ANNEXE D – COMPLIANCE INSPECTIONS

Introduction

D.1 As part of the review we arranged for 52 payday lenders to be inspected by OFT staff and/or by local authority trading standards services officers acting on our behalf.

D.2 By the end of the review, 50 inspections had been completed – one firm surrendered its consumer credit licence and another firm’s licence lapsed and was not renewed.

D.3 The vast majority of inspection visits took place before the changes to the payday industry codes of practice and publication of our updated Debt Collection Guidance incorporating revised guidance on the use of continuous payment authority (CPA).

D.4 We estimate that the 50 lenders inspected account for around 90 per cent of the payday market by turnover.¹ They comprised 32 online and 18 high street lenders. One high street lender also provided online loans. 46 of the 50 lenders were members of one or more of the four main payday industry trade associations.²

D.5 Thirty-seven of the lenders inspected were among the 50 whose websites were assessed as part of the advertising web sweep (Annexe E).

D.6 Each inspection visit took one to two days to complete. High street lenders received visits both to their head office and to one or more retail store locations.

D.7 Visiting officers inspected lenders’ policies, procedures and training materials, spoke with company directors and staff, listened to live or recorded telephone calls with customers,

¹ Based on the quantitative analysis in Annexe A.

² BCCA, CCTA, CFA and FLA.
observed loan transactions and reviewed customer account records and complaints.

**Key findings**

**Competence and complaint handling**

D.8 In 28 cases, including many of the larger lenders, business policies and procedural documentation had been created only days before the inspection, and were so new they had not been properly embedded across the business.

D.9 Systemic business failings included a lack of clear complaint handling policies and procedures or a failure to implement these consistently and to provide adequate staff training.

D.10 Complaint handling teams were often inadequately resourced, and staff insufficiently skilled to deal with the more complex queries.

**Breaches of legislation and FOS rules**

D.11 We found evidence to suggest that 24 lenders had breached the legal requirements of Part III of the Consumer Credit Act – for example, by trading under names not specified on their consumer credit licence. This is indicative of serious failings in their compliance monitoring systems.

D.12 Eighteen lenders did not appear to be fully compliant with other relevant legislative requirements, such as the Data Protection Act.

D.13 Thirty-eight lenders failed to comply with at least one of the complaint handling rules set by the Financial Ombudsman Service, and a lack of awareness of the FOS rules was commonplace.

**Pre-contractual information and explanations**

D.14 Nine of the 50 lenders did not provide pre-contract credit information (PCI) in the form prescribed by the CCA.
D.15 Four lenders did not give a pre-contractual explanation, and a further 43 did not explain all the matters required by the CCA such as the consequences of failure to make repayments.

D.16 Fifteen lenders made it possible for consumers to enter into a credit agreement online without first being clearly presented with the PCI form and an adequate explanation.

D.17 Twenty-eight of the 40 lenders who used CPA failed to explain how it operated or that the borrower had the right to cancel.

**Affordability assessments**

D.18 Only six of the 50 lenders were able to provide documentary evidence that they considered both income and expenditure as part of affordability assessments.

D.19 Although most lenders asked for a bank statement, this appeared to be mainly to validate employment or the existence of a bank account, or for fraud checking purposes, rather than to assess affordability. Lenders rarely asked for more than one statement.

D.20 Eleven lenders specified that a person had to be in permanent employment to be eligible. The others lent to consumers who were self-employed or in temporary employment, or whose income was limited to a pension or benefits.

D.21 Policies and procedures were often incomplete and lacked essential information such as loan acceptance criteria or how customer data should be used to reach lending decisions.

D.22 We saw inconsistencies in approach between policies/procedures and actual practice observed. For example, cases where customers were issued with loans even though they did not fit within the lender’s written criteria.
Rollovers

D.23 Forty-four of the 50 lenders allowed rollovers. Inspecting officers saw examples of loans that had been rolled over repeatedly, sometimes more than 12 times. Only 29 lenders operated a rollover limit.

