CHASM | Centre on Household Assets and Savings Management

Briefing Paper

New Horizons? The Future for UK Payday Loan Companies

The UK's consumer credit industry is one of Europe's largest with unsecured loans exceeding £157.1 billion in July 2012[1]. While banks and credit card companies remain the primary providers, there have been significant shifts in the personal loans sector of this market in recent years. Squeezed by limits on liquidity in the 2008 financial crisis and subsequent recession, the retail banks reduced their lending to both small businesses and individuals. At a time of rising costs, stagnant wages and uncertain employment, the effect was to force increased numbers of households to seek alternative means of obtaining cash advances, a supply-side opportunity quickly seized upon by high-cost credit firms and, most notably, payday loan companies.

Extending from sub-prime to mainstream credit, these companies have thrived. Between 2008 and 2012, new loans doubled from 4 to 8 million and rose in value from £900,000 to over £2 billion[2] augmenting turnover and profits for both high-street and online suppliers. In 2012, the market leader DFC Global, the American parent of UK siblings Instant Cash Loans Ltd (trading as The Money Shop and Payday UK), MEM Consumer Finance (trading as MonthEndMoney, PayDay Now and PayDay store) and Express Finance Bromley, saw

[1] Personal Finance Research Centre (2013) *The Impact on Business and Consumers of a Cap on the Total Cost of Credit* www.bristol.ac.uk/geography/research/pfrc/themescredit-debt/pfrc1302.pdf

[2] Office of Fair Trading/OFT (2013) *Payday Lending: Compliance Review Final Report* www.oft.gov.uk/shared.oft/Credit/oft1481.pdf

collective UK turnover of £347 million (up 55.6% on 2011) and profits of £89.9 million. CashEuronet UK LLC (trading as QuickQuid, PoundsToPocket, My Direct Loan and MoneyinMinutes) reported a 45% increase in turnover (to £198 million) while Wonga saw a 225% rise (to £184 million) and posted profits of £62 million.[3]

Past and current demand comes from a cross-section of individuals: men and women of varying ages, marital status, income and socio-economic group.[4] Some have poor credit histories and limited access to other forms of cash advance, others select the payday option on grounds of convenience, the relative anonymity of the approval process and the speed money is transferred.[5] They take on loans, averaging £200-£300 for 28-30 days which (minus transmission fees) are paid into their bank accounts; in return they authorise the lenders' withdrawal of the same sums plus interest charges at the end of the agreed period.

The total cost of borrowing varies by company but QuickQuid is indicative in charging £50 per £200 borrowed for 28 days (at a fixed annual interest rate of 326% and representative APR of 1,734%). For customers capable of repaying their loans on time, it is the end of a short but very expensive transaction. For those unable to meet their deadlines (28% of loans in 2011-2012), it is the beginning of a cycle of indebtedness. Forced to rollover or refinance their advances, they incur further fees and interest charges which, in turn, can lead to repeat and multiple borrowing. It's estimated that 50% of the sector's revenue is derived

[3] Lewis, J. (2013) 'Making money: profiting from high-street loans' www.thebureauinvestigates.com
[4] If there is a skew in this distribution, it's towards single males, between 18 and 35, from the lower SEGs earning under £24,500 pa. YouGov/CFA (2012) *Attitudes towards payday loans amongst payday customers and policymakers* www.cfa-uk, and CFA (2013) *Credit Crunched* www.cfa-uk/creditcrunched
[5] Ibid.

from late repayments with 19% coming from those obliged to extend deadlines four or more times.[6]

Payday companies maintain they're providing a useful service in meeting a need for short-term credit. They defend their charges and repayment practices by setting them against operational costs. Staffing, rents, investment in online systems, capital borrowing and credit checks mean outgoings are high and margins per transaction low; business is therefore driven by the number of underwritten loans (including those rolled over or refinanced) at existing interest rates with robust repayment strategies. Customers, they claim, are making informed choices, aware of both the cost of borrowing and the penalties of missing repayment dates.[7]

Their opponents disagree. Consumer groups, debt charities, government agencies, MPs and the media argue that costs are excessive and, further, many of the companies offering loans are failing to uphold standards of responsible lending. They point to systematic evidence of: misleading advertising; inadequate assessment of credit histories and loan affordability; the lack of transparency in the cost of borrowing; misuse of continuous payment authorities; aggressive debt collection and the mishandling of complaints.[8] When combined with case studies of malpractice e.g. lending to under-18s, encouraging borrowers to extend their

[6] OFT (2013) op cit
[7] Burton. M. (2010) *Keep the Plates Spinning: Perceptions of Payday Loans in Great Britain*, London, Consumer Focus
[8] OFT (2013) op. cit.

loans and harassing late payers, it's small wonder that the sector has been described as the "shabby end of the credit market". [9]

Whilst those railing against payday loans are largely in agreement as to what is wrong with the sector, the same is not the case with their proposals for change. A few critics want to ban this form of lending (with precedents set by several American states); others look to limit its expense by capping either the total price of credit or, more particularly, interest rates and default charges (as in a number of EU countries). Currently baulking at these options, the government is looking at two further measures: increasing competition among suppliers and, the more popular alternative, stronger payday regulation. In terms of the former, it is both encouraging high-street banks to retake the space they relinquished with new short-term loan products and also promoting credit unions to facilitate cheaper lending across wider communities. With regard to payday practices, its Financial Conduct Authority (the regulator from April 2014) is planning new company requirements regarding: advertising; credit and affordability checks; loan duration and debt collection procedures with strong penalties for non-compliance culminating in the loss of their trading licence.

Within the flux and frictions of Coalition politics, it is difficult to assess how many of these measures will eventually be implemented or their possible success. It is clear however that new horizons are planned for UK payday lending involving more competition in the supply of credit, higher standards in the way it is sold to consumers and more solid enforcement powers. Until such times, there will be numerous borrowers susceptible to errant financial practice without recompense.

[9] Margaret Hodge www.parliament.uk/business/committees/public-accounts-committee/news/consumer-credit-report/

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