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High cost consumer credit: the new regulatory regime.

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Summary

Credit can be an emotive issue, encompassing mixed responses to everything from free access to credit, reckless lending, problem debt, and the burden of student debt. But no subject has had a higher profile recently than the credit providers in the sub – prime or high cost credit (HCC) sector: summed up regularly as "legal loan sharks". No other symbol better epitomises the anger which its critics feel, than eye wateringly high interest rates.

The general criticism was summed up in the allegation that the companies were 'legal loan sharks'. Loan sharks are, strictly, unlicensed people who lend money at high rates of interest and who may use illegal methods, including violence, to enforce repayment.

The original regulator, the Office of Fair Trading has given way to the Financial Conduct Authority (FCA) which has introduced a new regulatory regime, which included limits on the number of loan 'rollovers' and a cap on the amount that loans can cost.

It was always expected that the change in the regulatory regime would have a profound impact on the sector. The FCA were very comfortable with the expectation that the new rules would result in a much smaller industry and that some people (people who previously only just qualified for loans) might no longer have access to credit but that, in economic welfare terms, they would be better off if without it.

The outcome has been a smaller industry, with fewer lenders, but not on the scale envisaged in the planning and forecasting work done by the FCA. The FCA had assumed that the industry might shrink to "three largest online firms [and] "it is possible that (only) one high‑street firm". Post change the FCA found that:

Market size

> Between January 2014 and June 2015, there were over 800,000 fewer individuals taking out at least one HCSTC loan than between January 2012 and June 2013.
>
> The biggest factor in decreased lending volumes was a significant drop in the number of applications.
>
> A clearly discernible decrease in acceptance: rates [which] dropped from 50% to 30% from the start of 2014 to the middle of 2015.

Number of firms

> 188 firms which originally applied for HCSTC permissions withdrew their applications, often after a direction from the FCA following consideration of the firm's authorisations application and where it was clear that the firm did not meet the standards expected by the FCA.

Firms' profitability

> Profitability has decreased: combined losses in the first half of 2015 were larger than the combined losses in the whole of 2014.

Default rates

> Declined through 2014 to June 2015: the proportion of loans being charged a late payment fee has steadily decreased from 16% in January 2014 to below 8% in April 2015. Some firms no longer charge late payment fees.

Changes to products

- The average length of loans has almost trebled. The average initial loan duration: 2012-2013 was 30 days;
- Start 2014, 40 days;
- June 2015, 80 days.

Average loan size – has remained around £250.

Lower costs for customers.

Loans originating at the start of 2014 typically resulted in the customer being charged around £100 in interest and fees. This declined over 2014 to around £80. Once the price cap was introduced, there was a further sharp drop to around £60.

The industry itself recognises the FCA's findings but ascribes the changes to more than simply the price cap. It stresses the impact of the limit on 'rollovers.

The limit in the number of 'rollovers' which has dramatically changed the 'dynamic' of the industry. If the lender can only rollover twice, then they need to be more certain that the loan can be repaid and, even if there is a rollover, the amount they can charge is effectively capped by the 100% repayment rule.

The industry feels that its response to the new rules and the move towards longer loans, in a more controlled framework has effectively blurred the lines between HCC and other consumer lending.

Given how differently the industry operates it is something of a surprise that complaints against it have increased sharply. Financial Ombudsman complaints data show a nearly fourfold increase in complaints and a tenfold increase in referrals. This may be more to do with the greater focus on the industry and the more interventionist approach from the Regulator than the fact that the industry has gone from bad to worse. The fact that the upholding rate of complaints has dropped sharply may provide some clue as to the quality of the complaints.

1. Introduction

Credit can be an emotive issue, encompassing mixed responses to everything from free access to credit, reckless lending, problem debt, and the burden of student debt. But no subject has had a higher profile recently than the credit providers in the sub – prime or high cost credit (HCC) sector: summed up regularly as "legal loan sharks". No other symbol better epitomises the anger which its critics feel, than the eye wateringly high interest rates.

In fact, the HCC sector is made up of several different markets. Some are highly competitive others, e.g. the home credit market, less so and the industry points out that there are good reasons why credit is expensive when measured in terms of its APR.

First, the loans are much smaller starting at £50 and up to £500, whereas loans available from banks are £1,000 or more. Second, the length of the loan is very different. Most HCC sector loans are for periods of a couple of weeks. Bank loans start at a year. Third HCC customers are often people who have poor credit records and cannot borrow from anyone else.

There have been numerous recent attempts to curb the activities of pay day lenders and others. A widespread campaign by MPs featuring debates in the House and proposals for legislative change lead to regulation of the sector being passed from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA). The biggest single regulatory change was the introduction of a 'cost of credit cap' introduced at the direction of the then Chancellor and implemented by the FCA. This Paper looks at how the changes have worked and what has happened to the industry since.

2. The Pre-Reform High Cost Credit Market

Market size and operation

A brief description of the size of the market before the reforms took effect can be found in the Competition and Markets Authority (CMA) Report into the sector, repeated in later Financial Conduct Authority (FCA) Studies:

> The CMA found that total payday loan revenue in 2012/13 was £1.1 billion, with 10.2 million loans issued, worth £2.8 billion. This was a significant increase on the previous year although the rate of growth has since reduced substantially. There were 1.8 million payday loan customers in 2012/13, and the average customer took out six loans in a 12‑month period (with 40% of customers using more than one lender in the year).
>
> According to the CMA's figures, 83% of payday customers have taken out a loan online and 29% on the high street (with 12% having used both channels). The average loan was £260 (but £290 online and £180 on the high street).[1]

In speeches criticising the industry there were often apparently contradictory statements about whether it was a competitive one or not.

A speech in Westminster Hall in 2010, claimed that the market was highly monopolistic, "Six lenders account for 90% of the home credit market-Provident accounts for 60%-so there is little competition to drive down interest rates."[2]

But in other speeches the complaint was of a rapid expansion in outlets which "Now [2009], in communities such as mine in Walthamstow, these companies litter our high streets".[3]

The industry had grown rapidly over 10 years with new companies entering and others expanding. In its 2010 report on high cost credit the OFT defined the market as including "pawn broking, payday and other short-term small sum loans, home credit and rent-to-buy credit".[4]

It concluded that there were some competitive issues with the sector:

> Second, and notwithstanding these comments, there are problems with the effectiveness of competition in these markets:
>
> - on the demand side, there is relatively low ability and effectiveness of consumers in driving competition between suppliers, given their low levels of financial capability
> - on the supply side, sources of additional supply such as mainstream financial suppliers seem to be limited, and

1 FCA; Proposals for a price cap on high‑cost short‑term credit, p15
2 HC Deb 25 January 2010 c24
3 HC Deb 9 November 2010, c23WH
4 OFT High Cost Credit Final Report, June 2010 p3

> - in such circumstances, competition on price is limited and there appear to be some suppliers charging higher prices than would be expected.[5]

In more detail, it found:

> There appears to be little substitutability on the demand side between payday lending, pawn broking and home credit, because of:
>
> - different lending criteria by lenders, which result in different demographics for borrowers of different products, and
> - different inherent characteristics of the products, such as the length of the loan period, which limit the choice of products for different groups of consumers, because of affordability constraints.
>
> On the supply side, substitutability opportunities appear to be limited, since different products require different business models and skills. As a result, most suppliers specialise in offering one product. The most notable exception is the joint provision of payday lending and pawn broking, which are frequently offered by the same suppliers who take advantage of economies of scope by better utilising their high-street premises to attract a broader range of customers.[6]

The OFT's view on the competitiveness of pay day lenders was:

> While the rates charged by payday lenders are high, they can be lower than for some mainstream alternatives such as unarranged overdrafts.
>
> Price does not seem to be a primary driver of competition, with suppliers attracting customers with the convenience and speed of the application process. An increasing number of suppliers are operating in the market and appear to compete with each other with different means to attract the growing demand. However, consumers do not seem to drive competition since they do not usually shop around for the best price.
>
> We are concerned by the confusion that brand proliferation is likely to be causing, in preventing consumers that do shop around from doing so effectively.[7]

The stand out feature of the market and the criticism of it were the interest rates it charged. The table below gives a snapshot of loan rates as they were at November 2010. It was not an exhaustive study but it represents the findings of an hour or so of searches across websites and advertisements.