D.24 Seventeen lenders actively promoted rollovers in marketing material or at the point of sale as a ‘feature’ of the loan.

D.25 Fifteen lenders proactively alerted customers to the rollover option prior to the loan due date, and we saw evidence of lenders deliberately encouraging borrowers to roll over the loan rather than repay on time.

D.26 Staff in two large high street firms told us rollovers were regarded as key ‘profit drivers’ and staff were encouraged to promote them. In one case this was even written into their training manual.

Default and arrears

D.27 Lenders’ collections strategies tended to focus on recovering the outstanding debt quickly and in full. 14 lenders operated employee incentive schemes designed to achieve this.

D.28 Twenty-seven lenders had dedicated collections teams in place, but only 10 had specialist teams to deal with financial hardship. 34 lenders failed to signpost customers to not-for-profit debt advice services.

D.29 Most lenders said they would consider negotiating alternative repayment plans, freezing or reducing interest or suspending collection activity, but it was unclear when this would be initiated.

D.30 In one case, call scripts instructed staff to say ‘your problem is not our problem’. In another, we saw internal file notes debating whether a customer who had rolled over a loan 36 times should be removed from collections and considered for a hardship plan.
Detailed findings

Business models

D.31 Payday loans are offered through two main channels: high street retail stores and over the internet.

D.32 All 18 high street payday lenders inspected also provided other credit products or financial services, such as pawnbroking, medium-term loans, cheque cashing, gold buying, foreign currency exchange, international money transfers or buying and selling of second-hand goods. Only four high street lenders said that payday lending was their principal business activity.

D.33 Online lenders did not typically offer other products or services although some offered instalment loans at lower interest rates.

D.34 Lenders used three main repayment mechanisms: CPA using debit card details; direct debit mandates; and post-dated cheques. Of these, CPA was the main repayment method. We found that 40 lenders used CPA, of which 26 (including seven of the 10 largest lenders) used it exclusively.

D.35 Four high street lenders offered only cheque-backed loans, three offered loans using debit card repayment (but not CPA) and eight used CPA. 11 offered more than one repayment method.

D.36 All 32 online lenders used CPA. Most used it exclusively, but seven also offered a direct debit option.

D.37 Twenty-five online lenders, including the 10 largest, used lead generators. Nine lenders bought leads from five or more lead generation firms and one used over 150.

D.38 High street lenders typically provided cash over the counter. Online lenders deposited monies direct into the customer’s bank account, generally within two or three days.

D.39 For same-day transfers, using ‘faster payments’ or ‘CHAPS’, there was usually an additional fee payable of £5 to £20. This additional
charge was not always made clear in advertising and marketing material, and we are unclear whether it was factored into the calculation of the representative APR.

**Types of loan**

D.40 The typical payday loan is where the capital, interest and charges are repayable in full, by one payment, on the due date. This is usually on the customer’s next payday or within one month.

D.41 Some lenders also offered other products:

- one lender offered loans for up to 34 days which were not aligned to customer pay dates
- three lenders offered a two-month repayment option, with only interest payable after the first month, and the capital and further interest payable at the end of the term
- five lenders offered monthly instalment loans but at interest rates normally associated with payday loans
- eight lenders offered loans on a ‘running-account’ basis with a credit limit, but practice varied as to when the customer was permitted to draw down on the credit limit
- two lenders offered guarantor loans under which the loan repayments had to be guaranteed by a third party.

**Policies and procedures**

D.42 We found that most lenders had invested significant time and resource in preparing for the inspections, including employing legal firms to review and update policies and procedures. The process of preparing for an OFT inspection meant that regulation and compliance became a focus for payday lenders, often for the first time, with some company directors expressly acknowledging that the visits had been an impetus for change.
D.43 Much of the documentation we inspected lacked creation dates or version control, or was dated only days before the visit. In some cases, written procedures and contractual documentation did not appear to be compliant with all relevant legislative and regulatory requirements. In other cases, policies existed but did not appear to have been implemented.

