

Response to the Financial Conduct Authority Consultation
Karen Rowlingson, Lindsey Appleyard and Jodi Gardner
CHASM, University of Birmingham
Contact: k.rowlingson@bham.ac.uk

Introductory Comments

Thank you for the opportunity to be involved in the Financial Conduct Authority (FCA) consultation on payday lending. We are researchers working on **FinCris**, an Arts and Humanities Research Council (AHRC) project focused on 'Ethics, Responsibilities and the Financial Crisis'. There are three streams related to this grant – economics, philosophy, and responsible lending and borrowing. We are working on the responsible lending and borrowing stream, which is based in the Centre for Household Assets and Savings Management (CHASM) at the University of Birmingham.

This paper draws on evidence from in-depth interviews with borrowers of payday lenders, doorstep lenders and credit unions carried out in May/June 2014. We present here a number of 'case studies' based on real life scenarios of borrowers we have interviewed to give an indication of how FCA reforms will impact those people currently using High-Cost Short-Term Credit (HCSTC). Given that we are drawing on a very small number of cases in this paper, we also draw on a recent report from the Competition and Markets Authority (CMA) which involved a much larger survey of payday borrowers.

Our response also draws on evidence from interviews with key stakeholders in Australia carried out in July/August 2014. The aim of these interviews was to explore the impact of similar reforms in Australia (in particular, the introduction of a national cap on credit introduced in July 2013). Interviews were carried out with a range of key stakeholders from organisations including ASIC (the Australian Securities and Investments Commission), Fair Trading Operations, Good Shepherd, Consumer Law Action Centre, FamilyCare, Credit Ombudsman Service Ltd along with academics from RMIT, University of Melbourne and QUT, Brisbane. No systematic analysis of the impact of the price cap has been carried out to date in Australia (though a report from ASIC on this is due for publication). However, as with the reforms in the UK, the price cap in Australia was introduced alongside many other reforms in this space and so the particular impact of a price cap will be extremely difficult to measure. Comparisons with Australia should also be tentative given different contexts, not least the fact that some states in Australia already had a cap and so the new reforms were likely to make little difference there. There was a general consensus, however, that the price cap along with other reforms had led to changes in both the culture and structure of the industry (with structural changes including diversification, consolidation and increased franchising in this sector).

Given the scope of our current research, we have limited our responses to the Consultation Questions relevant to this project (namely Questions 1, 2, 3, 4, 5, 9 and 10).

Q1: Do you have any comments on our general approach to developing our proposals for the price cap?

We would like to commend the FCA on their detailed and evidence-based approach to this complicated issue. It is evident that there has been a significant level of research and analysis undertaken in preparation for the price cap recommendations.

There are still, however, gaps in the analysis of how the price cap may affect low-income borrowers. Further research is therefore needed, particularly analysing what happens to the 11% of borrowers who will be unable to access credit under the proposed cap. Will the lack of access to HCSTC make them financially worse off, especially in light of the fact that only 20% of borrowers are using funds for discretionary purposes? If the expenses are urgent or necessary, will people simply find alternative ways to borrow, potentially at similar or even higher costs? For example, people could turn to home collected credit or use overdraft facilities or pawn-broking/lease lending (see Case Study 1). Payday lenders may also find ways to avoid the cap in order to meet the continuing demand. This has certainly been the experience in Australia, where much energy has been spent in tackling avoidance activity (including 'fake brokers', 'diamond selling' and 'budgeting DVDs' schemes). Consumers in Australia are still in need of loans and companies are keen to lend. Both groups are therefore seeking ways to do so, despite the changes in law.

This is an extremely complex issue, as our in-depth interview findings illustrate throughout this paper. The potential consequences of reducing access to payday lending are multiple and include the possibility that people:

- find alternative though similarly expensive forms of licensed credit, eg doorstep lenders, pawn brokers, rent-to-buy loans etc
- find alternative and possibly cheaper forms of credit, eg credit unions, local welfare/charitable assistance, mainstream banks
- find sources of money elsewhere, eg by selling something
- turn to illegal lenders
- turn to informal sources, eg family and friends
- go without certain goods/services which are either luxuries or, at least, non-essentials, and so do relatively little harm
- go without certain goods/services which are essential (eg food, heating), and therefore cause more harm than good.

