

**Briefing Paper BP6/2015**

**Is there (still) a problem with Payday Lending?**

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**What is payday lending?**

The original aim of payday lending was to lend a small amount to someone in advance of their pay-day. Once they received their wages, the loan would be repaid. Such loans would therefore be relatively small amounts over a short time period. Payday lending enables people to access credit quickly and conveniently, either in high street stores or online.

**Why did payday lending grow?**

Payday lending increased dramatically in the UK between the early 2000s and 2014 because it helped people manage unexpected drops in income and/or increases in expenditure at a time of growing income insecurity and price rises.

**Why did it cause concern?**

Payday lending caused concern among a range of pressure groups and campaigners due to: the very high costs of this form of credit (APRs of 4,000% were not unusual); the relatively high rate of default among borrowers; how default was handled; and the risk of getting caught in a cycle of debt by taking out one loan to pay off a previous loan and so on.

**What do payday customers think?**

Our research involved in-depth interviews with 21 payday lending customers interviewed between March and May 2014. It revealed complex and ambiguous views of payday lending among customers. While many among this small sample of customers saw this form of credit as an expensive last resort they also valued the quick access to much-needed cash which was often unavailable from any other source.

The ability to borrow also preserved people's feelings of independence and dignity, as they did not need to ask friends or family for help. The anonymity of online applications was also

valued by some. Customers were concerned, however, that the use of such credit could cause more harm than good if it led to 'debt spirals'. And our study did, indeed, find cases where this had occurred.

### **How did the government respond?**

In 2014, the government responded to concerns about payday lending by introducing rules requiring adequate affordability assessments; allowing for a maximum of two rollovers of the loan amount; and requiring a financial warning to be included in payday advertisements.

In January 2015, they went still further by introducing a cap on the initial cost of credit at 0.8% per day, with an annualised percentage rate of 1,270%; default fees were also limited to £15 and default interest could not exceed 0.8% per day. A 100% repayment cap also meant that borrowers would never have to repay more than double the amount they borrowed.

These reforms also related to other forms of High Cost Short Term Credit (defined by the Financial Conduct Authority (FCA) as loans of less than 12 months at an interest rate of over 100% APR) but specifically excluded weekly-collected credit.

### **What effect will the reforms have?**

According to the FCA, in the five months following the 2014 reforms, the number of loans and the amount borrowed from payday lenders dropped by 35%. It is still too early to measure the impact of the 2015 reforms but the FCA have estimated that 7% of current borrowers (some 70,000 people) will no longer have access to payday loans following the introduction of the price cap.

It is not clear what will happen to these people. Some will go without credit entirely. Others might find alternative, cheaper sources, including credit unions and friends/family. Others might use similarly or even more expensive forms including weekly-collected credit, unauthorised overdrafts and unlicensed lenders/loansharks.

### **Is there (still) a problem with payday lending?**

Even with a price cap, payday loans are still an expensive form of credit but our research shows that people were willing to pay a high price for quick access to credit. While the impact of recent regulatory reforms clearly needs to be reviewed, there are also broader issues around access to small amounts of affordable credit from mainstream banks and credit unions.

Furthermore, it is also now time for government to tackle the root causes of income insecurity and the inadequacy of state welfare safety nets. More specifically, potential reforms include: the reintroduction of an enhanced Social Fund; a reduction in benefit delays; policies to support people to save; and greater forbearance from creditors.

**This research was part of an AHRC funded project: FinCris: Responsibilities, Ethics and the Financial Crisis (2012-2015).**

The aim of our project was to explore issues of responsible lending and borrowing. In 2014, we carried out 43 semi-structured interviews with people who had borrowed different forms of credit within the last 12 months in the West Midlands and Oxfordshire regions of the UK. Our interviewees had borrowed from a range of different sources including high-street banks, credit unions, doorstep lenders, rent-to-own and both online and retail payday lenders. This briefing paper focuses on the 21 payday lending customers.

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