D.44 We regularly found that staff were unfamiliar with, or untrained on, processes and documents, with inconsistencies between the content of written policies/procedures and actual practice.

D.45 For example, one large lender admitted that employees were not given free access to policies/procedures in case they passed them on to another company. We also identified front-line staff with no access to training or procedural manuals or call scripts.

D.46 When we checked the customer account records of a large lender we found customers had been issued with loans even though they were ineligible under the firm’s policy as they were unemployed.

D.47 Two smaller lenders were unable to produce documentation that was capable of inspection, and we found significant gaps in the policies and procedures of 16 other lenders.

**Regulatory issues**

D.48 We found evidence to suggest that 24 of the 50 lenders had breached requirements of Part III of the CCA, including by:

- trading under names (including website domain names) that were not specified on their consumer credit licence

- engaging in other licensable activities, such as credit brokerage, without being licensed to do so

- failing to notify the OFT of changes to company officers or their principal place of business.

D.49 These are all serious matters that, if proven, could be the basis for regulatory action, including criminal prosecution or formal licensing
action. They indicate serious failings with regard to lenders’ competency levels and compliance monitoring systems.

D.50 In a number of cases we are also investigating evidence that lenders may have provided false or misleading information on their licence application.

Breaches of other legislation

D.51 Eighteen of the 50 lenders appeared to be non-compliant with the requirements of other relevant legislation, including:

- 14 lenders did not allow consumers to opt out of having their personal details passed to third parties, contrary to the Data Protection Act 1998
- 13 lenders were not fully compliant with the Electronic Commerce (EC Directive) Regulations 2002, for example by failing to include a geographical address, contact details or licence number on websites
- seven lenders did not allow consumers to opt out from receiving electronic marketing messages, contrary to the requirements of the Privacy and Electronic Communications (EC Directive) Regulations 2003.

Complaint handling

D.52 Thirty-eight of the 50 lenders were not complying with at least one of the FOS complaint handling rules. A lack of awareness of FOS rules, particularly amongst smaller businesses, was commonplace.

D.53 We found systemic business failings regarding complaint handling including lenders not having clear complaint handling policies and procedures in place, or failing to implement these consistently or to provide adequate staff training.
D.54 Where policies and procedures did exist, there was limited evidence that they were underpinned by effective processes covering complaint recording and monitoring.

D.55 These failings were compounded by lenders failing to embed a compliance culture within the business to encourage staff to take customer complaints seriously and to handle them efficiently and sympathetically.

D.56 Complaint handling teams were often inadequately resourced, and staff insufficiently skilled to deal with more complex queries or to identify when and at what stage these should be escalated. Although some lenders had started to develop relationships with debt advice organisations, these were not sufficiently well established or supported by dedicated teams.

D.57 Specific breaches of FOS rules that we encountered included lenders placing unreasonable restrictions on how customers could submit complaints. For example, some high street lenders insisted that customers must call or write to ‘head office’ and some online lenders insisted that complaints must be by post or telephone rather than email or via the website.

D.58 A significant minority of lenders failed to provide customers with the FOS’s consumer leaflet, which explains the role of the FOS and how consumers can submit a complaint to the FOS. A similar number failed to include in customer acknowledgment letters a summary of their internal complaint handling procedures.

D.59 Some high street lenders did not have integrated or consistent complaint processes between stores, area managers and head office, resulting in the lender not having a clear picture of overall complaint levels, reasons for complaints or how (or whether) these had been resolved.

Advertising and marketing

D.60 The findings of the compliance inspections in respect of lenders’ advertising and marketing are summarised in Annexe E.
Pre-contractual information and explanations

D.61 Forty-four of the 50 lenders provided a PCI form but in three cases the form was not compliant with the legal requirements. Six lenders did not provide a PCI form at all.

