Payday Lending Compliance Review

Interim Report

November 2012

OFT1466
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EXECUTIVE SUMMARY

1.1 Earlier this year the OFT launched a review of the extent to which payday lenders comply with the Consumer Credit Act (CCA) and meet the standards set out in the Irresponsible Lending Guidance (ILG).

1.2 In this interim progress report we set out our emerging findings.

1.3 From the evidence we have so far reviewed, there appear to be higher levels of compliance where the statutory requirements placed on lenders are more prescriptive, in particular regarding the advertising of loans and provision of pre-contractual information.

1.4 However, and of significant concern, in areas where lenders’ obligations are mainly set out in guidance, compliance is lower. In particular, we have concerns about:

- the adequacy of the checks made by lenders on whether loans will be affordable for borrowers,

- the proportion of loans that are not repaid on time,

- the frequency with which loans are rolled over or refinanced and the circumstances in which this occurs,

- the lack of forbearance shown by some lenders when borrowers get into financial difficulty, and

- some debt collection practices.

1.5 Despite the variation in business models and irrespective of how and where they operate, lenders across the sector must do more to ensure that they comply with the letter and the spirit of the law and of our guidance.

1.6 In several cases, we have uncovered evidence that calls into question the continuing fitness of the lenders to hold a consumer credit licence and we are already taking action as a result.

1.7 Action we are taking includes:
• Warning the majority of the firms we have inspected that they must improve how they treat customers or risk enforcement action in future. We will set out our areas of specific concern and require them to undertake an independent audit of the improvements they make to ensure they comply with their obligations under the law and the minimum standards we expect.

• Conducting formal investigations into firms where we have concluded that the evidence we have found may call into question their fitness to hold a licence.

• Assessing all of the evidence we have gathered to determine whether further investigations are called for.

• Following a warning to trade associations in February 2012 that their members need to improve standards of compliance with the law and guidance on advertising, we have written to relevant trade associations and to every individual payday lender we are aware of setting out our wider concerns and putting them on warning that standards of compliance need to improve.

1.8 Over the coming weeks, we will finalise our review of the evidence we have gathered, including further research into the nature of the payday loans market. We will publish our final report in the New Year.
2 INTRODUCTION

2.1 Earlier this year the OFT launched a review of the extent to which payday lenders comply with the Consumer Credit Act (CCA) and meet the standards set out in the Irresponsible Lending Guidance (ILG).

2.2 In this progress report we set out our emerging findings, outlining what we are doing already and what we plan to do to tackle the issues we are uncovering. We describe the work we have done so far and the evidence we are collecting. And we outline the steps leading to publication of our final report in the New Year.

2.3 That report will help inform both the public debate on payday loans by throwing light on the evolving practices of lenders, and our ongoing strategy to improve standards and tackle problems across the sector. That strategy will encompass: being even clearer about our expectations of lenders; encouraging trade associations to improve their members’ awareness of and compliance with these standards; raising consumer awareness of the risks associated with payday loans; and taking effective enforcement action where necessary.

2.4 Our review is taking place against a backdrop of wider initiatives, including changes to industry codes of practice and research by other organisations, that we need to take into account.

2.5 For these and other reasons, we do not yet have all the evidence we require, nor have we completed our analysis of the evidence that we have. Key inputs to the review, including a quantitative research project and a programme of more than 50 company inspections, are yet to be finalised.

2.6 Nonetheless, we are in a position to describe our emerging findings. We believe that doing so will help inform the ongoing public debate about this sector and support efforts to improve compliance.
3 THE PAYDAY SECTOR

3.1 There are no official statistics on the payday lending sector in the UK but clearly it has grown significantly since 2008, when we estimated it to be worth around £900 million.¹ Consumer Focus estimated the total value of loans in 2009 at £1.2 billion,² while more recent media reports have suggested it is in the range £1.7 to £1.9 billion.