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5 Ibid p4
6 Ibid p18
7 Ibid p19

Consumer credit loan availability

	Interest rate APR	Minimum amount £'s	Minimum Term	Criteria
Halifax	22.9%	1000	12 months	No CCJs, Must be in employment, Existing customer
Natwest	21.0%	1000	12 months	No CCJs, regular income, Existing customer
Lloyds TSB	20.9%	1000	12 months	No CCJs, regular income, Existing customer
Nationwide	24.1%	1000	12 months	No CCJs, must be in employment, existing customer
HSBC	19.1%	1000	12 months	Current account holder with minimum £700 per month into the account
Co-op	19.9%	2000	12 months	Minimum income of £10,000, homeowner or have a debit or credit card
Santander	18.9%	1000	12 months	Over 21, no CCJs, work more than 16 hours a week
Ocean Finance	17.1%	3000	3 years	Consider all circumstances' incl self employed, retired, CCJs and bad credit history; but loans are secured on property
Provident Financial	272.0%	50	1 week	Unemployed, CCJs, bad credit, no credit
Moneyshop	260.2%	90	1 week	Full time employment, bank account

Criticisms

The general criticism was summed up in the allegation that the companies were 'legal loan sharks'. Loan sharks are, strictly, unlicensed people who lend money at high rates of interest and who may use illegal methods, including violence, to enforce repayment.

Various pressure groups conducted campaigns against the industry. One, Compass, argued for:

> End Legal Loan Sharking
>
> Irresponsible lending can cause debts to become unmanageable: some loan and credit companies are charging annual interest rates equivalent to over 2500% (despite the Bank of England base rate being just 0.5%). Borrowing at these rates repeatedly tips customers into inescapable cycles of debt and poverty. High debt repayments are linked to rent, council tax and utility arrears, constraints on job seeking behaviour, poor diets, cold homes, and mental and physical health problems. This is legal loan sharking, a national scandal which must be stopped. In response to our growing private debt crisis we believe now is the right moment to adopt the policy of lending rate caps for all consumer credit.
>
> Affordable short-term credit is needed more than ever to help make ends meet as people face huge cuts in public services, reduced working hours, stagnant wages, and unemployment. Despite this because millions on lower and middle incomes are not catered for by many High Street banks, they have no choice but to borrow at usury rates. As a result, those most in need often pay the highest rates to obtain credit. Around 3 million people use high cost door to door loans which often charge £83 in interest and collection charges for every £100 borrowed.[8]

This campaign was cited in a speech supporting a ten-minute rule bill (*Consumer credit (Regulation and Advice) Bill*)[9] introduced by Stella Creasy who led much of the Parliamentary activity on this.[10]

8 Compass, direction for the Democratic Left, website at: http://www.compassonline.org.uk/campaigns/campaign.asp?n=10420
9 Bill 103 2010/11
10 HC Deb 3 November 2010

The OFT published work it had done into various aspects of the market. These included studies into:

- Debt collection practices
- Debt management
- Irresponsible lending
- Review of compliance with irresponsible lending guidance

On each of these issues the OFT had concerns about the way that the industry operated. Material on this and links to the original documents can be found on this link here. It culminated in March 2013 in the OFT making a referral to the Competition Commission on top of an ultimatum to the industry to alter its practices. The OFT website explains:

> The OFT is giving the leading 50 payday lenders, accounting for 90 per cent of the payday market, 12 weeks to change their business practices or risk losing their licences, after it uncovered evidence of widespread irresponsible lending and failure to comply with the standards required of them.
>
> The OFT has also today announced that, subject to consultation, it proposes to refer the payday lending market to the Competition Commission after it found evidence of deep-rooted problems in how lenders compete with each other.
>
> The action was announced in the final report on the OFT's compliance review of the £2 billion payday lending sector. The review found evidence of problems throughout the lifecycle of payday loans, from advertising to debt collection, and across the sector, including by leading lenders that are members of established trade associations.
>
> Particular areas of non-compliance included:
>
> - lenders failing to conduct adequate assessments of affordability before lending or before rolling over loans
> - failing to explain adequately how payments will be collected
> - using aggressive debt collection practices
> - not treating borrowers in financial difficulty with forbearance.
>
> The fifty leading lenders, each of which was inspected, will have to take rapid action to address the specific concerns the OFT identified with each of their businesses. They must demonstrate within 12 weeks that they are fully compliant, or risk losing their licence. Failure to cooperate with this process will trigger enforcement action.[11]

The Compliance Review (final report) mentioned in this release can be found here.

Industry response

The industry pointed out that it was unfair to compare their loans with those of banks. First, there is a very clear distinction between the size of mainstream lenders' loans and those in the HCC sector. The smallest

[11] OFT website, March 2013

loan available from the banks was £1,000. By contrast home credit loans tend to be up to £500 (£200 on average) and other lenders provide loans as small as £50.

Second, the term over which the banks lend is very different to what the HCC sector operates in, or can operate in. In practice, most home credit loans last for about a year. Other HCC loans are for much shorter periods than this and it is this which makes the APR so misleading.

Third, banks deliver loans by electronic transfer and collect the repayments the same way. The HCC sector works primarily with cash which is expensive to deliver and collect.

Fourth, banks will often not lend to:

- people with poor credit records;
- non-customers; or
- self-employed or unemployed people

These are all typical HCC customers.

Lastly, whereas many of the fiercest critics of the sector never had a need to use it, those who did were, in general, far less critical of it.

"Buy me a pint"

Much of the criticism of the industry focussed on the annual percentage rate (APR). This measure and the way that it is calculated was set by legislation (the CCA 1974):

> The APR is based on the total charge for credit (TCC) which includes interest and other charges which affect the cost of borrowing - even if they are not payable under the credit agreement itself. The APR is an annualised rate reflecting the timing of such charges, as well as the rates and amounts.
>
> The rules for the calculation of the TCC and APR are set out in the Consumer Credit (Total Charge for Credit) Regulations 1980. These include several assumptions which must be used where information is unknown or cannot be calculated accurately.[1]

Both sides of the HCC argument would probably agree that using the APR as the price comparator is not ideal for loans that are for much shorter periods of time – for example payday loans. Advertisements by such companies include the APR but direct customer's attention more strongly towards the actual cost of the loan - £10 as opposed to 250%. The consumer money 'expert' Martyn Lewis, in evidence to the Treasury Select Committee, gave the following example of the difference between the perception generated by quoting APRs and 'real' money costs might have – psychologically at least:

> I get so many e-mails and messages from people saying, "I've just seen an advert for a company charging 2,300% interest, that's disgusting, it should stop"-is that I did a pet calculation the other day which showed that if I lent you £20 and said, "Pay me back a pint of beer next week; buy me a pint for it," and the pint cost £3, that's 141,000% interest, if you compound it. Yet most people would say, "Buy me a pint and £20, is a pretty reasonable deal."