D.62 Forty-six lenders provided a pre-contractual explanation, but in 43 cases this was not compliant. The most common omissions were in respect of CPA, rollovers, the amount repayable and the principal consequences of failure to make repayments. Four lenders did not provide any pre-contractual explanation.

D.63 Three high street lenders did not comply with the requirement to provide an oral explanation, instead handing the consumer an explanation in writing. Eight lenders failed to advise the consumer to consider the PCI and explanation.

D.64 Fifteen online lenders made it possible for consumers to enter into a credit agreement online without having first passed through screens clearly displaying the PCI form and explanation.

D.65 Examples of bad practice included:

- only displaying the PCI form and explanation if the consumer clicked on a small or partially hidden link on the homepage, which could be easily missed

- providing the PCI and explanation by email without clearly alerting the consumer that they were included as an attachment or highlighting their importance

- failing to have a process in place for checking (for example via an embedded validation link) that the consumer had received and opened the email enclosing the PCI and explanation, prior to inviting him to sign the agreement

- failing to monitor the time that elapsed between the consumer receiving the PCI and explanation and signing the agreement, to assess whether the consumer was likely to have had time to read or consider the information provided
• emphasising messages around ‘speed’ throughout the process, including the use of countdown timers (to the closure of the next lending window) and inserting messages next to the PCI such as ‘3 minutes away’. 

D.66 One large online lender operated a policy of calling consumers who had not signed an agreement within one hour of receiving the PCI. This could be interpreted by customers as pressure.

D.67 Of serious concern was that two online lenders (including one large lender) appeared to engage in practices designed to discourage consumers from reading and considering the PCI and explanation. Their websites included wording that trivialised or downplayed these documents, for example by presenting them alongside statements such as ‘simply click the link below and electronically sign your Loan Agreement’ or referring to them as ‘small print’ or ‘FAQs’ or referring to the loan application process as involving ‘no paperwork’ or ‘no rules’.

D.68 During inspections of two large lenders, staff were heard advising customers to ‘skim’ through the emailed PCI and explanation.

D.69 High street stores are often busy outlets retailing a number of products and services. Most lenders did not provide a private area in store where staff could provide customers with the required explanations. This lack of privacy may increase the risk of consumers feeling pressurised into entering into an agreement quickly or without understanding the information or explanation provided, or feeling too embarrassed to ask questions.

D.70 We found that the risk of consumers missing the PCI/explanation was increased where applications were made on a website via a mobile telephone, because of the small size of the screen. Visiting officers identified cases where consumers had only restricted access to information on screen and/or difficulty opening attachments. However, call centre staff were unable or unwilling to answer questions, merely directing consumers to the website.
D.71 We came across many cases where sales staff did not appear to understand how CPA or rollovers operated, or the credit reference agency (CRA) checks that would be made, and so could not adequately answer questions put to them.

D.72 One medium-sized online lender stated during an inspection that if consumers asked too many questions it would probably refuse the loan as they could become ‘difficult’ further down the line.

D.73 During inspections of five larger lenders, it was clear that customers who were in the process of rolling over loans, or had already done so, did not understand that payments would only cover the interest and charges and not reduce the amount originally borrowed.

D.74 Of the 40 lenders that used CPA, we found that 28 did not give customers a clear explanation of this feature of the agreement. In particular, lenders did not adequately explain the impact of setting up a CPA or how it would operate. None of the 28 explained that the customer had the right to cancel the CPA, and one even stated that ‘there is no automatic right to cancel’.

D.75 We identified seven lenders that did not, in practice, allow customers to cancel CPAs.

D.76 Five lenders failed to include any information about CPA in the agreement terms and conditions, and a further 11 lenders failed to set out a reasonably clear and accurate description of CPA. In addition, we found that seven lenders were using CPAs in a different way to that set out in the agreement.