In order to understand the likelihood of these different scenarios occurring it would be helpful to have detailed survey and case study evidence about why people use payday lenders and what they might do if this source of credit were not available to them. The recent CMA Report explored these issues to some extent and suggested that some customers would struggle to find alternative sources of licensed credit. For example the report highlighted the fact that four out of 10 payday borrowers had no access to alternative financial products and therefore limited choice¹; 51% had not used any other credit product in the last 12 months.² However, six out of ten borrowers had never 'shopped around' before entering into a payday loan³, suggesting that some might have been able to find an alternative source of credit if this one had not been available to them. Or perhaps they already knew that there was no alternative and therefore no point in shopping around.

But what are borrowers using the loan for and what would the consequences be of doing without it? Six out of ten borrowers in the CMA survey said they spent the funds on something that they believe

¹ Competition Commission, *Research into the payday lending market: Final report* (2014) 80-81.

² *ibid*, 27.

³ *ibid*, 96.

they definitely could not have gone without.⁴ More than half of payday borrowers access the funds for living expenses, and this amount increases to 70% if car expenses and general shopping are included in the figure.⁵ Using high-cost credit for these general expenses is potentially harmful, as people can easily become reliant on the funds to get by every month and get caught in a very expensive debt spiral. As an example, recent research from StepChange highlights that this debt spiral and the need to keep up with credit repayments can result in children missing out on necessities; in the last year nine out of ten parents in problem debt in their research needed to cut back on essential items for their children in order to repay debts.⁶

The CMA survey is extremely helpful in providing evidence on a large sample of payday customers but survey data is often quite broad-brush and the meaning of terms like 'living expenses' can include a wide range of items some of which are basic necessities while others may be less vital for people to have. Also, people might say that they could not go without certain items but, nevertheless, manage to do so without particularly negative consequences. Our case studies of borrowers help us to understand the complexities here to explore, in depth, why some people use payday lenders and what the consequences might be for them if this source of credit is unavailable. We now turn to this evidence.

The FCA argues that after an initial period of difficulty, the majority of borrowers who can no longer access payday lending will be better off without access to credit, but it is unclear what information this is based on. Further information is therefore urgently needed to support this statement as we believe, without sufficient social structures in place to assist those financially excluded as a result of the price cap, this may not be the case, unless other support mechanisms are put in place.

Once again, Australia provides some helpful ideas here, with support for advice services and No Interest Loans/Low Interest Loans (provided by banks and micro finance institutions like Good Shepherd). It is also possible for people to take Advance Payments on social security benefits. And there are provisions for utility companies to support customers in difficulties. These mechanisms are outside the FCA's direct control but it is essential for the FCA to work with partners in other parts of government and the third sector to consider improving such mechanisms.

Case Study 1 – Payday Borrowing Less Expensive than Bank Charges

Amy⁷ was in her mid-20s and was a mother of a young child living with her partner, Howard. They had only recently moved in together after living with their parents. Despite her young age, Amy had taken out a wide variety of credit products including rent-to-buy loans, payday loans and home collected credit. She needed the credit for a range of things, including baby items and a replacement tumble dryer. She also, at one time, needed a loan to pay her rent due to delays with housing benefit:

'I was on housing benefits at the time and my landlady didn't want to wait for the claim to go in and we were getting harassed and I was pregnant, I wasn't very well and basically, just to get peace and quiet, I went and got a [loan] out.'

Another loan was for the deposit and first months' rent for an apartment for her and Howard to move into. When asked what she would have done if she did not have access

⁴ *ibid*, 68.

⁵ *Ibid*, 68.

⁶ For more information on the impact of problem debt on children and families, see StepChange Debt Charity, *Debt Trap: Exposing the Impact of Problem Debt on Children* (2014).