3.2 As the sector continues to grow, responding to increasing demand, we are seeing very different reports on who takes the loans, why and the impact on them.

3.3 We are aware of around 240 payday lenders. By the time we complete our review we will have inspected more than 50 leading lenders and obtained information from all 240.

3.4 It is clear that there is no single payday business model. Lenders use a number of different models, with the most obvious differences being between those operating exclusively online and others who operate primarily on the high street.

3.5 The industry argues that consumers increasingly choose payday loans over mainstream credit options, quoting research claiming, among other things, that:

- most customers are extremely satisfied
- 56 per cent said using payday loans had prevented a one-off financial difficulty from becoming a wider financial crisis
- 54 per cent felt the loans made it easier to pay bills on time.³

¹OFT Review of High Cost Credit, June 2010 www.of.t.gov.uk/OFTwork/credit/review-high-cost-consumer-credit/.

²Consumer Focus, Keeping the Plates Spinning, August 2010

³www.cfa-uk.co.uk/news.asp
3.6 Other recent reports paint a very different picture. For example, Which?\(^4\) recently reported that:

- half of borrowers cannot repay their payday loans
- 70 per cent regret taking out the loans.

3.7 This latter figure was closely matched in a report from ComRes/R3\(^5\), which also found that

- 48 per cent believed the loans had made their financial position worse, and
- payday loans are used by some borrowers to pay for rent and other regular household bills, including food and fuel.

3.8 Such reports raise wider social issues that fall outside the remit of the OFT.

\(^4\) [http://press.which.co.uk/whichstatements/half-of-people-taking-out-payday-loans-cannot-afford-to-pay-them-back/](http://press.which.co.uk/whichstatements/half-of-people-taking-out-payday-loans-cannot-afford-to-pay-them-back/)

\(^5\) [www.comres.co.uk/poll/579/r3-payday-loan-poll.htm](www.comres.co.uk/poll/579/r3-payday-loan-poll.htm)
4 THE EVIDENCE

4.1 The emerging findings are based on information we have received from a wide range of sources and interested parties, including:

- 1036 responses to a questionnaire,
- Submissions from 31 interested parties,
- A ‘sweep’ of the websites of 50 payday lenders,
- inspections through visits (not yet completed) to more than 50 individual lenders,
- 686 consumer complaints, and
- a mystery shopper exercise involving 156 online and high street lenders.

4.2 Respondents to our questionnaire comprised 674 holders of consumer credit licences, of which 239 identified themselves as payday lenders, 336 consumer organisations, six trade bodies and 20 local authorities.

4.3 Separately, we received submissions from 15 consumer bodies, three MPs and two Welsh Assembly Members, one local authority, six trade associations and four individual businesses.

4.4 We conducted a sweep of the websites of 50 lenders to assess the extent to which their advertising complies with relevant legislation and with the ILG.

4.5 By the time we complete our review, we expect to have inspected more than 50 payday lenders, including the larger online and high street lenders, and several based in Europe and the United States.

4.6 We reviewed complaints data from a variety of sources, in particular the Citizens Advice consumer service and the Financial Ombudsman Service (FOS), and complaints made by consumers direct to the OFT.
4.7 We commissioned an independent mystery shopper exercise to improve our understanding of the consumer experience when looking for loans. Researchers approached 156 online and high street lenders and recorded the information, advice and service they received when enquiring about payday loans.

4.8 In addition, we are undertaking our own quantitative research on the size of the market and loan performance, including the number and proportion of defaults and rollovers.

**Overall complaint levels**

4.9 As the payday lending sector has grown, so too has the number of complaints in total and the number of companies complained about. Although the numbers are significantly lower than for other, higher volume, credit products such as bank loans, overdrafts and credit cards, the proportion of complaints to FOS upheld in favour of the consumer is significantly higher in the case of payday loans.

4.10 FOS recorded a 797 per cent increase in the volume of complaints about payday loans between 2009/10 and 2011/12, during which time the total volume of loans appears to have increased by around 50 per cent.