To sum up, the HCC industry justified its charges in various ways – the APR is a poor measure, defaults are higher, time periods shorter etc. They argued that there was no obvious way to dramatically alter their cost structures and remain profitable. There was some support for this in an academic study on the supply of credit to poor households commissioned by the Joseph Rowntree Foundation: Affordable credit for low income households.

Put very simply, the industry argued that there would always be a need for short term borrowing, restrictions on their ability to lend meant that borrowers would be forced to borrow from other sources, possibly even more expensive unlicensed lenders: the real loan sharks.

Regulation

One of the criticisms of the pre-reform era was that the sector was under regulated. To some critics, the regulatory effort started (and ended) with the granting of a licence. The conditions of licensing were governed by the *Consumer Credit Act* 2006 which substantially updated the old 1974 Act.

Part of the OFT the applications procedure included the 'fitness' and credit competence' tests. 'Fitness' included:

> evidence:
>
> 1. of any past misconduct
> 2. of the skills and knowledge that you and the people participating in your business have in relation to the licensed activity and any relevant experience, and
> 3. of the practices and procedures that you propose to operate in the running of the business[12]

'Credit competence' includes:

> We consider the skills, knowledge and experience of you and those participating in your business to carry out the activities covered by your licence to a reasonable standard. We also consider the practices and procedures you propose to operate in connection with your licensable business activities. Our consideration of your credit competence relates only to the credit activities to be undertaken under the credit licence, not competence to run the business generally.
>
> All licensed businesses are expected to be competent to carry out the regulated activities for which they hold a licence. The levels of competence required and the corresponding type and degree of information we will seek from you will differ according to the categories of credit activity you engage in or propose to engage in. As noted above, the OFT considers that some business activities pose greater potential risks to consumers than others. The OFT will focus its resources on the higher risk activities.[13]

Many critics thought the vetting was not strict enough. Such comments were frequently repeated in a Westminster Hall Debate in December 2010.[14]

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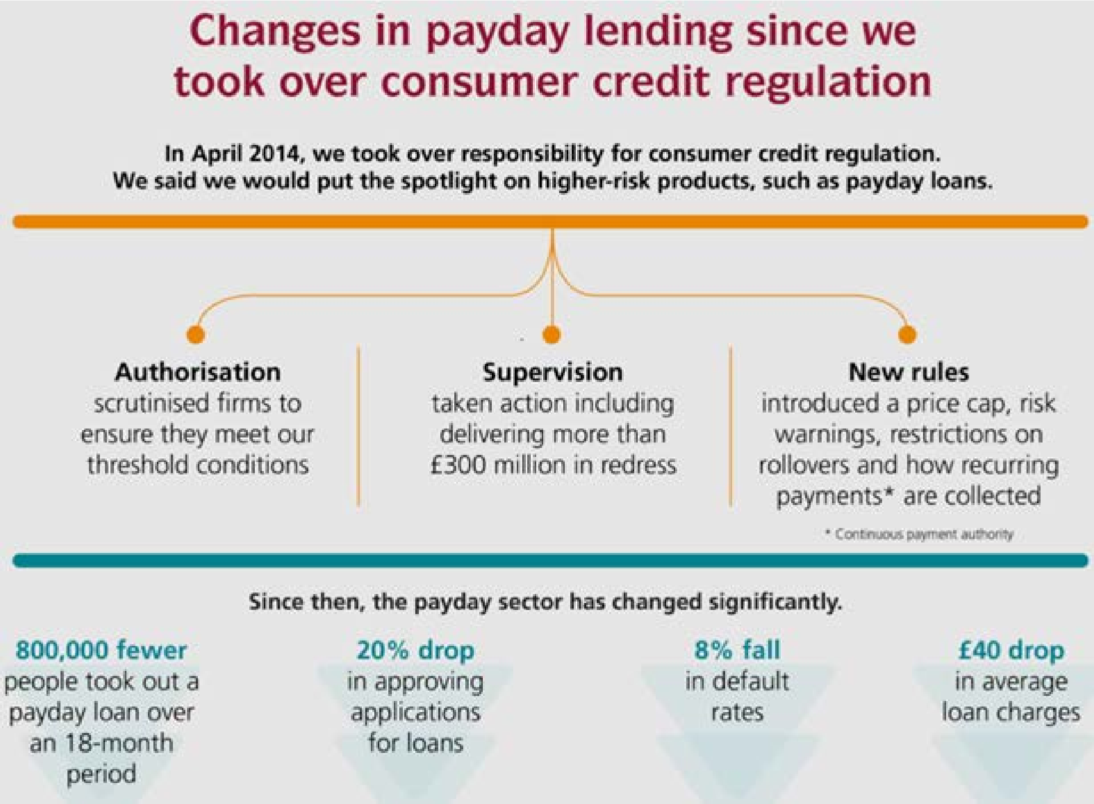
12 OFT, General guidance for licensees and applicants on fitness and requirements, p3
13 Ibid p6
14 HC Deb 9 November 2010, c23WH

3. The New Regime

From April 2014, by virtue of Section 7 of the *Financial Services Act 2012* all types of consumer credit have been regulated by the Financial Conduct Authority (FCA) and not the Office of Fair Trading.[15]

It was argued that regulation because the FCA regulated by rules, as opposed to regulation by legislation (OFT), it could be more flexible and responsive and deal with issues more quickly than the OFT which had to wait for legislation to change the law.[16]

A document 'setting the scene' was published in November 2016. An infographic setting out the main FCA related developments since 2015 is shown below:



The biggest single change to affect the HCC sector came about due to the conversion of government to the idea of a 'cap' to the cost of consumer credit.

The *Financial Services Act 2012* had already given the FCA the *option* to impose such a cap. In the *Financial Services (Banking Reform) Bill*, the government moved a decisive step further. Now the FCA was mandated to impose one regardless.

15 The new system of regulation is dealt with in more detail in another Standard Note (SN/BT/6842)

16 A government document outlining the regulatory structure, post transfer, can be found here.

The justification for the change in view was set out during the Lords proceedings by the Minister, Lord Newby, he stated that:

> FCA powers are already sufficiently broad to ensure that charges of all kinds can be covered in the cap. This Bill presents the ideal opportunity to ensure swift action to protect consumers from unfair and spiralling costs and to give the FCA a definitive parliamentary mandate to act now. That is why the Government are introducing this amendment to require the FCA to impose a cap on the cost of payday loans. Under this new duty, the FCA must use the powers given to it by the Government in the Financial Services Act 2012 in relation to such loans.[17]

Another significant strand of the new regime was the treatment of individuals who had difficulty in making repayments. Whereas in the past such people were seen (it is alleged) to be a source of revenue, the FCA required the industry to treat them with forbearance and sympathy.

3.1 The cost-of-credit cap

15 July 2014 saw the publication of the FCA's major study and proposals for controls on the cost of credit: Proposals for a price cap on high-cost short-term credit.[18] It includes considerable analysis of the potential impact and benefit of such caps. Some interesting facts emerged from its analysis:

- The FCA acknowledged (for the first time) that some people (people who only just qualify for loans) would be better off if they could not get credit: in the light of its cost, getting credit was a negative benefit anyway.
- The benefits for people who qualify for loans more easily is more nuanced: "Overall, borrowers with higher credit scores would experience smaller benefits from no longer having access to HCSTC but perhaps also smaller costs. For a particular structure and level of the cap, we must judge – based on the evidence on the various costs and benefits – whether, on balance, access to HCSTC makes consumers better or worse off. Accessing HCSTC at lower prices *may tip the balance* in favour of retaining access".[19]

In short, the FCA found very little positive consumer evidence for the industry at all although they state, but don't say why, that "We do not think it is desirable to leave consumers entirely without the option of using HCSTC".[20]

- The FCA rejected the argument that by restricting access to credit people would go to illegal lenders. They claimed that only 2% of declined borrowers claim to have done this.

