Briefing Document

High Cost Credit Bill

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STEPCHANGE DEBT CHARITY is concerned that serious failings by payday lenders are causing vulnerable borrowers to fall into a vicious cycle of high-cost debt. During the first six months of 2013, 30,762 people contacted the charity for help with payday loan problems, almost the same as for the whole of 2012 (36,413). Since 2011, the average amount owed on payday loans has increased by £400 to £1,665, showing the severity of financial difficulties – people now owe more on payday loans than a whole month's income (£1,298).

Multiple payday loans are a key driver of acute repayment problems. More than two thirds of borrowers who contacted the charity for help with payday loans in the first half of 2013 had more than one payday loan and 33 percent owed 4 or more, with customers granted one unaffordable loan after another. The Office of Fair Trading's (OFT's) findings ("widespread irresponsible lending") and in particular **the scale of repayment problems show that problems are not confined to a small number of rogue lenders**. Around 2.7 million loans could not be paid on time (or at all) in 2011/12 – around a third of the total.

KEY CONCERNS: StepChange Debt Charity has identified a number of serious issues relating to payday loans which are causing significant consumer detriment:

- **Poor lending checks** – Payday lenders are failing to properly assess whether applicants for a loan have enough disposable income to repay on time. According to the OFT's compliance review, only 6 out of the largest fifty firms in the market make any attempt to check a borrower's disposable income.
- **Rollover** – The OFT says three quarters of payday lenders are renewing loans without checking whether they will be affordable, even though rollover is a clear warning sign that a borrower could be experiencing financial difficulties. The OFT notes that payday lenders have a strong incentive to rollover loans, making half their revenues this way.
- **Repeat borrowing** – Government-commissioned research by the University of Bristol suggests payday loan customers are often getting drawn into cycles of repeat borrowing. Although payday loans are only meant to be suitable for "occasional use", the typical borrower is taking out 5 payday loans a year – in effect, nearly one every other month.
- **Multiple loans** – (see above)
- **Misuse of Continuous Payment Authority (CPA)** – StepChange Debt Charity has seen numerous examples of customers caused significant distress by lenders misusing CPAs. This includes cases where money has been taken from people's accounts leaving them unable to cover food and housing costs.
- **Default interest and charges –** The cost of rollover and default means payday loans are particularly expensive for borrowers who cannot repay on time. Although lenders say they freeze interest and charges as soon as they realise a borrower is in financial difficulty, compared to other countries, the maximum cost of credit is extremely high (see Appendix: Table 1).

CASE STUDIES

- A 49 year old woman came to StepChange Debt Charity for help with 6 payday loan debts worth almost twice her monthly income. When she could not afford to pay her first loan on time, another payday lender gave her a bigger loan. However, she soon struggled to cover even the interest on the loans she had taken out and was subsequently unable to make repayments. After 9 months of spiralling debts, her payday loan balance totalled more than £1,500.

- A 39 year old woman sent a template letter to a payday loans company, explaining she was getting help from StepChange Debt Charity for her financial problems. The letter withdraws authorisation for lenders to recover monies owed via continuous payment authority. However, the lender ignored the request, saying it would "need to try for payment" as per the loan's terms and conditions. The lender subsequently took £400 out of her bank account when she received her pay, leaving her unable to pay for food or rent.

- A payday loan company issued a 44-year old man with a claim for £1,830 in penalty charges incurred for default on a loan of £120. The claim detailed two overdue penalty charges totalling £80, a debt recovery fee of £100 and a total of £1,650 in charges for 330 unsuccessful attempts to recover payment (at £5 a go). The lender also charged £178 in interest, or 1 percent on the original loan principal every day.

THE HIGH COST CREDIT BILL is an important opportunity for MPs to make sure the Financial Conduct Authority (FCA) takes action to tackle specific features of payday lending that are causing significant detriment to consumers. The Bill would end some of the worst practices in the market and provide better protection for borrowers struggling with repayment. The key measures in the Bill are:

- **A payday loan debt ceiling** to set a firm boundary for responsible lending decisions. An 'affordability ceiling' would put a hard stop on unaffordable payday loan debts (either in absolute terms or as percentage of a borrower's monthly income).
- **A cap on rollover and a limit on default charges** – this would stop small debts from being excessively inflated and thereby limit the amount borrowers can owe on any given loan.
- **The introduction of a real-time central database** (owned by the FCA) requiring lenders to log details of all high cost loans. A regulatory database would give the FCA the information its needs for a more focused approach to supervision and provide a powerful tool for securing compliance with responsible lending rules (such as those mentioned above).
- **Health warnings on all payday loan advertising** to make sure customers are aware of the risks of using high-cost credit and that it is not a way to deal with long-term financial problems.
- **Clear and timely notice of every repayment attempt by the lender** (via continuous payment authority). This will prevent customers from being pushed into hardship by unstoppable claims on their account and ensure borrowers can prioritise essential household bills (food, fuel and rent).

- **Trigger points requiring lenders to signpost borrowers to free and impartial debt advice** – for instance when a borrower is turned down for a loan or fails to make a payment.

StepChange Debt Charity welcomes the Government's decision to transfer consumer credit regulation to the FCA in April 2014. The current regulatory regime has not been an adequate protection for large numbers of borrowers. The OFT's recent compliance review shows large swathes of regulatory guidance have effectively been ignored by an industry that seems to have become a law unto itself. **However, it is by no means clear how the FCA will use its new powers to get on top of problems in the market.**

The High Cost Credit Bill is an important opportunity for Parliament to make sure the FCA takes action on specific problems that the OFT has not been able to deal with. This is particularly important given the FCA's timetable for transition, which gives lenders an initial 6 months "grace period" where they will not have to meet the regulator's new requirements. We do not believe 15 months (from now) is an acceptable period of time to wait for real change from lenders. **The High Cost Credit Bill is therefore an important move to ensure the FCA has a clear plan to deal with specific problems in the market from day one.**

APPENDIX: Table 1: **Maximum cost of credit – a UK-Canada comparison**: One of the leading payday lenders in the UK also operates under a different brand in Canada, where it abides by a voluntary rollover ban. Table 1 compares the maximum cost of a payday loan from both the UK and Canadian franchises as well as the maximum cost of a short-term loan from a well-known UK online provider.

	Online lender – UK	Storefront lender – UK	Online lender – Ontario, Canada
£300 loan (or nearest equivalent)	£300	£300	£297
Interest and charges – loan paid to term	£90	£84	£62
Maximum loan term (including rollover)	4 months	4 months	42 days
Maximum default interest and charges	**£290**	**£267**	**£25**
Maximum default interest and charges as % of original amount to be repaid	74%	70%	7%

1. UK online lender charging £5.50 transmission fee, 1 percent interest per day, and £20 default fee. UK storefront lender charging £27.99 per £100 borrowed and £15 default fee. In the province of Ontario, its Canadian franchise charges $98.70 for a $470 loan over 42 days, with a $40 charge for default. Figures in the table are in pounds (or dollar equivalent) and have been rounded to the nearest pound.
2. Currency conversion: £1 = $1.58 (June 2013). All loans for initial 28 days unless stated.