4.11 The total number of complaints about payday loans in 2011/12 was 296, compared with just under 19,000 about credit cards. Eighty one per cent of the payday complaints were resolved in favour of the consumer, compared with 44 per cent for credit cards and 37 per cent for overdrafts and personal loans. Complaints to FOS about payday loans encompassed a range of issues, including charges, lack of forbearance and debt recovery practices.
Table 1: Complaints to the Financial Ombudsman Service about payday lenders 2009-2012

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<th>Financial Year</th>
<th>Total new complaints</th>
<th>% of resolved in favour of consumer</th>
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<tbody>
<tr>
<td>2009/10</td>
<td>33</td>
<td>58%</td>
</tr>
<tr>
<td>2010/11</td>
<td>59</td>
<td>64%</td>
</tr>
<tr>
<td>2011/12</td>
<td>296</td>
<td>81%</td>
</tr>
<tr>
<td>Q1 2012/13</td>
<td>126</td>
<td>77%</td>
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4.12 When we launched the review, we invited people to tell us of their experiences with payday lenders. In total we received 686 responses, of which 95 per cent were from individuals and the remainder from consumer advisors. Almost half related to aggressive debt collection practices or lack of forbearance when consumers were in financial difficulty. Other recurring themes were inadequacy of affordability assessments and poor customer service and complaint handling procedures.

Advertising and pre-contractual information

4.13 The CCA and associated regulations impose requirements on the advertising of loans, to include a representative APR in certain circumstances, for example, and to ensure that this, and the representative example where triggered, are shown with sufficient prominence.

4.14 Lenders are required to provide pre-contractual information, in a prescribed form, in good time before the borrower enters into an agreement. And there must also be an adequate pre-contractual explanation setting out, in particular, features of the loan which may make it unsuitable for some borrowers or may impact adversely on them.
in ways they may not expect. It must also highlight the principal consequences of failure to make repayment under the agreement.

4.15 We conducted a sweep of the websites of 50 lenders to assess the extent to which their advertising complies with relevant legislation and with the ILG. Our inspection visits have also examined lenders’ advertising practices and pre-contractual disclosures.

4.16 On advertising and the provision of pre-contractual information, we have found only limited evidence that lenders fail to comply with the letter of the law and the ILG. Our examination of the websites of 50 payday lenders found that generally they comply with the more prescriptive statutory obligations, such as the requirement to include a representative APR.

4.17 However, we are concerned about the extent to which advertising appears to target people in financial difficulty and encourage rolling over of loans. For example, around one third of websites included statements such as ‘no credit checks’, ‘loan extension guaranteed’ and ‘extend loans up to 4 or 5 times’. If true, these would indicate irresponsible lending and failure to carry out adequate checks on affordability.

4.18 We are also concerned that potential borrowers may not always be given balanced information about the costs and risks of loans and that the information given may not be explained adequately, making it more difficult to compare payday loans with other credit products and to make a considered assessment of the pros and cons of taking a loan. In some cases, key information seems to be hidden away or downplayed.

4.19 In addition, the initial evidence from the mystery shopping exercise and inspection visits suggests that, in most cases, this information is given only after the lender has approved the loan application, at the stage at which the borrower must confirm that he or she wants to proceed. This raises the question of whether the information is provided too late in the process to help consumers make a considered assessment of whether a loan is in their best interests.

4.20 In February, we warned the trade associations that their members must ensure website content is legally compliant and adheres to the key
principles of the ILG. We also warned that failure to do so would be a factor we would take into account when considering whether they remain fit to hold a licence. While we have begun to see improvements in this area, more needs to be done and we will be pursuing this further with lenders and the trade associations.

**Affordability of loans and use of rollovers**

4.21 Before granting a loan or increasing significantly the amount of credit made available, lenders are required by law to undertake an assessment of **creditworthiness**, based on sufficient information, obtained from the borrower where appropriate and from a credit reference agency (CRA) where necessary.