⁷ All names are pseudonyms

to payday lending for this expense, Amy commented:

'Do you know what? Even now I don't think I could have done it any other way. There was no-one else who could financially help because we exhausted all resources asking people ... we didn't have enough because [money she obtained from other sources] was the majority of the deposit and we had to find the first month's rent.'

Amy was also still paying most of these loans off, and it appeared that she would be doing so for quite a while. She also had one payday loan that was *'sitting at the bottom of a drawer'* in her house as she was *'too scared'* to find out how much was left owing on the loan and did not want to tell Howard about the money owing on this loan.

Despite these issues, Amy and Howard were trying to iron out the finances for the sake of their baby and wanted to provide a financially stable household going forward. Howard was paid on a weekly basis and their level of income could change on a month-to-month basis, depending on how much he earned from additional jobs and overtime:

'My bank has recently said to me – because they nearly got me with bank charges– because I got a bit confused with our finances over the bank holiday and I thought, 'Oh hang on. It's not going to come out,' and I got really scared. I was like, 'Oh no,' and rang the bank and said, 'Look. I think I'm going to get a bank charge, just remind me how much is the bank charge ...' It's like £6 a day. I'm trying to work out is it cheaper to get a [payday loan] ... or is it cheaper to have the bank loans. ... yeah, I do panic a lot when it comes to that.'

At the end of each month Amy and Howard sat down and worked out the family finances and whether they had enough funds for all their expenses. If they were unable to afford to repay all of their outstanding debts, they then checked to see if it would be cheaper to get a short-term payday loan to keep them going until Howard was paid next or whether it would be better to incur the bank charges associated with going into unplanned overdraft.

Amy and Howard, like many people today given the labour market, were struggling to manage on a low and irregular income. In these circumstances, payday lending, for them, was a helpful option and often a cheaper one than going into an overdraft situation. Delays with benefit payments and a lack of patience from their landlord contributed to their problems. If payday lending had not been available to them it is difficult to see that their situation would be much improved.

Q2: Do you have any comments on the proposed price cap structure?

Q3: Do you have any comments on the price cap levels?

The proposed cap would set interest at 0.8% per day, meaning that the ‘average’ payday loan will cost consumers £24 per £100 lent. This is still expensive credit, equating to an APR of 1,270%. The OFT reported that the average payday loan was costing £25 per £100 lent, so the cap only represents only a £1 reduction on the average cost. Some providers charge more, for example, The Money Shop currently charges £29.99 – so the cap will only result in a reduction of £5.99 per £100 lent. This suggests that the impact of the cap will be relatively small. Wonga, however, charges £37.15 to borrow £100 over a month so there may be more of an impact in some parts of the industry and with some kinds of loans.

Stakeholders in Australia suggested that any cap needed to be simple enough to be easily understood by lenders and borrowers but not so simple as to be too blunt a measure. The Australian system has a number of different caps for different sized loans which is complicated and so the simplicity of the UK’s single cap is an advantage of the proposals, even though there is some rationale for varying rates of interest depending on the size of loan.

The £15 cap on default charges may also help to reduce the risk of lenders using such charges to make up for lower interest rates. The £15 limit however still seems quite high, especially in light of the fact that a ‘typical’ loan will only cost a borrower £24. We therefore question whether the proposed level will fulfil the aim of “providing the right incentive to firms by not rewarding failure to properly assess affordability”. The fact that lenders can obtain over 50% of the total interest paid in a single late penalty may incentivise less scrupulous lenders to structure loans inappropriately, or provide loans to people who cannot repay on time. These types of activities are similar to what the OFT has recently reported in the Payday Lending Compliance Review. We would suggest that a lower figure should be used, something that reflects the actual cost of the default to the lender and in line with the limitations that already exist in other financial services regimes.

