Capping the cost of payday lending in the UK: What will the impact be?

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Introduction

In November 2013, the United Kingdom Government announced that the Financial Conduct Authority (FCA) will be legally required to implement a cap on the total cost of credit by early 2015. The cap will relate to high-cost short-term credit (HCSTC) (defined by the FCA as loans of less than 12 months at an interest rate of over 100% APR but excluding doorstep lenders). The FCA are currently working on what form the cap might take and what impact that the cap might have.

This paper draws on evidence from a major study for the Arts and Humanities Research Council on *Responsible Lending and Borrowing for Low-income Consumers*[1]. Part of this study involved in-depth interviews with borrowers of payday lenders, doorstep lenders and credit unions. This paper draws on early analysis of some key case studies from these interviews to highlight the potential impact of a cap. 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. As well as considering the impact of the cap, the paper also considers what might be done to reduce the potentially negative consequences that might occur, in the short if not long-term, when the cap is introduced.

Potential impact

The impact of any cap will, of course, very much depend on the level and nature of the cap when it is finalised. If the cap is set very high then it may have little impact on lending in this field. If set very low then it may have a major impact. There are also decisions to be made about whether the cap is applied to fees and charges as well as interest and so the nature of the cap can vary in different ways.

The FCA published proposals for the cap on 15th July 2014. Their 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[2], so the cap only represents only a £1 reduction on the average cost. Some

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1 The project continues until June 2015 with a number of publications planned.

2 http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/Credit/oft1481.pdf

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.

However, 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 stop a single loan spiraling out of control. To work effectively, it should, however, 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. Also, customers could borrow from a number of lenders at the same, or similar, time. A real-time lending database could help to reduce the risk of this if restrictions on the number of loans taken out was introduced.

The £15 cap on default charges is also helpful to reduce the risk of lenders using such charges to make up for lower interest rates.

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 and this undermines the protection afforded to consumers. For example, the cap does not extend to home-collected credit, which can provide loans of £70-£80 or £100 lent. It may 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. We therefore believe that serious consideration should be given to extending the cap to cover all forms of credit including bank overdrafts and home-collected credit.

This paper considers a number of possible consequences if the cap were so low that payday lending became unavailable to consumers as an option. These potential consequences 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 occuring 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 choice[3]; 51% had not used any other credit product in the last 12 months.[4] However, six out of ten borrowers had never 'shopped around' before entering into a payday loan[5], 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 they definitely could not have gone without.[6] 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.[7] 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.[8]

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.

Case Study 1 – Payday Loan for White Goods

David[9] 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*

3 Competition Commission, *Research into the payday lending market: Final report* (2014) 80-81.
4 ibid, 27.
5 ibid, 96.
6 ibid, 68.
7 Ibid, 68.
8 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).
9 All names are pseudonyms

> *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.

David felt he had little alternative but to take out a payday loan. If this had not been available he might have gone without the tumble dryer and potentially suffered negative health consequences. Or he might, perhaps, have found alternative sources of borrowing such as a doorstep lender or bought the item from a rent-to-own shop (both sources of credit being similarly expensive to a payday lender).

It is worth pointing out here that David would not have needed to borrow from a payday lender if the local authority had been able to support him better. Perhaps the local authority could also have sign-posted David to a local credit union to help him? Also, the consequences of going without a tumble dryer would have been much less negative if he lived in damp-free, warm housing. But without changes in the provision of local welfare assistance and/or improved housing conditions it is not clear that the absence of payday lending would have been beneficial to David.

Case Study 2 – Payday Loan for Essential Bills

Edward was a 60 year old single man who worked part-time and did not have any dependents. He took out a payday loan to cover an electricity bill that was higher than expected due to a very cold winter season. The loan was for £100 for a two-week period. Edward took the loan out because of a short-fall in funds to pay the bill and concern that because he was on his 'final notice' if he did not do something to pay he would get additional fees from the electricity company and/or disconnected.