Affordability assessments

D.77 All but one of the lenders we inspected appeared to attempt some form of affordability assessment before issuing loans to new
customers. However, only 14 lenders carried out an affordability assessment before rolling over or refinancing loans.3

D.78 We found that lenders deployed a variety of methods and took account of various factors when assessing affordability. These ranged from sophisticated fully automated credit checking systems to basic manual checks. Many used a combination.

D.79 Twenty lenders showed us newly created procedures and documents relating to affordability assessments, but in most cases without clear evidence that these had been fully embedded within operating procedures.

D.80 Some of the documentation that we saw was incomplete and lacked essential information such as the name of the CRA used, the loan acceptance criteria or how customer data should be used to reach lending decisions.

D.81 We identified inconsistencies of approach between policy and practice during the visits to a number of lenders (including large lenders). This included cases where customers were issued loans even though they did not fit within the lender’s specified lending criteria, or where loans were approved for amounts above the recommended level set out in written policies.

D.82 Contrary to advertising claims of speedy processing, sometimes the application process was delayed by several days where lenders sought to verify employment status or required documentary evidence to be provided post-application.

D.83 Two high street lenders used a third party to guarantee cheques presented by customers. It appeared that a creditworthiness check of the guarantor had been conducted, using CRA data, but no affordability assessment had been undertaken.

3 One high street lender also operated online and had a separate policy and procedure for affordability assessments for each sales channel. It has therefore been counted as two lenders here, with the total number of lenders referred to in this section equating to 51.
Affordability assessments – methodology

D.84 Eleven lenders (nine online and two high street) specified that a borrower had to be in permanent employment. The others told us they were prepared to lend to consumers who were self-employed or in temporary employment, or whose income was limited to a state or private pension or benefits.

D.85 Forty-two lenders (28 online and 14 high street) operated lending limits. The average upper limit for a new customer was £370, and £700 for returning customers.

D.86 Four online lenders stated that if the amount of credit sought exceeded their lending limit, they would be unlikely to offer a lower amount in case the consumer applied for additional loans elsewhere (which could put at risk their ability to repay).

D.87 Twenty-four lenders (18 online and six high street) said they would lend only if net monthly income (after tax and deductions) was above a specified amount. This ranged from £160 to £900 per month, with a typical figure of around £700.

D.88 Twenty-six lenders (17 online and nine high street) operated limits for loan value to net income ratio. These generally ranged from 35 to 65 per cent, and from 35 to 40 per cent for a new customer.

D.89 All 18 high street lenders requested a wage slip and/or a bank statement to validate employment status and/or income. Eighteen online lenders verified employment status by making a discreet call to the applicant’s employer. Six online lenders required documentary evidence of income such as a scanned or faxed copy of a wage slip or bank statement. A further four lenders said they required evidence only in certain cases or left this to the discretion of staff.

D.90 Twenty-eight lenders (12 online and 16 high street) said they reviewed customers’ income and expenditure details including other credit commitments and essential outgoings. However, we have only limited evidence that this happens in practice, as only
six lenders maintained records of income versus expenditure calculations.

D.91 Nor did we see much evidence that lenders actively seek such information from customers at the application stage. Only 15 small to medium-sized lenders asked customers for details of other payday loans or credit commitments and/or other outgoings such as mortgage payments, rent and priority bills.

D.92 Twelve of these lenders (eight online and four high street) asked consumers to declare credit commitments, eight lenders (five online and three high street) asked consumers to declare other payday loans and 14 lenders (eight online and six high street) asked consumers to declare other outgoings. However, only six of these lenders – all small firms accounting in total for around 0.1 per cent of the payday market by turnover – asked consumers to declare information in all three areas.

D.93 One larger high street lender said that it was piloting an income and expenditure form in a few branches. However, this initiative did not appear to be supported by clear and consistent policies and procedures. Staff instructions were inadequate, with no guidance given to front-line staff on how to assess affordability.