The proposed cap on interest is accompanied by a proposed cap on the overall cost such that in total, no one will have to pay back more than twice what they borrowed. This should in theory stop a single loan spiralling out of control. To work effectively, it will, however, need to be coupled with a limitation on how many loans borrowers can take out in a certain period. The current protection could be avoided by lenders, who, once the 100% limitation is reached, tell the customer to get out a new loan and use those funds to repay the existing financial obligation. An example of this is outlined in Case Study 2 below. Also, customers could borrow from a number of lenders at the same, or similar, time. This issue is dealt with in more depth in Q4 below.

Case Study 2 – Spiralling Out of Control

Sarah was 28 and a single mum with two children who had recently started working in hospitality on a zero-hours contract. Within the last twelve months, Sarah had accessed high-cost credit from one online payday lender and one high-street payday lender even though she had been unemployed at that time. Sarah used her loans which totalled £440 ‘just to get by’, for her small children and for essentials such as ‘food and electric and gas’. Sarah did not mention any application for local welfare assistance. This might have been an option though access to such schemes is extremely limited and difficult.

When Sarah applied and took out the payday loans she was not working and knew she would not be able to repay the loan. However, Sarah said she completed the application

process because *'it was just getting offered to me and I needed it'*. So there appeared to be very few checks of her ability to repay.

Unsurprisingly then, Sarah had not repaid any of her payday loans from either of these lenders. She now believed, if she were to try to do so, she would have to repay a total of £900 for the two loans but this figure is likely to be significantly higher due to default charges and fees.

If Sarah had been unable to access money from the payday lenders she said that she would have just *'struggled'* to live. Sarah is now employed although her work is not guaranteed and her income fluctuates significantly which makes it difficult to budget and plan ahead let alone plan to repay her debts.

If there had been effective credit checks and due diligence within the payday loan application process, it is unlikely that Sarah would have been able to access any high-cost credit from online or high-street payday lenders. This case study reminds us that the cost of credit is only one issue for regulators and that rigorous credit checks need to be in the loan application process so that people are able to prove that they have the means to repay their loans. The fact that Sarah did not pay the loans back will probably make it more difficult for her to access credit in the future.

Q4: Do you agree with our proposals on repeat borrowing?

We strongly believe that a firmer approach to repeat borrowing is needed to prevent people getting caught in a debt spiral and becoming reliant on HCSTC. Whilst we agree that a sharp 'cap' on the number of loans a person can obtain in a given period of time could do more harm than good, there are a number of other ways that this issue can be approached. Repeat borrowing is a real concern to a large number of borrowers, as outlined by case study 3. Whilst this situation would be markedly improved under the proposed regime (as the repayments would be less), the debt spiral concern would still remain, as outlined by Case Study 3.

Case Study 3 – Repeat Borrowing

David was a disabled man in his mid-20s living with his wife and daughter. At the time of the interview, David's wife was heavily pregnant and he was very excited about the upcoming birth. Neither of them were working due to his disability and her caring responsibilities.

Approximately 18 months before the interview, David's tumble dryer broke down suddenly. He was very hesitant to get a loan to buy a new one but did not have sufficient savings. The family was living on a low and fixed income, as David's partner was also his carer. He therefore got a payday loan to get a new dryer. This raises the issue of whether or not a tumble dryer is a necessity or something that people might go without rather than borrow (at high cost) to pay for. When asked about this, David explained:

'it was a case of it's middle of winter, winter in England not being funny but you can't hang clothes out on the line. We're in a property that has a severe damp problems so we couldn't stick clothing on airers or stuff like that without escalating damp so it's a case of we needed a tumble dryer'

David therefore saw the tumble dryer as a necessity. If the family had not been able to buy a dryer there may have been negative consequences for their health due to increased damp problems in the home. David did consider alternatives in terms of support from the local council but this was not available to him:

'we spoke to the guy on the council to see if they could give us hand, give us an emergency loan or anything like that and they weren't willing to do anything.'

One of his friends suggested a payday lender as they had used that same lender in the past. David got the loan thinking that:

'I could then buy the tumble dryer and pay it off the next time I got paid, the problem was the next time I got paid I had other bills that had to go out and I couldn't turn round and not pay the electric bill because then we'd have been cut off and I couldn't not pay the gas bill. And it's like, what will I do now, I'll have to get out another one.'