Because of his previous experience with bankruptcy, Edward was reluctant to get any credit but due to the urgent nature of the expense, believed that the loan could not have been avoided. When asked how his bankruptcy had affected his approach to money, Edward stated:

> *'… it's taught me to be a hell of a lot more careful with money, I guess. Yes, I mean, if you haven't got so much to spend, you're more careful, obviously, because, well, I mean, some people aren't'*

He managed to repay the loan within the two week period, as he did not want to get caught in a constant need for credit, stating:

> *'because that's when they really start making money out of you. They make money out of you anyhow, but probably on a small sum probably not that much, like if you don't pay it back I think there's a charge for not paying it back and then they roll it over and the compound the interest up and that's how, you know, you see these people who are paying, who get these huge bills, it's just because they kept them rolling over and the compounded interest has gone up and up.'*

When asked why he did not call the electricity company to try and organise a repayment plan, Edward stated:

> *'I think it's worth paying twenty odd quid interest rather than getting twenty quid's worth of phone calls trying to do that, and then they probably put you on a higher tariff or they said that you've got to have … a prepay meter and you'd have more aggro that way.'*

Edward has now learnt from the situation and has taken steps to ensure his need for a payday loan does not reoccur. He commented:

> *'[My electricity account] wasn't on a standing order at that time. I put it on a standing order subsequently, to try and avoid having it, and I now pay a bit more rather than a bit less so you don't get that kind of situation, but on that occasion I got caught out.'*

To ensure that he was able to repay the payday loan within the two-week period, Edward sent a personal item to be auctioned and used the proceeds from that to repay the loan.

In Edward's case, lack of access to a payday loan might have resulted in him selling his personal item sooner and using the proceeds to pay his bill. In this case, he would have saved the interest charges/fees and been better off. Of course, the need to sell a personal item is not ideal and a better solution might have been found if the energy company had been more approachable and less potentially expensive to contact. Edward might also have benefitted from free debt advice if he had realised this was an option.

Case Study 3 – 'Debt Cycle' with Payday Lending

Trixie was a 35 year old single mum with two children, one of whom has 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 spiraled 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 has 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.

If Trixie had not had access to a payday loan then she might have approached an alternative lender or managed without any loan. She, herself, regretted borrowing from a payday lender and said she would have preferred if this source of credit did not exist.

Case Study 4 – Weighing Up the Cost of Bank Charges and Payday Loans

Amy 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 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.

Case Study 5 – Payday loan for a night out with friends

Carl was also in his mid 20s, single, working full-time and living with his parents. Carl used a payday lender on three occasions over a period of nine months. Carl said that he borrowed the money to go out with friends at the weekend and to bridge the gap between pay days:

> *'the first two times was a night out, so [I was] sitting at home at ten o'clock, all my mates were out, couldn't get the money so I thought, that's how I initially got into it because I really wanted to go out and I needed the money so that's how I initially started using the pay day sites. First few times was probably underneath £100 each time and then the last time I used it, it was £150 and that was because I need[ed it] to last about a week until I got paid'.*

Carl admitted that he didn't shop around for the 'best deal' as easy access was key to this type of lending:

> *'To be honest well no but I mean that's the whole point of the sites isn't it? It's money that you need straight away and if you need it desperately then you're going to pay what you need to'.*

Carl said that if he hadn't been able to access a payday loan he *'probably wouldn't have gone out'.* So initially Carl felt that he didn't necessarily need the money and thought that he would be able to repay at his next payday:

> *'I think the thing was, the way I see life it's about memories, it's about going out having fun, I knew I'd have the money to pay them back and I knew that the interest, fair enough I don't want to pay it but I knew that I had that money accessible in my account. So I, yeah like I knew I could pay it off, I knew it weren't going to be a big deal'.*

However, Carl then started to borrow for more general expenses and then found repayments a struggle. When his parents discovered this they repaid the debt for him so he wouldn't incur default charges:

> *'I had about ten days until pay day and I borrowed £150 and I think they quoted me sort of about £37/£40 interest so, but obviously if you pay it late you have a £30 late fee and things like that. But I ended up, my mum and dad found out I did it when I got back which was about five days before I had to pay it back and they made me ring up and pay it off with their card just to save me a bit of money'.*

Carl felt embarrassed asking for financial help from his parents to repay the loan early for him. However, if Carl's parents had not have the loan for him he would have been unable to repay and incurred additional fees and charges. This example shows the trajectory from optimistically taking on a payday loan to dependence on accessing high-cost credit. It also reflects the broader impact on household finances and reliance on intergenerational financial support.