D.94 Two small online lenders claimed to contact all customers on receipt of a loan application to request expenditure details in order to determine disposable income levels. However, our reviews of recent loan decisions found the forms were absent in some cases.

D.95 Sixteen high street lenders said they used bank statements to check income and expenditure, management of overdrafts and payments to other lenders, debt management companies or gambling companies. However, very few lenders required two or three sequential bank statements to be provided.

D.96 Six online lenders said they required a bank statement in order to check other credit commitments, and five of these said they also used the statement to check other expenditure.
D.97 Inspections of three major high street lenders suggested that, whilst identity and income verification checks seemed thorough, affordability checks were only of a cursory nature, and information from bank statements showing multiple payments to other payday lenders or high-cost credit providers had been overlooked.

D.98 We also found cases where lenders had issued loans to customers on the basis that their payday loan repayments to other providers were small. Staff did not appear to have considered the possibility that these could be partial repayments made as part of a repayment plan or recovered via CPA.

D.99 Affordability checks appeared to rely heavily on the knowledge and judgment of individual employees and their familiarity with the names of other lenders and debt management companies.

D.100 Twenty-two lenders appeared to use bank statements mainly, or only, to check identity for fraud purposes and to validate employment or receipt of a pension or benefits, and/or that the consumer had a bank account from which funds could be taken, but not to assess whether the borrower was likely to be able to repay the loan in a sustainable manner.

D.101 When carrying out affordability assessments, all lenders told us that they took account, to some degree, of the customer’s repayment history. However, due to poor levels of record keeping and reporting systems, some lenders were unable to provide verification of this.

D.102 Thirty-four lenders (24 online and 10 high street) conducted CRA checks. 17 lenders used one of the three main CRAs, nine lenders used one of the newer/niche CRAs and eight lenders used data from a mix of mainstream and newer CRAs. 22 lenders (18 online and four high street) reported data back to the CRAs.

D.103 Twenty-five lenders (18 online and seven high street) used a credit scorecard obtained from a CRA. Eleven lenders (nine online and two high street) used bespoke credit scoring models, incorporating varying combinations of their own lending data, CRA
data, geographic and demographic profiling data, employment
details and other information.

D.104 Larger online lenders told us that their bespoke credit scoring
models incorporated many variables, including the number of
defaults or debts showing delinquent status, the number of days a
loan was overdue and the number of credit applications.

Rollovers

D.105 Forty-four lenders (28 online and 16 high street) allowed rollovers.
Some lenders also offered partial rollovers, where the customer
had to pay down some of the principal, and/or ‘top up’ rollovers
where the capital rolled over could be topped up by taking out
further credit. Eight lenders offered ‘running-account’ agreements
which provided for ‘top-ups’ during the original agreement period
up to the customer’s internal credit limit.

D.106 We saw indicative evidence of high levels of loan rollovers and
refinancing and repeat borrowing, involving some of the larger
lenders. This included some extreme examples where loans had
been rolled over repeatedly or issued on a sequential basis,
sometimes in excess of 12 times.

D.107 In a visit to one large lender, officers found internal file notes
debating whether a customer who had rolled over 36 times should
be removed from collections and considered for a hardship plan.

D.108 One large lender operated a loyalty membership scheme with
different reward tiers dependent on the number of loans that were
successfully paid back. However, this included loans that were
rolled over. One account reviewed showed that a customer had
attained the highest membership status under the scheme by
taking out 13 sequential and rolled-over loans.

D.109 Staff in two large high street firms told us rollovers were regarded
as key ‘profit drivers’ and that staff were encouraged to treat
them as new loans rather than indicators of financial difficulties. In
one case this was written into their training manual.
D.110 We identified four lenders that applied an additional charge to roll over, typically around £10. Where lenders allowed customers to roll over a loan after they had missed a payment, practice varied, with some waiving the default fee.