He therefore went into a debt spiral and needed to get loan after loan out to repay the existing debt. The last loan was six weeks before the interview. The only reason that he did not need to get out further credit was that members of a sports team he was part of saw the damage that the payday loans were doing to him and all 'chipped in' to help him

pay off the debt.

David calculated that he obtained approximately 36 payday loans to repay the initial cost of the dryer, costing approximately £50 each time:

'it's stupid when you consider the sort of concept of £200 to buy a tumble dryer ... you pay twice a month for 18 months. So if you're paying £50 a time and you're talking 36 x £50. That is sort of ridiculous when you're having to live on benefit money and all the rest of it, that is immense. And so disheartening because I'm suffering from depression and knowing that you're not able to turn round and say right well ... we'll go away to the coast for a weekend during the summer holidays because of the fact that you haven't got the money and you haven't been able to save any money because every bit of money you get goes out, that £50 that we've been doing without is £50 that we haven't been putting in to the daughter's savings fund. And not being able to do that made me feel like a let down and it made the depression a whole lot worse because of the fact that I felt that I'm stuck in this unbreakable cycle.'

These calculations mean that David paid £1,800 in interest over 18 months for a £200 tumble dryer (and this amount does not include any additional charges he might have incurred, such as default fees, bank charges for going withdrawn, late payment fees etc). Because all of David's family's income came from his social security payments, this is government money going, effectively, into the hands of payday lending companies.

A more nuanced approach to this issue should be considered. For example, we draw your attention to the regime in Australia. Australia has recently instituted the *Consumer Credit Legislation Amendment (Enhancements) Act 2012 (Cth)* which, amongst other things, instituted a unique approach to minimum time access periods in an attempt to prevent consumers from being caught in a payday 'debt spiral'. The Enhancements Act made a number of amendments to the *National Consumer Credit Protection Act 2009 (Cth)* generally, as well as some specific provisions related only to small amount credit contracts, also known as SACCs (unsecured loans of AUD\$2,000 or less with a length of 16 days to 1 year).⁸

Under the prescriptive responsible lending regime of the Enhancements Act, the borrower will be presumed to be unsuitable for additional loans if, (a) they are currently in default under an existing SACC or (b) *have had two or more SACCs in the past 90 days*. In addition, when assessing loan suitability for a SACC, if the borrower has an account in an authorised deposit-taking institution, the lender must obtain and consider statements from their account over the past 90 days before approving a loan. The limitation on the number of SACCs that can be given to borrowers acts as a delay in providing the consumer with further funds, effectively limiting the number of loans that they can get in a 90 day period.

Overall, the Australian stakeholders tended to argue that the 'presumptive requirements' on multiple lending and default had been at least as effective as the price cap in changing the nature of this sector of the market. It was argued that these provisions had changed the culture and mindset to force lenders to look more seriously at both the ability to repay the monthly amount and the overall cost of the loan.

⁸ Loans 15 days or less are now effectively banned in Australia: *Consumer Credit Legislation Amendment (Enhancements) Act 2012 (Cth)*.

Q5: Do you have any comments on the scope of the price cap?

The fact that the current limitations only apply to particular loan products defined as ‘High-Cost Short-Term Credit’ means that avoidance of the cap will be possible, which undermines the protection afforded to consumers. For example, the cap does not extend to home-collected credit, which can provide loans which would otherwise qualify as HCSTC. It may also be possible for payday lenders to change their business model so that the loans fulfil the definition of a ‘home credit loan agreement’. Bank overdrafts, whether arranged or unauthorized, may also charge more than the proposed cap (see Case Study 1 above). Loans could also be structured so that they run over 12 months, thereby avoiding the cap altogether.

Evidence from our Australian stakeholder interviews certainly suggests that existing lenders will seek ways to avoid the cap and will diversify into other areas of lending which are not covered by the cap. In light of our findings, we are not convinced by the FCA’s justifications for limiting the scope of the price cap and believe that further consideration should be given to extending the cap to cover all forms of credit including bank overdrafts and home-collected credit (see case study 4).