17 HL Deb; 9 December 2013, c685
18 FCA; Proposals for a price cap on high-cost short-term credit; CP14/1015 July 2014
19 FCA; Proposals for a price cap on high-cost short-term credit; p29
20 FCA; Proposals for a price cap on high-cost short-term credit; p36

- The finding that "only the largest lenders currently make significant profits – most are only marginally profitable, and some make no profit at all" contradicted many critics of the industry.
- The FCA, in the light of the price cap, expected the (payday) industry to shrink to "three largest online firms [and] "it is possible that (only) one high-street firm" can carry on. It found that the three largest lenders have a combined market share of 72% by revenue.[21][22]
- "Most firms' revenue is generated through interest charges".[23] This finding again contradicted much of the criticism of the industry which asserted that it deliberately encouraged customers to roll over loans to earn money on default charges and repeat fees. *Payday lending: fixing a broken ma*rket, a Report by the Association of Chartered Certified Accountants, argued that the only way the industry can make money is by repeat lending and fees – put simply the acquisition costs of a new customer are so high they can never be recouped by a single loan.[24] Since July 2014 firms are unable to roll over loans more than twice in a single year.
- With respect to the impact on individuals of restricted access to HCC the study found that 24% of customers applied for HCC because it was their only option and of those 55% said they used loans for everyday expenditure (housing, basic living costs and bills)[25]
- On personal responsibility, the FCA said that "Our proposals will ensure that consumers are treated in a fair way while still being responsible for their own decisions. However, we believe that it is in the best interests of certain consumers not to have access to HCC given the unacceptable risk of default, the lack of benefits and the consequences of access to HCC to them".[26]
- On the consequences of a higher rate of declined applications the FCA said: "the survey results indicate that, if consumers no longer had access to HCSTC, approximately 60% would not borrow, 25-30% would go to family and friends (we have taken steps to differentiate between 'friends' and 'illegal lenders'), and around 10% would borrow from formal sources of credit, and 5-10% would find funds in other ways (e.g. decrease savings)".

The cap fits

The cap came into effect in January 2015. The key elements are shown below:

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[21] FCA; Proposals for a price cap on high-cost short-term credit; p16
[22] The FCA set out how they think that they have met this particular statutory duty in annex 2 of the Report. See p103 for details
[23] FCA; Proposals for a price cap on high-cost short-term credit; p16
[24] ACCA; Payday lending: fixing a broken market; May 2014
[25] FCA; Proposals for a price cap on high-cost short-term credit; p17
[26] FCA; Proposals for a price cap on high-cost short-term credit; p101

1. **Initial cost cap of 0.8% per day - Lowers the cost for most borrowers.** For all high-cost short-term credit loans, interest and fees must not exceed 0.8% per day of the amount borrowed.
2. **Fixed default fees capped at £15 - Protects borrowers struggling to repay.** If borrowers do not repay their loans on time, default charges must not exceed £15. Interest on unpaid balances and default charges must not exceed the initial rate.
3. **Total cost cap of 100% - Protects borrowers from escalating debts.** Borrowers must never have to pay back more in fees and interest than the amount borrowed.[27]

3.2 Rollover Relief

The other significant change to the regime was that the number of rollovers a person could have on a loan was limited to two. As mentioned above, there was a lot of criticism of lenders who deliberately lent money in the expectation that the borrower would not be able to repay the first time. The loan would be rolled over, including, large new fees for doing so. This process happened multiple times for many borrowers resulting in enormous total charges for comparatively small initial loans.

The new rules required that there could not be more than two rollovers for each loan. In their consideration of this measure the FCA noted:

> It is clear to us from the responses to the consultation that there is a consensus that some sort of restriction on rollover is necessary, but there is a debate centering on how many should be allowed. We understand the concerns raised by consumer groups about the impact of rollovers on consumers, and in particular the negative effect on consumers of loans being rolled over numerous times that were not affordable at the start.
>
> We also recognise that there is a need for some flexibility for consumers to roll over their loans if they are unable to repay on time as a result of unexpected circumstances, such as being paid late. However, it is clear to us that the benefits of this flexibility diminish rapidly and the cost to the consumer increases sharply. Repeated rollovers can exacerbate financial difficulties. If a customer has run into unforeseen financial difficulty which prevents repayment even after a rollover then the best way to address it is forbearance and the agreement of an affordable repayment plan, not extending the loan and increasing the debt.[28]

3.3 Other measures

Treatment of defaulters

Another major piece of regulatory work by the FCA related to the way that the firms treated borrowers who could not repay.[29] In it, the FCA found everything from:

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[27] FCA website
[28] FCA; PS14/3 Final rules for consumer credit firms
[29] FCA; TR15/3: Arrears and Forbearance in High-Cost Short-term Credit

> **In a number of cases we found evidence of serious non-compliance and unfair practices.**
>
> - These include firms which had engaged in misleading practices to obtain monies from customers in arrears.
>
> - We have intervened swiftly to prevent ongoing risk of harm to consumers and to secure commitments from firms to put things right. We acted to ensure that past practices were investigated, that systems and controls were strengthened to mitigate the risk of these happening again, and that firms agree to pay redress to customers.

Elsewhere:

> **Most firms were implementing significant changes, but none of the firms we reviewed were sufficiently prepared for FCA regulation and they had not yet adapted their businesses to meet the required standard.**
>
> - All firms were implementing significant improvements and a number were making good progress towards a collections culture focused on treating customers fairly.
>
> - A number of firms had implemented revised policies and procedures, retrained their staff on how to identify vulnerable customers, started to monitor compliance more effectively, and revised their staff incentives.
>
> - However, the level of reform required to bring their policies, procedures processes and IT systems up to scratch was substantial, and some firms were struggling with the pace of change needed. They all – to varying degrees - lacked the necessary oversight, risk management and compliance monitoring. This had led to poor outcomes for many customers. In some cases, firms had only very recently documented their policies and procedures.

The upshot of this investigation and the instructions to CEO's to review their businesses was that one Payday firm, CFO Lending, agreement with the FCA to provide over £34 million of redress to more than 97,000 customers for unfair practices. The redress consists of £31.9 million written-off customers' outstanding balances and £2.9 million in cash payments to customers.

Comparison websites

As of December 2016, pay day lenders have had to subscribe to one of the comparison websites. This makes it clearer to borrowers their other options.

4. The Industry Today

4.1 The FCA's First Review

At the time it took over regulation, The FCA was committed to a two-year review of how the new regime operated. The final review was published on 31 July 2017.