4.22 In the ILG, we make it clear that we also expect them to assess **affordability** – that is, an individual’s ability to repay a specific loan in a sustainable manner without incurring further financial difficulties or other adverse consequences.

4.23 The evidence we have reviewed so far suggests that lenders take very different approaches to these checks. For example, while high street lenders generally require applicants to provide a bank statement and/or wage slip, typically, online lenders do not require any documentary evidence in support of an application; most online lenders use CRA checks or have created their own bespoke credit scoring tools.

4.24 All the lenders we have inspected perform checks on creditworthiness but it is unclear whether these are in every case sufficient to meet the statutory test. For example, in relation to checks of bank statements and wage slips by high street lenders, in some cases this may be primarily to verify identity and the existence of a bank account, rather than to check the borrower’s likely propensity to repay the loan.

4.25 Of even greater concern are doubts about the extent to which lenders actively check the affordability of the loan, taking into account the individual borrower’s circumstances, particularly when rolling over or refinancing a loan.
4.26 Our concerns are twofold: first, whether affordability checks are undertaken to inform key decisions, including whether to renew or rollover a loan, as well as whether to make an initial loan; and second, where affordability assessments are carried out, whether they are adequate.

4.27 On the timing and frequency of affordability assessments, while 72 per cent of lenders who responded to our questionnaire told us that they conducted affordability assessments for all new customers and 65 per cent did so for each new loan, only 22 per cent said they conduct an affordability assessment each time a loan is rolled over.

4.28 31 per cent told us that they limited the number of rollovers or refinancing a customer could have. The average limit reported was four loans per person; responses ranged from one to 12. Thirty one per cent told us they do not impose limits and 38 per cent did not answer the question.

4.29 So the approach taken by lenders varies significantly and in some cases, in excess of the limits stipulated in industry codes.

4.30 The evidence about the number of loans that are not repaid on time gives cause for concern that lenders’ affordability checks may not have been adequate or sufficiently tailored to the individual. More than half of the 336 debt advisors who responded to our questionnaire expressed doubts about whether affordability assessments had been carried out and about the quality of those that were. Many said that, in their view, the loans were not affordable from the outset.

4.31 The complaints data we have reviewed supports this view. A quarter of the complaints alleged that the payday lender had unduly encouraged borrowers to roll over loans or refinance, sometimes without verifying whether this was in the borrower’s interests or without providing adequate information and explanation.

4.32 A key element of our further work will be to seek to quantify the proportion of loans rolled over, refinanced or not repaid. We will compare this with the proportion of other forms of lending that prove
unaffordable. This will inform our thinking on whether payday lenders are sufficiently rigorous in assessing creditworthiness and affordability.

4.33 We are also considering the extent to which lenders are checking whether borrowers hold multiple high cost loans at one time. Evidence from debt advisors suggests that this is a feature of problem debt, their clients holding six loans simultaneously on average. StepChange Debt Charity (formerly the Consumer Credit Counselling Service) recently noted that over 2,000 of its clients this year have had five or more payday loans, a three-fold increase from 716 in 2009. At the more extreme end of the scale, 173 of those who sought its help in 2012 had ten or more payday loans while only 42 had this number in 2009.6

Forbearance and debt collection

4.34 The ILG and Debt Collection Guidance7 require lenders to treat borrowers fairly, and with understanding and due consideration, when they are in financial difficulties. The guidance also sets out examples of debt collection practices which are unfair or improper, such as harassing borrowers for payment or failing to suspend collection while discussions take place with a view to a repayment plan.

4.35 Most of the lenders we have inspected provided some evidence that they attempted to contact borrowers who miss repayments on loans using a variety of methods and at varying stages. Three quarters of those who responded to our questionnaire said they contacted the consumer. Two thirds specified that they send a letter. Almost half said that they froze, reduced or suspended interest and charges on the loan but the data does not reveal at what point in the debt recovery process this typically occurs.