Case Study 4 – Home-Collected Credit and Vulnerable Borrowers

Sasha was in her mid-30s and was an unemployed mother of three young children, one of whom had special needs. She showed a number of signs of being financially excluded. She had been made redundant in 2007 and claimed out-of-work benefits since then. She did not have a bank account and relied on her post office account and used cash for all expenses. Sasha currently had numerous loans with a doorstep lender working in her area. In addition, Sasha occasionally used another doorstep lender for one-off credit needs, such as taking her children on a holiday, but has had a steady stream of doorstep loans since 2005.

Sasha’s use of doorstep credit started because a door-to-door salesman offered to take some professional pictures of her children for £250, but she did not have the funds at the time so needed to get a loan to pay for the photos. She was working part-time at that time, was not earning high wages, and she quickly became dependent on home-collected credit for her everyday expenses. As outlined by Sasha herself:

‘once I’d paid that, then do you want another loan, and it’s like well, I could buy this for the kids, I could buy that. It’s like easy money, you have to pay it back but it’s easy money when they’re offering it you and you’ve got like two kids and single parent and then I was made redundant in 2007, so I had a newborn baby and my son and, you know, she offered me money which kind of helped out buying beds and, you know, things like that. So it’s kind of easy money.’

Almost 10 years after the initial loan, Sasha had become dependent on doorstep lending and was caught in a deep debt-spiral. When asked about how she felt about the loans, Sasha commented:

‘Well, I’d rather not do that. I’d rather have my money and save my own money, like what I’m paying them a week save that and pay no interest, but we don’t live in that kind of world. So obviously I don’t want to pay an extra £300 for a £400 loan, but in times of need it’s how we live, really, you know?’

She used the most recent loan to buy new bikes for her children and was intending to buy a new dining table. Unfortunately when she went to purchase the table, it was no longer available so she bought something else though she said she couldn't remember what it was. When asked what she would have done if she did not have access to the doorstep credit, Sasha stated:

'I'd have probably tried to save the money and get them the bikes. It's just ... it's easier when they offer you and say you can renew and you've got something in mind that, like I see them and thought oh, they're a good bike, I'm going to get the kids them for Easter, and then I'm not just buying them a bike for the sake of buying them a bike, I'm using Easter as an excuse. But I would have saved up and probably took me a bit longer to get them, but then she offered and said oh, that loan's finished, you can have another one and I'd already had the bikes in mind and I want a new dining room table ... but I wasn't approaching her; she just said one of your loans is finished and I didn't even realise it had come to an end. You can renew that and I was like, oh, okay then. Because I'd already had stuff appear that I want ... You know, you've always got stuff that I need to get this or ... and when you've got a house and kids you've always got stuff that you want to buy and obviously they come and then they say this one's paid off, so I just keep renewing ones that are paid off.'

The case study is a clear example of a financial product creating its own demand as opposed to fulfilling a clear consumer need⁹. This is an aspect of payday lending, but is also evident in doorstep lending due to the relative ease of access. Sasha's needs are understandable (bikes for her children and a new dining table) but, as she said herself, she could have gone without these temporarily without particular detriment while she saved for them. This would have meant going without for a period of time but saving a considerable amount of money in terms of interest payments.

⁹ See Sarah Beddows and Mick McAteer, *Payday lending: fixing a broken market* report (2014).

Q9: Do you have any comments on the proposed approach to data sharing?

We generally support reforms that aim to increase the role of data-sharing for HCSTC. Data-sharing is an important aspect of responsible lending, and unless lenders have access to a secure, reliable, detailed and widely available data on borrowers it will be difficult for to ensure people do not become over-indebted. In addition, if a limitation on the number of loans is enacted (see response to Question 5 above), a real-time database would be crucial. We however remain doubtful whether the industry will be able to deliver an adequate solution and believe that the FCA should intervene at an earlier stage. As outlined by Case Study 5 below, it is relatively easy for a single payday loan to spiral out of control and end up with a single consumer owing money to many different lenders.