FCA findings

The Review began with a document which called for inputs to the discussion: *High-cost credit including review of the high-cost short-term credit price cap*. It included an analysis of how the market changed between 2014 and June 2015 (six months on from the imposition of the cap). The FCA found:

- The market had got a lot smaller
- Lenders had refused more loan applications
- There were significantly fewer lenders
- Loans were for generally longer periods
- Loans were generally cheaper
- Loans were less profitable
- Borrowers were less likely to default

An extended (author's emphasis and edit) summary from the FCA document is shown below. Note: the FCA uses the abbreviation HCSTC instead of HCC used in the rest of this Paper.[30]

Market size

> Our data show **a major contraction in the HCSTC** market over the course of 2014 compared with 2012-2013. The number of consumers and the number of loans fell steeply: between January 2014 and June 2015, there were over 800,000 fewer individuals taking out at least one HCSTC loan than between January 2012 and June 2013.
>
> The **biggest factor in decreased lending volumes was a significant drop in the number of applications**, suggesting substantially reduced demand for HCSTC. The drivers behind this are as yet unclear.
>
> […]
>
> In addition to reduced applications, there is also **a clearly discernible decrease in acceptance: rates** [which] dropped from 50% to 30% from the start of 2014 to the middle of 2015.
>
> […]
>
> **Given the scale of regulatory change across 2014, it seems likely that firms changed their appetite for lending as part of an overall strategy to prepare for the full range of new regulatory requirements**, the authorisation process and

30 FCA; Call for input on high-cost credit and review of the high-cost short-term credit price cap

increased supervisory focus on compliance, particularly in relation to creditworthiness assessments.

Number of firms

As of November 2016, 144 firms are fully authorised to carry out HCSTC lending. However, a number of these firms do very little HCSTC lending; the number of firms whose main focus is HCSTC is much smaller.

188 firms which originally applied for HCSTC permissions withdrew their applications, often after a direction from the FCA following consideration of the firm's authorisations application and where it was clear that the firm did not meet the standards expected by the FCA.

Firm revenues and profitability

Changes in firm revenues have followed a similar pattern to the drop in lending: the lenders in our sample earned revenue of £409m in the first half of 2014 which reduced to £225m by the second half of 2014 and £110m in the first half of 2015.

Profitability has also decreased: combined losses in the first half of 2015 were larger than the combined losses in the whole of 2014. The profitability of all the firms in the 2014 to June 2015 sample decreased, with some previously profitable entities becoming unprofitable, although some were still profitable. […]

Default rates

Declined through 2014 to June 2015: the proportion of loans being charged a late payment fee has steadily decreased from 16% in January 2014 to below 8% in April 2015 (with some firms no longer charging late payment fees). The proportion of loans entering arrears for seven days or more similarly reduces from 16% to 12%.

Our analysis suggests that […] firms are **rejecting the highest risk applicants and that tightened lending criteria** have had an impact on the risks of default for borrowers.

Changes to products

Our examination of business models during the authorisation process and in our supervisory activity indicates **a shift away from the traditional 30-day 'payday loan' product towards longer term instalment products**. This is borne out by our detailed loan data: the average initial loan duration in 2012-2013 was 30 days; at the beginning of 2014, it was 40 days; by June 2015, it had increased to 80 days.

We have n**ot seen, however, a corresponding increase in average loan size** – this has remained around £250. Lower costs for customers.

There was a notable decline in average revenue customers were charged […]. **Loans originating at the start of 2014 typically resulted in the customer being charged around £100 in interest and fees. This declined over 2014 to around £80. Once the price cap was introduced, there was a further sharp drop to around £60**.

Another measure of the impact the new regulatory regime may have had can be found in the date collected by the Financial Ombudsman on complaints made to the service.

FOS payday loans complaints

	Enquiries	New Cases	Referred to Ombudsman	% of cases upheld
April - December 2016	11,211	7,810	1,680	56
April - December 2015	4,090	1,669	388	66
April - December 2014	3,333	635	151	66

Source: Ombudsman News

These figures may require some further analysis.

Given how differently the industry operates now than it did before it is something of a surprise that complaints against it have increased sharply. This may be more to do with the greater focus on the industry and the more interventionist approach from the Regulator than the fact that the industry has gone from bad to worse. The fact that the upholding rate of complaints has dropped sharply may provide some clue as to the quality of the complaints.

The industry's response gave no real reasons or explanation either:

> Our members demonstrate a strong commitment to treating customers fairly and to providing appropriate products and services. We are disappointed when anyone has cause for complaint. The bigger picture based on recent research by the Social Market Foundation showed the changes in the short-term credit market have had clear benefits for consumers. It revealed people are paying less to borrow, fewer people incur fees for missed payments and more people are paying off their loans early.[31]

FCA Action

When the final review was published in July 2017 the FCA announced that it did not intend to change the price cap, but would review it again in three years' time.

The review re-iterated its benefits:

> **HCSTC loans are cheaper** – the cost of a typical loan has gone from over £100 to around £60, saving 760,000 borrowers a total of £150m per year
>
> **Firms are less likely to lend to consumers who can't afford to repay** – default rates on HCSTC loans in 2016 were around a third of what they were in 2014, and firms' revenue from late payment interest and charges is about half of what it was debt from 2013-2016, while Citizens Advice saw a 60% drop after 2014.

31 Consumer Finance Association website

> We have also looked carefully at the effects of FCA regulation on consumers who have been unable to take out HCSTC products.
>
> 85% of people who applied for HCSTC and were declined chose not to take out an alternative credit product – 60% did not borrow at all, while those who did went mainly to friends or family rather than using high-cost credit products
>
> 63% of people we surveyed who had applied for HCSTC and been declined believe they are better off as a result
>
> We have seen no strong evidence of a rise in illegal money lending because of the price cap. Fewer customers are experiencing HCSTC debt problems – StepChange saw a 30% drop in clients with HCSTC

Notable in the Review is the fact that it is now looking at other HCC markets (and beyond). Including:

> Rent-to-own (RTO)
>
> 1.23 Our initial findings highlight concerns about the high costs of RTO borrowing for this particularly vulnerable consumer group, and the consequences of that borrowing.
>
> 1.24 We will look in more depth at why consumers use RTO to obtain goods and whether more affordable alternatives are available. We will take a leading role in supporting collaboration to share best practice and foster innovative thinking and will convene a forum to encourage cross-agency public policy solutions, for example, how provision in this market could be enhanced through such schemes as social housing providers supplying essential goods.
>
> Home-collected credit
>
> 1.26 We have similar concerns to RTO about the potential for high levels of financial distress experienced by longer-term borrowers. We will focus on particular features of the business model which may incentivise consumers' long-term indebtedness and where we identify that this causes harm, explore options for potential action to protect consumers. These could include, for example, introducing restrictions on refinancing and rollovers, imposing time gaps between borrowing or time limits on the total duration of borrowing.
>
> Catalogue Credit
>
> 1.27 Our analysis raises concerns about the high level of arrears experienced by borrowers, with the fees and charges that are triggered by arrears, and the associated risk of financial distress. In addition we have observed high levels of interest charged outside interest-free periods and will look in more depth at the impact on borrowers and the transparency around interest-free periods.[32]

In a separate part of the Review the FCA announced that it had been looking at, and would return to, the cost of unauthorised overdrafts which, it said, were in many cases costlier than pay day lending. Its initial findings were that:

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[32] FCA; *High-cost credit Including review of the high-cost short-term credit price cap*, July 2017

> Based on the evidence we have to date, we believe there is a case to consider the fundamental reform of unarranged overdrafts and whether they should have a place in any modern banking market.[33]

4.2 The FCA's Second Review

In January 2018, the FCA published High-cost Credit Review – update.

This update focussed on arranged and unarranged overdrafts, rent-to-own, home-collected credit and catalogue credit. It had been gathering further evidence from firms on these products and conducting consumer research.