4.36 Debt advisers painted a different picture. Forty nine per cent said lenders routinely contacted their clients and only two per cent reported that

6  [Link](www.stepchange.org/News/Multiplepaydayloandebtissoaring.aspx?nid=230)

lenders had frozen or reduced interest and charges on their clients’ loans. A possible explanation for this disparity is that customers in financial difficulties who are proactively contacted by their lenders and granted forbearance over fees and charges are less likely to end up seeking debt advice.

4.37 Poor debt collection practices were the subject of half the consumer complaints that we reviewed and local authorities and trade associations cited handling of defaults and arrears as the largest single category of complaints made to them about payday lenders.

4.38 Issues highlighted in complaints included aggressive debt collection practices, such as threats to coerce payment and excessive collection charges, persistent and excessive telephone calls, including calling consumers at their place of work, refusal to accept offered repayment plans, refusing to deal with debt advisors and alleged misuse of continuous payment authority. We have also seen evidence of firms using misleading or deceptive practices in order to recover debts.

4.39 Whilst they relate to a small minority of firms, some of the practices fall well below the standards we expect, which is why we have launched several formal investigations.

4.40 Our further work will look at these areas more closely and we will consider what action needs to be taken to improve compliance, in particular in debt collection.

Use of continuous payment authority

4.41 Continuous payment authority (CPA) is a method of collecting repayments on payday loans by withdrawing money from the borrower’s bank account. It is an alternative to direct debit or cheques and is used by most online payday lenders and by some operating on the high street, accounting for the majority of loans.

4.42 Issues concerning the alleged misuse of CPA were a recurrent theme in consumer complaints and evidence from consumer bodies and debt advisers. They included: consumers who were not aware that they had signed up to use of CPA or what it involved, problems in cancelling CPA,
and payment being taken in a manner that left consumers unable to meet essential living expenses. This links with questions of forbearance where consumers are in financial difficulties.

4.43 We set out our position on the misuse of CPA in debt collection guidance issued in October 2011. We launched a supplementary consultation in December 2011 and have been considering the responses received in the light of wider developments, including evidence gathered through the compliance review. We have today published revised guidance, setting out our revised position on the misuse of CPA, together with a summary of responses to the consultation. These can be found on the OFT website at www.oft.gov.uk/about-the-oft/legal-powers/legal/cca/debt-collection.
5 NEXT STEPS

5.1 Over the coming weeks, we will complete our research and analysis of the evidence.

5.2 We will write to all payday lenders, pointing to this report and advising them of our emerging findings and where we will seek improvements. Further, we will be warning the majority of the firms we have inspected that they must improve how they treat customers or risk enforcement action in future. We will set out our areas of specific concern and require them to undertake an independent audit of the improvements they make to ensure they comply with their obligations under the law and the minimum standards we expect. This mirrors the approach we took in our review of compliance with the Debt Management Guidance in 2010.

5.3 We will continue the formal investigations which we have already begun and assess the evidence to determine whether further investigations are called for.

5.4 We have been in discussions with trade associations about the advertising of payday loans since the launch of the review. Over the next few weeks we will continue to engage with them, to explore the extent to which they may be able to assist in raising standards across the sector, including through further changes to their codes of practice or guidance to members.

5.5 We will publish our final report in the New Year. At that stage, we expect to set out our view of what further improvements may be required by lenders to ensure that they are fully compliant with the standards required by the spirit and letter of both the law and relevant guidance. In forming our conclusions we will also consider whether other action may be necessary, including whether to make recommendations to the future Financial Conduct Authority, to Government or to industry code sponsors. In doing so, we will consider whether our final evidence leads us to conclude that the problems we have identified are systemic in nature, affecting the market as a whole, rather than essentially ones relating to compliance by a proportion of individual firms.