Case Study 5 – Multiple Lenders and ‘Debt Cycles’

Trixie was a 35 year old single mum with two children, one of whom had recently turned 18. She lost her job in 2012 and turned to a small payday lender to help bridge the financial gap until she was able to find new employment. She believed that it would be easy to obtain similar employment and therefore only took out £200 to help ‘*bridge the gap*’ and buy groceries and petrol for her car. Unfortunately finding employment took significantly longer than anticipated and her £200 loan quickly spiralled out of control until she owed £860. Even when she found employment, it was still difficult to repay the debt. As Trixie stated:

‘it got to a point where when I started my work ... where every month ... when I got paid I had about £2 to £3 left in my bank account so then I would have to re-borrow to get it back up so it was escalating, it was horrible, really bad. But I couldn’t go to my bank, I couldn’t get a low APR, I couldn’t get lower repayments or anything.’

Because of her escalating financial situation, Trixie had to use a large number of payday lenders (up to five at the same time) and had multiple loans to keep her going because of the shortfall left due to the repayments of previous loans.

When asked about her experiences with payday lending, Trixie stated ‘*looking back now I never would have done it, I was desperate*’. When asked about responsible lending, she commented that the government should just ‘*get rid of these payday lenders ... just get rid of the lot of them because they’re making this country more in debt, way more in debt*’.

When asked about what should happen with the payday lending market, Trixie highlighted:

‘Obviously everyone that wants to borrow, everyone needs help at some point in their life and make sure they can afford it, not be so aggressive as well, payday lenders are very, very aggressive especially on the phone, if I didn’t pay I’d get phone calls, I’d get emails, text messages, literally bombardments and it’s all young quite cocky people on the other end of the phone. They’re ... really nice to you when you’re taking out the loan but as soon as you need to pay it back and like with [one of the payday lenders] I had to have a guarantor and luckily my cousin was my guarantor but if I rang them up and said, look I can’t afford on this

date, I will be able to pay on the next date, no we need that money on that day and if you don't pay it then it will come off my cousin's debit card ... and then they'd bombard her with text messages.'

The way that payday, and other, lenders respond to people who are having difficulties is very important and in June 2014 the FCA ordered Wonga to pay £2.6m in compensation to customers who were threatened with letters from non-existing solicitors so their record here is not good.

Trixie's last repayment was due to be made the week after this interview, and she was relieved to have this stress out of her life. Two years and more than a thousand pounds later, she had finally repaid that initial £200 loan and got herself out of a long and painful debt spiral.

Q10: Do you agree with the costs and benefits identified?

The FCA has done an excellent job summarising the costs and benefits associated with the proposed price cap. We do however have a concern over the fact that there remains a focus on consumers still being served by the current market, especially when the FCA's own evidence indicates that 50% of people are *worse off* as a result of using payday loans. Increased focus is therefore needed on getting consumers out of the HCSTC market and towards more sustainable and affordable credit products, as opposed to merely structuring the market to reduce the damage that can be caused by this type of credit. As argued above, reforms which simply remove access to this form of credit may do more harm than good, unless alternatives are available. These alternatives may be more affordable forms of credit such as from credit unions (see case study 6) and microfinance institutions but other initiatives should be pursued with other stakeholders. For example, work should be carried out with utility companies to ensure that people are supported when they face difficulties meeting bills. And better provision of local welfare assistance needs to be a priority. Unfortunately, local welfare assistance is becoming even more difficult for people to access just at a time when they will need it most. This is not directly within the FCA's remit but suggests the urgent need for partnership working with other key stakeholders such as the Department for Work and Pensions.