D.111 Only 29 lenders stated that they limited the number of rollovers, and the average in such cases was 4.6. One lender allowed only one rollover, and a further 12 lenders limited rollovers to two or three times. 13 lenders limited rollovers to four to six times, and two lenders allowed up to 12.

D.112 Only 14 lenders (eight online and six high street) said they conducted an affordability assessment on all rollovers. One online lender required information on expenditure and performed a discreet telephone call to employers to validate continued employment. The six high street lenders asked customers to bring an up-to-date bank statement into the store.

D.113 We found a range of practices across the other lenders. Some did not conduct any assessment prior to rolling over a loan; some made periodic assessments; and some carried out an assessment only if specifically alerted to changes in the customer’s situation.

D.114 One lender stated that it always performed affordability assessments on rollovers. However, significant inconsistency of approach was identified, with staff confirming no assessment took place. In addition, template emails used by the lender did not cover the potential scenario of a rollover loan application being rejected on the basis of an affordability assessment.

D.115 We identified 17 lenders (13 online and four high street) that actively promoted rollovers in marketing material or at the point of sale, or otherwise communicated the option as a ‘feature’ of the loan. For example, informing consumers at the point of sale that they could roll over the loan later if they could not afford to repay.

D.116 An inspection officer heard one online lender calling consumers with the loan decision saying that they were ‘more than welcome to defer’ the repayment. In other examples, lenders’ websites
stated that if customers experienced difficulty repaying the loan, they could log onto the website to roll over.

D.117 We identified 15 lenders (12 online and three high street) that proactively alerted customers to the rollover option prior to the due date. Typically this took the form of a ‘reminder’ or ‘courtesy’ telephone call, email and/or text message three to five days before the loan was due to be repaid. One high street chain trained staff to consider this ‘reminder’ call as an opportunity to play down full repayment and ‘sell up’ a rollover.

D.118 A collection agent at one large online lender advised the visiting officer that rollover was in place for customers who could not afford to repay the loan, and as long as customers could find the funds to service the interest that would be the option provided.

D.119 Twenty-six lenders had no limit on the number of sequential loans a customer could take out over a year provided that they repaid the previous loan in full and on time. Two lenders insisted on a one-day breathing space between repayment and taking out a new loan, and one lender would not re-lend within seven days.

**Default and arrears**

D.120 The key focus of lenders’ collections strategies appeared to be on recovering the outstanding debt quickly and in full rather than establishing whether the customer had the ability to repay the loan either at all or in instalments.

D.121 Lenders used a range of different communication methods to contact customers including telephone calls, text, emails, letters or a combination of all four. Contact was particularly intensive in the period immediately following the repayment date.

D.122 Inspection officers were able to listen in on calls with customers. Some customers were clearly distressed as a result of being subjected to repeated and intensive contact over short periods.

D.123 We found that typically an account in arrears was escalated quite quickly to ‘bad debt’ status. Some lenders retained the debt in-
house whilst others outsourced it to a third party debt collection agency or sold the debt on to a debt purchase business. One lender passed unpaid accounts to an external debt collection agency nine days after the repayment due date.

D.124 Meaningful relationship building and collaborative working between payday lenders and the not-for-profit debt advice sector appeared to be in its infancy, and limited to a few larger lenders.

D.125 We had concerns that the sector generally was not allocating sufficient skilled resources to be able to deal with the increasing numbers of customers experiencing financial difficulties. Whilst 27 lenders had dedicated collections teams in place, only 10 had set up specialist teams trained to deal with financial hardship and other complex cases. The disparity in size between the teams was significant.

D.126 Our experience with some of the large lenders was that ‘hardship’ teams had only just been set up prior to our inspection visit. A recent new entrant was still in the planning stages of setting up such a team.

