Consultation Response

Payday Lending: Consultation on a market investigation reference

StepChange Debt Charity consultation response to the Office of Fair Trading

StepChange Debt Charity London Office
6th Floor, Lynton House, 7-12 Tavistock Square, London WC1H 9LY
Policy Contact: Joseph Surtees
Tel: 0207 391 4582
Email: joseph.surtees@stepchange.org

We are an independent charity dedicated to overcoming problem debt. Our advice and solutions are effective, tailored and importantly, free. Foundation for Credit Counselling. Wade House, Merrion Centre, Leeds LS2 8NG. Company No 2757055. Charity No 1016630. www.stepchange.org

Introduction

StepChange Debt Charity is the UK's largest charitable provider of telephone and online debt advice, advising over 400,000 consumers last year. We are the UK's biggest provider of not-for-profit debt management plans (DMPs) and in 2012 helped 129,000 heavily over-indebted households repay in excess of £327 million. The charity maintains a data warehouse containing the details of more than 14.5 million phone calls and 1.8 million clients, enabling us to provide expert evidence on the problems facing the UK's financially vulnerable population. The data warehouse is a unique tool for understanding the problems affecting those with unsustainable consumer credit debt. Supporting the data warehouse a Social Policy network of experienced debt advisors provides qualitative, case study, evidence on existing and emerging problems in the consumer credit sector. We are happy to share our knowledge and expertise with the Office of Fair Trading (OFT) and Competition Commission. This response contains evidence taken from both our data warehouse and Social Policy network.

Overview

We support the findings of the OFT's compliance review on the payday lending sector and welcome the decision to refer it to the Competition Commission for action to remedy poor business practices. We believe a Competition Commission investigation should help the Financial Conduct Authority (FCA) develop a regulatory response to problems in the payday sector when responsibility for consumer credit passes to the regulator in 2014.

We believe there are systemic problems in the payday sector causing significant consumer detriment. The charity sees many examples of problems caused by the use of roll-over, multiple loans to a single individual and misuse of continuous payment authority (CPA). These examples are not limited to a single firm but are common across the entire sector.

Payday borrowers face severely constrained choice when looking to access credit and are making borrowing decisions under the pressure of extreme financial difficulty. Once they have taken out a payday loan, high repayment costs often trap them in a cycle of dependency where loans are rolled-over, or multiple new loans are taken out. As such we do not believe that competition is effective in delivering consumers good outcomes or constraining the behaviour of firms in this sector. This situation is exacerbated by a lack of adequate affordability assessments across the sector, where firms often appear to take little or no account as to whether loans increase the financial problems of customers in the long run.

For these reasons we support the OFT's decision to refer the payday lending sector to the Competition Commission.

Summary of main payday lending issues seen by StepChange Debt Charity

Payday lending causes significant problems for our clients and consumers across the UK. Since 2010 the number of our clients with a payday loan has increased fivefold and last year over 36,000 (19 percent of clients) had high-cost debts of this type. The proportion of complaints to our Social Policy network about payday loans over the same period have increased from less than four percent to almost one-third. Average client debt on a single loan is £551, well in excess of the typical £265 loan identified in the OFT compliance review, and total average payday debt (£1,657) now exceeds average monthly income (£1,320) for clients with this type of product. We would like to see the Competition Commission come up with tough solutions guaranteed to protect consumers, while ensuring access to affordable credit for those who need it.

The OFT's compliance review identified a range of detrimental practices by payday lenders. StepChange Debt Charity evidence echoes many of the problems found by the regulator although in some ways the review understates the devastating effects they can have on families. Our clients are among those most damaged by the actions of many firms in the sector and are representative of some of the most financially vulnerable consumers in the UK.

Case study 1

The charity recently advised a client with severe mental and physical health problems. Despite the client's only income coming from employment and support allowance and disability living allowance he was able to take out eight loans with five separate companies. These loans have been rolled-over multiple times, adding significantly to the debt. For example, one company has rolled-over the debt each fortnight for a year, at a cost of £10 per roll-over. This has had a severe impact on his stress levels, which has been exacerbated by his creditors relentlessly chasing him for repayment, often telephoning as early as 6.30am.

Problems in the payday sector

The charity believes there are several areas of detriment in the payday sector the Competition Commission will need to address.

1. The 'rolling-over' of payday loans

Rolling-over is common among payday lending customers and a significant source of income for creditors[1].

StepChange Debt Charity evidence suggests problems that may have been caused by the rolling-over of loans. Although UK-wide the average amount borrowed on a payday loan is £265[2], the average debt of our clients on a single payday loan is £551. This shows that in many cases debt may have been rolled-over a significant number of times before contacting the charity.

[1] Office of Fair Trading: *Payday Lending compliance review – Final report*
[2] Office of Fair Trading: *Payday Lending compliance review – Final report*

In its compliance review the OFT found that many lenders are providing roll-overs when customers would be better served with a repayment plan. Rolling-over a loan therefore not only increases repayment amounts significantly, it can be viewed as payday lending firms 'writing new business'. When this is done in an unsustainable way it is prohibited by the OFT's Irresponsible Lending Guidance (section 6.25).

Case study 2

StepChange Debt Charity advised a woman who contacted us after being on a DMP with a for-profit debt management company. While on the DMP her income fell sharply after she left work on maternity leave. She attempted to maintain payments by taking out payday loans with multiple lenders, who allowed her to borrow money despite the fact they knew she was on a DMP and was on maternity leave. Subsequently unable to keep up payments on the payday loans the lenders have rolled-over the debt several times, significantly increasing it. The client's debt on payday loans is now over £6,000.