Case Study 6 – From High-Cost Credit to A Credit Union

Gemma was a single mother in her thirties with four children. She did not currently have any paid work. Gemma first borrowed from a doorstep lender when she was 18 years old, working part-time with two small children and had moved into her first home which needed furnishing:

'they only gave me a couple of hundred pound for my first loan and then after a few months they gave me £1,000 but it was £140 a month back and I couldn't afford it so I got into arrears and that's how I got bad credit'

Gemma explained what happened when she was unable to repay her doorstep loan:

'if you miss a payment they bang your door, they don't leave you alone and then you feel like people know your business because they're always outside your house and stuff like that. And some of them can get quite nasty and stuff but I found the one that I had she was always knocking the door and she was really loud and she wouldn't stop ringing me.'

Being unable to repay her loan and the practices of this doorstep loan agent had a significant impact on Gemma:

'It really made my life miserable, I was depressed that's why, I was crying and it was like, I felt bad I felt like £140 a month I was giving it's a lot of money, I was depressed and then it got to the stage where I thought these companies are just making money off vulnerable people'

The doorstep loan repayments meant that Gemma could not afford sufficient food for her and her family. It was only by chance when a family member found out the situation

Gemma was in that they repaid her debt for Gemma.

Gemma then found out about credit unions. Gemma believed that:

'Credit Unions are really, really efficient and really good and they're more understanding about people's needs, family's needs and they don't even hassle you'.

Credit unions can also respond to people's needs quickly as in Gemma's experience:

'I phone them up and they give the money within the hour so it goes onto my card, you get your personal card with them and you can have it into your bank or on the cards and I always have it on my cards because if it's emergency and it's like desperate they can give it me within the hour and then all that happens is it comes out of the kid's child benefit ... So it is good for people out there that haven't got much and there's an emergency situation'.

If Gemma had not been able to access credit from credit union, she would have:

'struggled and probably had to buy less shopping and stuff because I would have no choice, I would have had to get some kind of finance because, or try and save but it's hard to save when you've got children and they always need something'.

This example highlights the need for access to affordable credit for those on a low income and the significant negative impact that high-cost doorstep lending can have on an individual and a household.

Conclusion

The FCA is to be commended on providing and drawing together an extensive range of evidence, in a very short amount of time, to feed into the proposed new cap. Understanding the impact of the cap is, however, extremely complex for many reasons. Evidence from our in-depth interviews suggests that if some people have their access to payday lending removed, as will be the case with the proposed reforms, this is likely, overall, to have a more harmful than positive impact, *unless alternatives are put into place*. These alternatives should include reforms of local welfare assistance and wider provision of affordable credit. Work with utility companies should also take place and great support be given to advice agencies.

One issue that we have not discussed in this paper is the concern that some people might turn to illegal lenders if they lack access to other forms of credit. None of our sample (of 44 people in total, using a range of different sources of credit) mentioned illegal lenders. The evidence from a range of other studies is very mixed with some suggesting that demand for illegal lending actually goes down when legal lending declines (Gibbons paper on Japan¹⁰) while others suggest that illegal lending might substitute for legal lending¹¹. The problem here is that it is extremely difficult to measure illegal lending given its criminal and underground nature. Measures to tackle illegal lending through local teams will be vital to keep on top of the potential for this form of credit to expand in the next few years.

Research to measure the impact of the changes, ideally longitudinal research starting before the new cap is introduced, will be essential to both improving our understanding of the outcomes of the reform and also feeding into debates on other areas of policy action in relation, for example, to the social security system and provision of affordable credit.

A final reflection from the Australian interviews is the need to ensure that the FCA has sufficient resources and will to pursue avoidance activities, review the reforms and take a proactive approach to regulation here. Australian stakeholders also suggested that the re-licensing process could be extremely helpful as, it was argued, it would be harder to remove licenses from lenders once they had been given than to restrict them in the first place.

¹⁰ Damon Gibbons, *Taking on the money lenders: Lessons from Japan* (Centre for Responsible Centre, 2012).

¹¹ See, for example, Consumer Finance Association, *Response to HMT/BIS Impact Assessment* (2013) and *Should UK payday loans costs be capped? International Comparisons* (2013); Policis, *The Effect of Interest Rate Controls in Other Countries* (2004).