It found that unarranged overdrafts were, as the pay day loan industry used to point out, even more expensive than other high cost forms of borrowing:

> The majority of unarranged borrowing is under £50, so a typical fee of £5 a day can amount to 10% (or more) of the amount borrowed. In contrast, the HCSTC price cap limits interest and other charges to 0.8% per day, or 40p a day for a £50 loan. While we must be careful when comparing two such different products, the fact that unarranged borrowing fees and charges can be over 10 times those of HCSTC indicates that the market might not be working well for consumers.[34]

The FCA has clear concerns about the rent to own market:

> Our analysis indicates that rent-to-own customers are a particularly vulnerable group of consumers. In 2016 they had a median annual income of £16,100. Taking into account all the debt held by these customers and recorded on credit reference files, the median amount of outstanding debt more than doubled from £2000 in November 2014 to £4300 in November 2016.[35]

It is looking closely at the relative cost of using this market to buy goods. It "acknowledge that there are higher costs associated with hire purchase, but the costs we are seeing are particularly high in some cases".

Its focus in the home credit market is the number of people who roll-over loans and end up paying significantly more interest as a result.

They have yet to come to any conclusions regarding the catalogue credit market. It is used by people from a slightly broader (higher) income range, so the effects may be less severe on them and "Online shopping has blurred the boundaries between traditional credit products, and we are considering what that means for catalogue credit".[36]

Some of these concerns were repeated by the Head of the FCA, Andrew Bailey, in a speech in May 2018. Having set out the issues, Mr Bailey concluded with the following explanation of the FCA's views, especially

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33 FCA; *High-cost credit Including review of the high-cost short-term credit price cap*; July 2017
34 FCA High cost Credit Review- update; July 2018
35 FCA High cost Credit Review- update; July 2018
36 FCA High cost Credit Review- update; July 2018

on the subject that there are people whose circumstances are such that credit provides no personal benefit:

> Assessment of high-cost credit
>
> We believe that there are some important basic principles which can help us set priorities. I would highlight four such principles. First, the cost of credit matters, and we did establish a measure for payday loans which linked the cost in interest and charges to the amount borrowed. That measure was of course based on the particular features of the payday loan market and we need to approach its relevance to other markets with care. This approach applies most easily to fixed-term loans. Second, for revolving credit, our focus has tended to be on whether customers are frequently in long-term persistent debt. And thirdly, we will consider the complexity of the product and sales practices, how difficult they are to understand and whether there are notable behavioural biases. Lastly, the proper assessment of affordability by lenders is important.
>
> When thinking about the high-cost credit market, we also adopt two other broad principles to assess whether our regulation meets the public interest. First, credit can provide a socially valuable function for people. That said, as the payday cap has demonstrated, there are consumers for whom their economic welfare improves if they do not have access to credit. Second, and flowing from this, we have to take great care to consider what a market working well could look like for the majority of users and what the alternatives to high-cost credit could be, rather than simply clamping down on the immediate harm presenting itself without regard to intended consequences.
>
> […] There is a group of consumers who are on such low or uncertain incomes or whose personal circumstances mean that any lending is likely to be inappropriate or unaffordable. Parts of the social welfare system are designed to provide assistance to them.
>
> There is another group of consumers who are on low incomes and may be financially vulnerable but are nonetheless able to sustain low repayments for small sums. However, the personal circumstances of these consumers can mean they are especially susceptible to unexpected changes to their income or expenditure demands, for example dealing with changes to their living arrangements at short notice. Reflecting risk of default, borrowing for these consumers is particularly costly, potentially further decreasing their ability to meet their wider financial obligations and increasing risk of harm from the consequences of default. This is particularly the case where they need to borrow to obtain essential household goods, such as a fridge or washing machine.
>
> Our view is that the provision of credit can nevertheless have a socially valuable function. high-cost credit users typically have low credit scores and many do not have savings but may need credit to make ends meet and avoid wider financial difficulties, for example, default on household bills or priority debts. They may also have very limited options for obtaining essential goods or for managing other larger purchases or bills. Consumers can benefit from using credit where repayments are sustainable and appropriate forbearance is shown if they have temporary repayment problems.
>
> […]

> Let me therefore draw an important conclusion from this part of the assessment of high-cost credit. For many, but not all, users of high-cost credit, access to borrowing is an important feature which can allow sensible smoothing of income flows and the purchase of necessary durable goods. I do not take the view that credit should not be available to this part of the population. Translating this into the responsibilities of the FCA, we have a responsibility to ensure there is a framework of rules that firms comply with which reduces the risk of consumer harm but allows the provision of credit where it is appropriate and affordable.
>
> What are the alternatives and what should be done?
>
> Many people benefit from having access to credit on affordable terms which nonetheless recognise the risk characteristics of the individual. The FCA has already been active to seek to reform and to tackle harm that has built up. The payday loan cap has meant that the cost in fees and charges of a typical loan has moved from over £100 to around £60, which we estimate saves borrowers around £150m per year. Across all consumer credit sectors around £900 m of redress for consumers, in the form of write downs and payments, has been secured for around 1.6m consumers.
>
> Default rates on payday loans have fallen by about one third and firms' revenue from late payments interest and charges is about half of what it was. We think the payday cap has been effective and is set at the right level. Debt charities have also validated to us, and I am grateful to the charities for arranging my visits to their centres around the country, that the cap has alleviated debt problems.
>
> I am aware that some stakeholders have called for us to introduce price capping in other areas of the high-cost credit world, and overdrafts. We are examining a range of potential approaches to address the harm we see to consumers using these products, and I expect to set out our views in the next month. As I have said, these will be tailored to the particular harms we have found in different markets – we will be consistent in applying the principles I have set out, but that does not imply that our solutions for different markets will be the same.[37]

FCA Action

The FCA published the outcome of its second review in May 2018. There were two documents:

High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit Discussion on rent-to-own pricing (CP18/12); and

High-cost Credit Review: Overdrafts (Cp18/13).

Note: these are Consultation Papers and proposals may change as a result of representations. As they currently stand the proposals are set out in extracts from the Paper below. It is the proposals on the rent to own RTO sector which are the most striking – an extension of a pricing cap similar to that introduced for payday lending.:

[37] Speech Andrew Bailey; New City Agenda; 2 May 2018

Rent-to-own

The costs to consumers of using RTO are high, sometimes exceptionally so, both when compared with what consumers would pay on the high street for the underlying goods and when compared against the cost of using other forms of high-cost credit to borrow the money to finance the purchase.

Given the issues we have identified with RTO pricing, **we believe the case is made, in principle, to consider the introduction of a price cap**. We believe that the costs of RTO and the financial vulnerability of the consumers who use it provide sufficient grounds for us to undertake the significant additional analysis we need to reach a final conclusion on consulting on the structure, level and rules for a price-cap.[38]

Home-collected credit

In home-collected credit we have identified particular risks to consumers of repeat borrowing and long-term use of what is essentially a shorter-term product.

1.24 We are proposing new rules to ensure firms are treating customers fairly when they borrow again. We have also observed consumers re-borrowing in ways which add to the already high costs of borrowing.

1.25 We are consulting on guidance setting out our view on the interpretation of the ban on 'canvassing' cash loans off trade premises in the Consumer Credit Act 1974 (CCA). This makes clear that **firms cannot visit a customer to offer new loans or refinancing unless this is in response to a specific request by the customer. This will help ensure firms do not unduly influence consumers to borrow again.**

1.26 We are also consulting on a new rule that means **firms will have to provide consumers the comparative costs of taking out another loan on top of an existing loan,** so they can compare with the costs of refinancing (which may be more expensive overall).[39]

Catalogue credit and store cards

We are consulting on new rules to:

• Require catalogue credit and store card firms which offer 'buy now pay later' (BNPL) and similar offers to provide consumers with clearer explanations of the implications and costs of not paying back within the offer period.