The issue of rolling-over debt is strongly linked to the lack of adequate affordability checks across the payday sector already identified by the OFT. Because in many cases firms appear to have taken insufficient account of the financial situation of their customers, rolling-over a loan is often inevitable. Worse, in many situations it appears encouraging the rolling-over of loans is a deliberate commercial strategy by firms designed to maximise profit[3].

We would hope that an investigation by the Competition Commission would result in remedies to ensure that roll-over is not being used as a business practice designed to make profit from consumers without regard to both responsible lending guidance and the needs of payday customers. The need for a roll-over should be treated by payday lenders as evidence of financial difficulty. When approached by a customer seeking a roll-over the default option for firms should not be to provide a roll-over, but instead refer to a free debt advice provider.

2. Multiple and repeat borrowing

Another problem arising from inadequate affordability checks is that StepChange Debt Clients with payday loans have often taken out multiple loans to cover existing repayments. Over the previous three years there has been a sharp rise in the average number of payday loan debts held by our clients, almost doubling from 1.6 in 2009 to three in 2012. Two-thirds of clients with payday loans have two or more. The more payday loans held by a client, the higher their level of payday loan debt. A client with one payday loan will, on average, owe £686, a client with five or more, £3,360. Large numbers of payday loans can mean unsustainable monthly repayment amounts leading to severe financial difficulty. Over 65 percent of our clients with a payday loan have contractual payments worth more than 100 percent of income, compared to 14 percent of all other clients.

[3] Office of Fair Trading: *Payday Lending compliance review – Final report*

We have also seen examples of aggressive debt collection practices that can lead to a situation where people prioritise debt repayment over essential household bills, in a way that creates the conditions for spiralling multiple payday loan debts.

Case study 3

Early in 2013 the charity advised a client who had taken out multiple loans from a retail payday lender. The repayments on these debt spiralled out of control and she became unable to meet them. She is now being aggressively pursued for the debt by the firm. Not only does the company ring the client incessantly she has been shouted at in the street by the branch manager, who has also visited her place of work to check she is still in employment.

We believe that a market investigation by the Competition Commission could consider the effect real-time universal data-sharing, backed by an enforcement database, may have. Mandating all payday firms sign up to such a system may be of long-term benefit to the consumer, especially if there is a limit on the number of payday loans an individual can have at any one time, or over a 12 month period

3. Debt collection practices and use of continuous payment authority (CPA)

The OFT compliance review specified debt collection, particularly misuse of CPA, as problematic in the payday lending sector. The ease with which CPA is used reduces the need for appropriate affordability assessments. Because firms are confident that by using CPA they are able to recover money at a low-cost, it can mean credit is not extended on a responsible basis. Our evidence strongly supports that finding. In 2012 the charity's Social Policy network received almost 200 complaints from clients about CPA misuse – it was the third most complained about issue by clients accounting for over six percent of all complaints. Our advisers often hear about payday lenders ignoring clear signs of financial difficulty and using CPA to take out money customers cannot afford to repay, without any regard to whether this results in people being unable to pay essential household bills.

Case study 4

In January 2013 the charity was contacted by a client whose financial difficulties were exacerbated due to CPA misuse by a payday lender. The client had sent a letter to both the payday lender and her bank informing them she wanted to cancel the CPA. However, payment was still taken from her account by the payday lender using an alternate trading name. Subsequently when the client approached her bank to have it refund the money she was informed that they could not have stopped the payment, because the payday lender has "three or four" channels through which to taken CPA repayments

The problem is often made worse by the failure of high-street banks to adequately train their staff on the use of CPA. Specifically that it can be cancelled by contacting the account operator, not only the firm with the authority

.

Case study 5

A StepChange client recently took a template letter for cancelling CPA into the local branch of his bank. He was told they could not forward the letter on and there was nothing the bank could do to cancel the payments. The branch staff member then proceeded to screw up the letter before handing it back to the client.

A Competition Commission inquiry can establish whether debt collection abuses in part stem from a lack of adequate competition in a market that emphasises maximal profit over responsible lending. If this proves to be the case any solutions proposed should address this root cause, while ensuring strict compliance monitoring continues. Payday lenders should assume customers are in financial difficulty if a CPA fails to return the entire agreed-upon sum on the agreed-upon date. In this instance firms should refund the entire amount to the customer's account, pro-actively contact them to discuss any financial problems and refer them to a free debt-advice charity.

Next steps

We are pleased at the decision to refer to issue to the Competition Commission. StepChange Debt Charity would be pleased to provide the Competition Commission with any evidence it needs during the course of its investigation. There are specific areas which the Competition Commission will need detailed evidence on in order to understand the payday sector fully:

- The effect of roll-over on debt size and the policy of lenders when offering roll-over to customers
- Inadequate affordability assessments and the subsequent effects of this on creditor behaviour
- Whether contracts within the payday loan sector seek to justify unfair business practices
- How far the inflation of repayment amounts due to consumers being offered multiple loans causes consumer detriment
- The misuse of CPA

However, while we support the referral of the entire payday sector to the Competition Commission, its on-going investigation should not discourage the OFT and Financial Conduct Authority (FCA) from keeping up pressure on the industry. While its investigation is continuing, a period that will overlap with the transfer of consumer credit regulation to the FCA, rigorous enforcement action needs to continue to root out firms already identified by the OFT as in breach of existing guidance. StepChange Debt Charity is happy to continue to work with the OFT and the FCA on monitoring these issues.