chairman of the Financial Inclusion Commission, recently said in reference to the impact of the new regulatory regime that: "While the supply of that lending has disappeared the demand doesn't. The demand keeps on growing. And it's in that respect that the illegal loan sharks are getting into a feeding frenzy."[88]

In 2014, it was estimated that 310,000 families have been in contact with illegal lenders in the UK, and the Illegal Money Lending Team believe this to be an under-estimate.[89]

In January 2014 Tony Quigley, Head of the Illegal Money Lending Team, said that by a conservative estimate, borrowers are paying at least £700 million a year to illegal lenders. He suggests that, often, the only way that illegal lenders[90] can ensure the loans are repaid is through "fear, intimidation and acts of violence".

And it is not just the physical effects of illegal lending that impact on borrowers and the escalation in crime and anti-social behaviour. A study undertaken by the Illegal Money Lending Team, in September 2010, reported loan shark victims suffering from severe depression as a result of the precarious financial position this puts them in and the stress of dealing with loan sharks.[91]

The evidence outlined above relates to the market as it was in 2010. The reduction in the supply of credit we have witnessed since then is very likely to have made matters considerably worse – as has been the case in other countries.

PRICE CAPS ELSEWHERE

Price restrictions were introduced in Japan in 2006. Following this, there was a surge in the number of consumers having to turn to illegal lenders. Between 2009 and 2011, the number of people using illegal money lenders in Japan, rose by 1,400 % from 420,000 to 5,810,000.[92]

In France, research undertaken by Policis in 2004 revealed that regulatory restrictions led to significant increases in the levels of problem debt, over indebtedness and insolvency.[93] In addition, 7 % of people in France on low incomes, with poor credit ratings, were prepared to admit that they, or someone in their household, had used an unlicensed lender. This compared to 3 % in the UK.

88 BBC News - 'Personal debt goes up by 23% in a year in Wales', February 2015
89 The Illegal Money Lending Team – Spring Newsletter, 2014
90 The Guardian - Sixty victims of loan sharks in witness protection, January 2014
91 Debt Management Today - Survey highlights shocking effect loan sharks have on victims, September 2010
92 Institute for Research on Credit Business, Waseda University - The risk of Yamikin (illegal lenders) market, which is spreading quietly in Japan, October 2012

The situation in Germany was even more acute. According to Policis, 8 % of those on low incomes, with poor credit ratings, were prepared to admit that they, or someone in their household, had used an unlicensed lender.[94] In addition, lower income households in Germany were two or three times more likely to contact an illegal lender than those in the UK. Again, this is a clear, unintended consequence of regulation that is too restrictive.

Policis also note that it is almost impossible to obtain accurate information about the level of illegal lending due to the reluctance of victims to talk about their situation, often based on fear of repercussions. The reality is that the problem is likely to be far worse than the evidence suggests.[95]

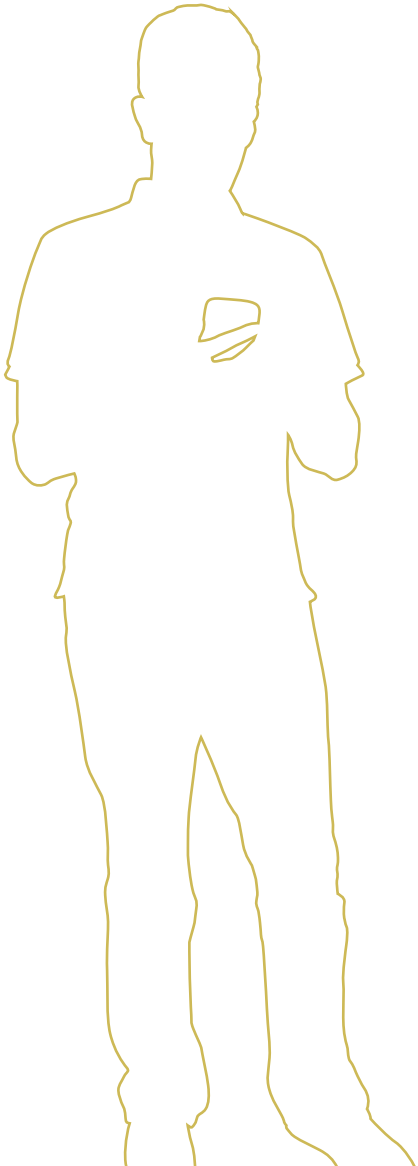
Robust regulation of the short-term lending market is essential. However, getting regulations wrong can result in the most vulnerable customers feeling the greatest impact, without any alternative forms of affordable credit in place.