• Require these firms to remind their customers when the offer period is about to come to an end to prompt repayment.

• Give catalogue credit consumers more choice about whether and how their credit limits are increased.

• Ensure catalogue credit firms do not give credit limit increases to customers in financial difficulties or increase the interest rate on their account.

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38 FCA; High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit Discussion on rent-to-own pricing (CP18/12); May 2018

39 FCA; High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit Discussion on rent-to-own pricing (CP18/12); May 2018

• Require firms to use the information they hold to identify customers at risk of financial difficulty and take appropriate steps. We also propose to apply these rules to store cards.

• Require firms to offer customers in persistent debt help to repay it more quickly. We also propose to apply these rules to store cards.[40]

Other proposals

Aside from these specific sectors the FCA said that it was looking to find ways in which to encourage alternatives to Rent to own and other high cost channels. After repeating what policy makers have called for over at least the last 30 years – "the development of credit unions" – it also looked at the relationship between housing providers and domestic credit needs:

> The role of local authorities and registered social landlords (RSLs) as direct providers of furniture and household goods, or as introducers (brokers) for others who may offer alternative sources of credit.
>
> We also consider there is a case for the Government to contemplate changes. One area for possible change is in the guidance to social landlords on the Universal Credit Regulations 2013 to clarify how furniture schemes can operate under the universal credit system. A second area is whether the exemptions for local authorities under FSMA for credit broking should be extended to RSLs through a change to the regulated activities order, increasing the scope for RSLs to help their tenants understand the options available outside RTO. [41]

Overdrafts

The Consultation Paper on overdrafts contains less definite proposals than those in the RTO and the other markets Consultation Paper. The FCA's main concern with overdrafts is with unarranged overdrafts and the fact that a relatively small number of people, possibly vulnerable in other ways, make repetitive use of the facility:

> Our research has found that charges for overdrafts are highly concentrated, with a minority of consumers paying the majority of fees. The current distribution of charges across the PCA market appears potentially harmful – particularly for unarranged overdraft users. There is a significant difference between arranged and unarranged overdraft prices, with firms making around ten times the yield on unarranged lending than on arranged lending. Furthermore, vulnerable consumers are more likely to use unarranged overdrafts and pay more in charges.
>
> An overdraft is primarily intended as a short-term credit product, but these fees often fall on consumers using arranged overdrafts repeatedly over long periods. For these customers, an overdraft may not be the most suitable credit product.[42]

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[40] FCA; High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit Discussion on rent-to-own pricing (CP18/12); May 2018

[41] FCA; High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit Discussion on rent-to-own pricing (CP18/12); May 2018

[42] FCA; High-cost Credit Review: Overdrafts (Cp18/13); May 2018

Using a derived data set, the FCA found that the people most likely to use unarranged overdrafts were also people most likely to make use of other high cost credit products:

> Analysis of CRA [credit reference agency] data shows that consumers who take out other high-cost credit products also often use overdrafts. In particular, we saw that around 20% of catalogue and store card credit users have outstanding overdraft debt. For home-collected credit this number rises to around 30%, for rent-to-own it is 40% and for high-cost short-term credit, around half of users have outstanding overdraft debts. For these consumers, their overdraft debts account for 4–10% of their total outstanding debt.[43]

The possible changes the FCA is think of include various measures around making the cost of overdrafts clearer for consumers and the encouragement of pro-active alerts for customers if they are using the facility frequently. More interventionist proposals include:

> Simplifying overdraft pricing structures, in particular: –
>
> - banning all fixed overdraft fees, other than fees for refusing a payment due to lack of funds ('refused payment fees')
> - requiring firms to charge a single interest rate for arranged overdrafts on each customer account, which can vary between different PCA products or, potentially, individual accounts
> - requiring the rate for unarranged overdrafts to align with arranged overdrafts, with any rate differences to be based on significant and reasonable differences in the cost of providing the credit – standardising how prices are represented, through requiring an annual percentage rate (APR) in advertising for arranged overdrafts
>
> a potential backstop price cap for overdraft charges
>
> guidance around exactly which costs firms should consider when ensuring refused payment fees reasonably reflect the actual costs, as required by law.[44]

4.3 Industry view

The body representing the broad HCC industry is the Consumer Finance Association. Two documents have been produced either by it or commissioned by it. One is *Impact of regulation on High Cost Short Term Credit: how the functioning of the HCSTC market has evolved* (the CFA Report) published in March 2017. The other is by the Social Market Foundation: *A Modern Credit Revolution: an analysis of the short term credit market* (the SMF Report) published in 2016.

The CFA Report

The CFA feels it has a good story to tell. Its findings broadly back up those of the FCA. It highlights:

- the cost of credit has come down by around a third;
- default rates have approximately halved;

43 FCA; High-cost Credit Review: Overdrafts (Cp18/13); May 2018
44 FCA; High-cost Credit Review: Overdrafts (Cp18/13); May 2018

- due to regulatory interventions, lenders have been incentivised to offer affordable loans, that consumers pay-off according to the original terms of the loan;
- the average amount paid by consumers in additional fees has halved since 2013;
- lenders are offering longer-term loans, better meeting the needs of consumers, giving them an opportunity to take advantage of early repayment at lower rates, and improving the affordability of each repayment instalment.[45]

It claims that the impact of the price cap must be seen within the overall change in regulatory focus that the FCA has brought in. It acknowledges the direct effect of the cap in reducing prices to customers but also notes a change in the whole pattern of customer borrowings:

> But, in addition, the proportion of customers being charged late fees has fallen sharply, both due to a reduction in late payment by customers and many lenders choosing not to charge late fees at all. The number of rollovers and extensions of loans has fallen sharply, and the average number of new loans taken out by HCSTC customers each year, across all lenders according to FCA data, has fallen from 6 in 2013 to around 4 today.[46]

This changing pattern is, naturally enough, reflected in the experience of lenders:

> [N]ow lenders' business models are far less reliant on consumers incurring late fees, extending loans or relending. Instead, many consumers are, on average, paying back their loans on time and indeed often ahead of schedule. We estimate that HCSTC lenders now receive, on average, more than 80% of their revenues from the original contractual interest of the loan, excluding all late fees, late interest and revenues from rollovers and early relending. This compares to an estimated 60% of revenues from the contractual interest payments in 2013.[47]

Looking in more detail at the impact of the new regulatory regime, the Report suggests that it has been the limit in the number of 'rollovers' which has dramatically changed the 'dynamic' of the industry, rather than the price cap alone. If the lender can only rollover twice, then they need to be more certain that the loan can be repaid and, even if there is a rollover, the amount they can charge is effectively capped by the 100% repayment rule.