In Carl's case, lack of access to a payday loan might have meant that he did not go on a night out with his friends. This would not have caused major harm but he would have missed out on social activities that were important to him and given that he understood the cost of the loan and could afford it, he made the choice to spend his money in this way. However, the fact that his parents subsequently helped him out with a loan to avoid default fees suggests that his borrowing had become more problematic and the initial unproblematic loan had led to a more difficult situation.

Case Study 6 – Unemployed and access to high-cost credit

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.

Case Study 7 – 'Debt Cycle' with Home-Collected Credit

All of the case studies so far concern payday lending because this will be subject to the cap on the cost of credit. However, our study also included customers of other forms of credit and these faced similar issues as payday customers. We therefore give a couple of examples of such customers here.

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 being 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 doorstop 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 need[10]. This is an aspect of payday lending, but is also evident in doorstop 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

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

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.

Case Study 8 – From doorstep lending to 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.

Conclusions

Our case studies, alongside evidence from the CMA survey, suggest that if the cap on payday lending made this form of credit much less available then some people would find alternative, though similarly expensive, forms of licensed credit, eg doorstep lenders, pawn brokers, overdrafts, rent-to-own shops etc. These forms of credit have a lower profile than payday lending which is widely advertised on TV, the internet and print media. It may therefore be less accessible but if people need credit then many would, presumably, find these sources. Use of these alternative sources would not particularly benefit or harm customers as the costs would be similar unless that cap was extended to other kinds of lenders.

Some people, however, might find, and positively benefit from, alternative and possibly cheaper forms of credit, eg credit unions, local welfare/charitable assistance, mainstream bank loans. However, mainstream banks rarely offer the kind of loans that payday lending customers are looking for (ie small loans) and it is becoming increasingly difficult to access local welfare assistance following reforms of the social fund and cuts in local authority budgets. Credit unions could provide a very beneficial alternative but have a very low profile at the moment and, in any case, would be unable to meet the potential demand from payday lending customers, without further financial support and advertising to raise the profile.

Some people who currently use payday lending might find money elsewhere, for example by selling items. If this is something of particular personal value or need then this may not be beneficial but if it is an item they can easily do without then this could be a positive alternative. Some people might turn to informal sources for money, eg family and friends. This option is not available to everyone and often comes at an emotional cost of feeling shame for needing help. Financially, however, it could be a positive outcome.

If an alternative source of finance cannot be found then people may have to go without certain goods/services. Where these are either luxuries or, at least, non-essentials then this will do relatively little harm and, again, the financial benefit of saving interest charges and fees could be substantial but where people have to go without certain goods/services which are essential (eg food, heating) this could do considerable harm.

The quantitative evidence is not strong enough to be able to determine how many people fit into these different categories and it is, indeed, complex for each individual case, to determine where they might fit.

The evidence tends, perhaps, towards avoiding a very low cap on the cost of credit which might then particularly affect those who need this credit most. While other reforms are being implemented in terms of rollovers, affordability checks, harm-warnings, tougher penalties and tighter licensing regime are being implemented, it seems risky to introduce a cost of credit cap that will effectively ban payday lending. However, if broader reforms could be introduced in relation to increasing access to local welfare assistance and credit unions while reducing benefit delays and making utility companies more supportive when customers face difficulties, the need for payday lending and other forms of relatively high cost credit would reduce.

The proposed cap is not a very low cap and, indeed, might be seen as a rather high cap. As argued above, it might actually do very little to reduce the more expensive payday loans. Australia's cap is closer, in effect, to a 300% APR, far lower than the 1,270% proposed cap in the UK. The cap on interest therefore looks very conservative and, if it goes ahead, may need to be reconsidered once the impact of all the reforms is evaluated in 2015.

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 Japan[11]) while others suggest that illegal lending might substitute for legal lending[12]. 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.

When the cap is introduced, it will be important to prepare for the possible impact on borrowers, particularly in terms of providing people with advice about alternatives. The Money Advice Service and money advice charities will need further support to deal with queries. When Australia introduced its cap in July 2013, there were a number of other measures in place to support people in financial difficulties, as well as providing access to short-term funds when needed. This includes expanded financial counselling services, the ability for people on welfare to access emergency government loans and the creation of a not-for-profit no-interest and low-interest loan scheme.

Finally, given the difficulty of predicting the impact of the cap and other reforms, it will be very important for the FCA to carry out research to evaluate the impact and then take appropriate measures to ameliorate any problems as they occur.

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

[12] 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).