D.127 We identified two lenders that had no documented policies and procedures for handling default and arrears, and 16 lenders had severely deficient procedures. Two lenders using template business policies provided by a trade body had failed to adapt these to their own business. It was therefore difficult for inspection officers to form a view on how a lender might be likely to handle different case types.

D.128 Examples of bad practice included:

- procedures that lacked any detail on how the company would handle situations involving mental capacity issues

- high-level policies (often merely quoting OFT guidance) which lacked accompanying detailed staff guidance.

D.129 Inconsistency of approach between policies/procedures and practice was commonplace. For example, one large lender said it
would always show forbearance and accept any repayment amount offered, and the visiting officer reviewed many accounts where this had occurred. However, there was also evidence that the lender had placed restrictions on customers including that repayment plans could not exceed four months in duration.

D.130 Another large lender had introduced lower eligibility criteria for its hardship repayment plans several months prior to the inspection. However, staff in the relevant team did not recognise these changes and were still applying criteria from the previous policy.

D.131 We identified 34 lenders (24 online and 10 high street) that failed to routinely signpost borrowers in arrears or financial difficulty to not-for-profit sources of debt advice.

D.132 Fourteen lenders had employee incentive schemes designed to increase the collection of outstanding debt. For example, one large lender set staff a monthly target (and substantial cash bonus) to collect 65 to 70 per cent of the previous month’s outstanding loan book. This raises concerns that staff may overlook forbearance in favour of collection in order to meet targets.

D.133 Thirty-six lenders applied a default charge when the loan was not repaid on the due date. In 18 cases this was as high as £35. All but eight lenders charged interest on accounts in arrears.

**Forbearance**

D.134 Most lenders said they would consider negotiating alternative repayment plans, freezing or reducing interest and charges or suspending collection activity and CPA. However, it was unclear when such policies would be applied, and whether they were being applied in practice.

D.135 Generally, the larger lenders had two approaches: the standard collections cycle (typically involving CPA use) and a facility to offer forbearance or dedicated assistance to customers in serious financial difficulty. Specialist staff working in hardship teams were generally able to exercise more autonomy than collections teams.
D.136 One lender had a blanket policy of ignoring the principle of forbearance. Call scripts used by the lender included responses such as ‘your problem is not our problem’ and instructions to staff stated that ‘objections to immediate payment are just excuses’.

D.137 The main obstacle for customers wishing to discuss alternative repayment options was getting past the initial collections agent. Inspection officers commented that agents often prevented customers from speaking to the hardship team where one existed and did not actively inform consumers that they were entitled to be treated with forbearance.

D.138 Consequently, customers could be talked into committing to high repayments or unreasonably short repayment plans, which were likely to fail and place them back into collections because they were not sustainable.

D.139 Two large lenders had strict eligibility criteria for ‘hardship’ cases. These included the long-term sick or those who had been made redundant, but not consumers who were vulnerable due to problem indebtedness such as those with multiple loans or who had continuously rolled over loans. Some lenders did not treat agency or contract workers with the same forbearance.

D.140 The principle of allowing breathing space was not always observed. Lenders were not always entirely clear about the period of time during which collections activity would be suspended. One large lender gave customers four days to complete income and expenditure forms and provide evidence of redundancy or reduced hours, and two bank statements, otherwise collection activity would be resumed.

**Continuous payment authority**

D.141 Large lenders made repeated use of CPA over a period of up to 90 days from the initial due date. Multiple attempts to debit smaller amounts if the full payment was not recovered were an integral part of collection strategies.
D.142 CPAs tended to be activated automatically in the early hours of the morning. Transparency surrounding the operation of CPAs was lacking, and customers were often unaware that CPAs had been set up or their right to cancel. Whether due to poor staff training, or by design, lenders often did not respond to customer requests to stop taking payments using CPA.

D.143 Six lenders (including five online) did not have policies and procedures in place in relation to CPAs, or desk instructions or procedures for dealing with customer queries or complaints.