> Furthermore, lenders now also limit the extent to which they relend to customers, even if they have paid back in full. In addition, the limit of two unsuccessful CPA requests reduces the ability of lenders to collect money from late-paying customers, as it is more difficult for lenders to collect funds from the customer's

[45] CFA; *Impact of regulation on High Cost Short Term Credit: how the functioning of the HCSTC market has evolved*
[46] CFA; *Impact of regulation on High Cost Short Term Credit: how the functioning of the HCSTC market has evolved*
[47] CFA; *Impact of regulation on High Cost Short Term Credit: how the functioning of the HCSTC market has evolved*

> bank account. The price cap also limits the total value of late fees that can be applied (the cap is £15 in total for all late fees).[48]

The downside of this improvement is, it claims, a:

> reduction in access to credit was much larger than the FCA expected during the price cap consultation and has resulted in a mixed set of outcomes. […] many consumers no longer have access to credit, and so are less able to manage their cash flow and ensure they have sufficient finances to meet their spending requirements. As documented by the SMF, this has changed the demographic of HCSTC consumers, as certain groups of customers no longer have access to credit.[49]

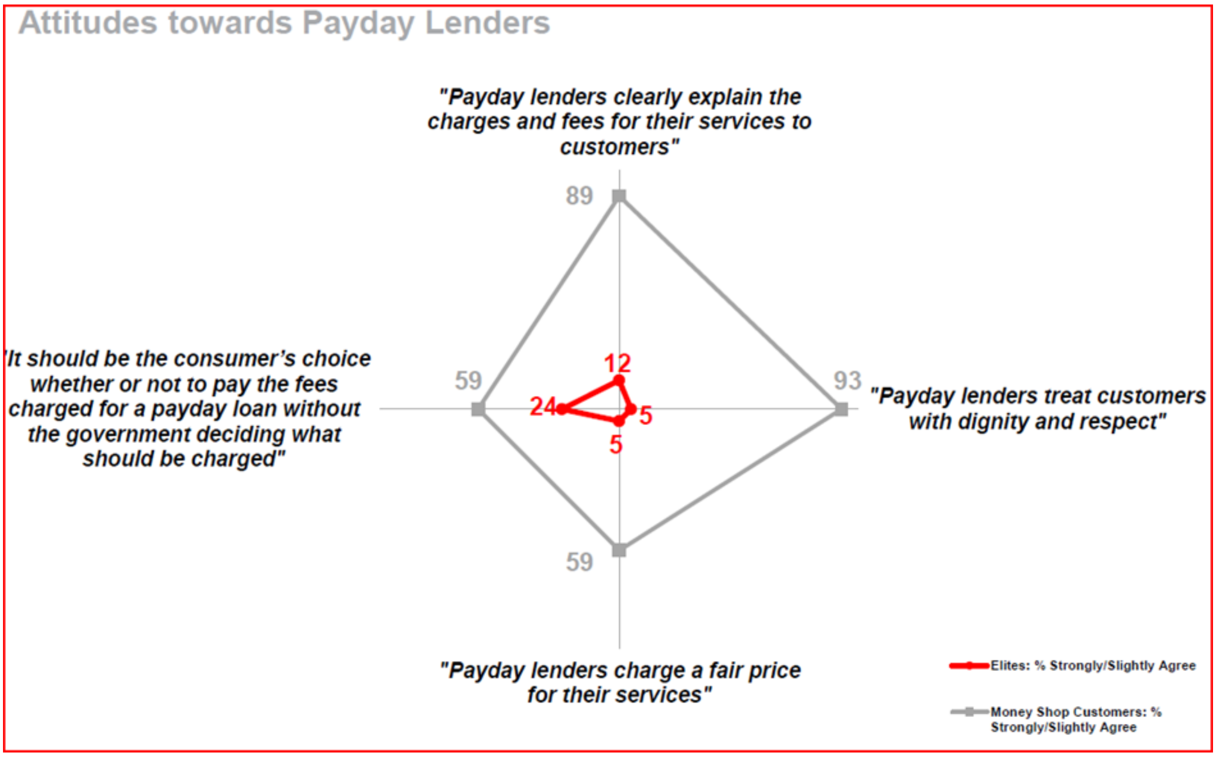
In total, it sees the cheaper cost, longer credit terms and the greater certainty of repayment which now characterise the market as meaning that:

> it has resulted in what was previously referred to as the 'payday loan' market becoming, in many ways, indistinguishable from the broader market of credit available to subprime consumers.[50]

The Social Market Foundation Report

The SMF report (*A Modern Credit Revolution: an analysis of the short-term credit market)* was published in 2016 and obviously covers much of the same ground as the FCA and the CFA studies. It differs to an extent in that it made use of survey evidence from polls of HCC customers. Significantly, in the past, there is some evidence that the industry's customers were more positive about the unreformed market, than those who did not use it. For example, a CFA survey - '*Attitudes towards Payday loans and lenders* published in 2014 - was a small survey of the attitudes of users of HCC and policy makers (including 100 MPs and 100 Peers) about various aspects of the HCC industry. It included the following graphic:

48 CFA; *Impact of regulation on High Cost Short Term Credit: how the functioning of the HCSTC market has evolved*
49 CFA; *Impact of regulation on High Cost Short Term Credit: how the functioning of the HCSTC market has evolved*
50 CFA; *Impact of regulation on High Cost Short Term Credit: how the functioning of the HCSTC market has evolved*



On various measures consumer views are more favourable towards the industry post reforms than before.

Costs and affordability

38% or respondents thought that loans in 2015 and 2016 were cheaper than before, 29% thought the opposite. A majority thought their loans were now affordable though 26% disagreed. The Report points out that these findings may be influenced by the stricter lending criteria which has weeded out more risky borrowers. In another question, 40% of respondents said that "short terms loans are more difficult to access than they used to be".

Convenience

90% of respondents said that their loan was "a convenient way of borrowing" as against 77% of pre- 2015 borrowers.

Alternatives

Various questions were asked about the options open to people who use HCC or who had been refused credit due to the tighter restrictions. Asked if they could not borrow from an HCC provider what would they do, about 35% said they would borrow from family or friends. This is practically the same figure for both pre- and post-2015 respondents.

There was a clear preference for 'virtue' on the part of the post 2015 group than their pre- 2015 peers. Options such as 'gone without daily essentials', 'cutback on other forms of spending', 'not bought what the loan was for', were all significantly more popular with the post 2015 group. However, to tarnish the halo a little, this group was also more likely to find another way to borrow either by 'credit card or bank loan', 'authorised or unauthorised overdrafts', 'use of logbook loan' or, significantly 'borrowed from an unlicensed lender who is not a friend or relative' – the classic 'loan shark'. The survey suggests that borrowers are far more aware of the opportunities and dangers of HCC but still, even more so it appears, willing to risk using the group which all sides would like to see disappear. The theory that borrowers are more 'savvy' now than before is supported by the only category in which the pre 2015 group substantially outscore the latter group – 'don't know'.

Future trends?

The SMF Report concludes with some observations about the social role of credit:

> Aside from any future regulatory change, providing means of credit for those who cannot access the market remains a fundamental and growing social policy consideration. Access to the market is reducing at the same time as social credit – in the form of the Social Fund – is being cut back. Alternative forms of finance should continue to be promoted – both because they may be cheaper for some consumers and because diversity of provision can drive competition. Credit unions could potentially play a role here – although it is likely that they will only be an option for a comparatively small proportion of consumers. For instance, a consumer survey for the Competition Commission found that only 2% of consumers using payday products in the past 12 months had also used a credit union, although 15% of consumers reported that they could have used a credit union product instead of taking out a payday loan.
>
> The fact that many current and past consumers of short-term credit are in employment may mean there could be opportunities to provide credit via employers. For instance, loans provided via the workplace to employees may enable lenders (which may or not be employers themselves) to assess credit risks more thoroughly and, potentially, develop mechanisms to deduct money from wages before borrowers receive the money in their account.[51]

[51] Social Market Foundation *A Modern Credit Revolution: an analysis of the short term credit market*

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