The fact is that a reduction in the supply of credit is not matched by a corresponding reduction in the demand. Consumers are forced to make extremely difficult choices which could have dire consequences for them and their families. It is not possible to regulate human behaviour.

Prohibitive regulations can lead to an increase in illegal lending. But if restrictions are set at the right level, they can help to reduce levels of illegal lending. Therefore, the aim must be to set regulations that ensure lenders are still able to compete and remain profitable, while offering short-term credit at a reasonable price.

93-95 Policis - The effect of interest rate controls in other countries, 2004

Conclusion



This report provides the most up to date a snapshot of what the short-term loans industry looks like in 2015.

It has demonstrated that people from all walks of life use short-term loans. It has also explained the motivations for using this form of credit and why people continue to favour it over other options. It shows that people understand and value short-term loans and the product works well for their requirements. How the UK population manages its finances, its social life and conducts business is rapidly evolving with technological developments driving these changes.

Alongside these developments, the UK continues to deal with the hangover of the credit crunch. Financial pressures continue to impact families and credit is an accepted and essential part of life. The economy is now improving, but the threat of a rise in interest rates casts a shadow and will hit family finances hard. The recession has also led to fundamental changes in the UK workforce with variable incomes now the norm. For this reason short-term credit remains a valuable part of the personal finance tool kit as individuals look to the future.

Extensive regulatory intervention, of which the full impact is not yet known, has already caused a dramatic reduction in the supply of short-term credit. But this has not been met with a corresponding reduction in demand. Being denied access to credit is not a better outcome for most consumers. Regulatory changes are already causing some detriment with consumers turning to illegal lenders.

It is understandable that people with regular monthly salaries often struggle to understand why anyone would use a short-term loan to manage their finances. Policy-makers and stakeholders believe that it would be better for people to not borrow at all. However, this is a failure to understand alternative lifestyles. Short-term loans fit well with today's busy lifestyles, and suit borrowers who need small sums without hassle that can be paid back quickly.

Consumers in the UK are demanding and they want things at their fingertips. Digital technologies allow lenders to meet this consumer demand but also drive innovation and more accurate lending decisions through greater knowledge and understanding of a consumer's immediate financial situation in real time. In this age of

ecommerce where purchases can be made in one click or flick of a finger on a smartphone, all lenders should be adopting real-time data sharing if they want to fully understand their customers and make responsible lending decisions. Short-term loans will continue to drive change in financial management and innovation in the consumer credit industry.

For this reason regulators need to be cautious about imposing further restrictions on this market before the impact of the current regulation is known. Lenders are adapting to consumer demand and are on a clear path of improvement[96]. Unfortunately those customers who are being forced to look for credit elsewhere as a result of the regulatory restrictions will not be afforded the same protection as from legitimate lenders.

The industry supports a reasonable approach to regulation in the interest of ensuring a vibrant and competitive short-term lending sector, but this industry is now at a tipping point. Without a fair and balanced package of regulations, customers will be forced to seek credit elsewhere and face dire consequences.

96 http://www.fca.org.uk/news/thematic-reviews/tr15-03-arrears-and-forbearance-in-high-cost-short-term-credit

IN ASSOCIATION WITH

EQUIFAX®

Consumer Finance Association
T: +44 (0)203 178 7408
F: +44 (0)203 170 5909
E: enquiries@cfa-uk.co.uk
W: www.cfa-uk.co.uk

© Consumer Finance Association, July 2015
The Consumer Finance Association is a company limited by guarantee.
Registered in England no. 6731978. Registered office: 78 Pall Mall, London SW1Y 5ES