

# Review of high-cost credit

Final report

June 2010

OFT1232

© **Crown copyright 2010**

This publication (excluding the OFT logo) may be reproduced free of charge in any format or medium provided that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the publication specified.

# CONTENTS

<i>Chapter</i>	<i>Page</i>
Executive summary	4
1 Introduction and scope	11
2 Summary of research and analysis	17
3 Findings from the review	26
4 Conclusions and recommendations	45

## **EXECUTIVE SUMMARY**

### **Introduction**

The high-cost credit sector consists of pawnbroking, payday and other short-term small sum loans, home credit and rent-to-buy credit. This is a significant and valuable sector in the economy with loans to consumers totalling £7.5 billion in 2008.

This review was launched because of concerns that consumers of high-cost credit, including many on low incomes, suffer from a lack of options when seeking credit, that the price they pay for credit is too high, and that the recession has limited suppliers' willingness to lend money.

We have found that, in a number of respects, these markets work reasonably well. We make some recommendations for improvements to the functioning of these markets. However, to the extent that problems in these markets arise from more deep-seated issues, such as weaknesses in the financial capability of consumers, we believe that the sorts of recommendations made by the OFT will only make a limited difference. More radical approaches would be required if the Government or others wanted to tackle the wider social, economic and financial context in which high-cost credit markets exist. Addressing such issues is beyond the scope of this review and outside the OFT's remit. We have considered the case for price controls for pawnbroking, payday loans, home credit and rent-to-buy credit and have concluded that they would not be an appropriate solution to the particular problems found in these high-cost credit markets.

### **Key findings and features of high-cost credit**

The key features and characteristics of high-cost credit markets include:

- Despite limited overlaps between consumers of different high-cost credit products, they share some characteristics:
  - a need for credit and limited inclination to search for the most suitable option

- lower-than-average levels of income and financial capability, and
  - many instances of poor or no credit history.
- High-cost credit is by its nature expensive. This derives from a number of inherent elements of the products, including:
    - the low value of the loan, meaning that administration costs are higher per loan
    - high-cost business models, particularly for home credit, where a network of agents is needed to call at customers' homes to make loans and collect payments
    - the incidence of missed or late payments, and
    - the particular need in some markets to prevent fraud and to account for bad debts.

Our analysis of this sector and its features lead to two main findings:

- First, in some respects, the markets for high-cost credit work reasonably well. For example:
  - suppliers have met the demand for easier access to their products
  - they fill a gap in the market not served fully by mainstream financial suppliers
  - there is evidence with some products that lenders show forbearance with repayment difficulties and do not penalise borrowers when payments are late or missed, and
  - the level of complaints from consumers is low.

Moreover, in the absence of mainstream financial suppliers, the likely counterfactual to the existence of this sector would seem to be that significant groups of people are denied access to licensed credit in the UK.

- Second, and notwithstanding these comments, there are problems with the effectiveness of competition in these markets:
  - on the demand side, there is relatively low ability and effectiveness of consumers in driving competition between suppliers, given their low levels of financial capability
  - on the supply side, sources of additional supply such as mainstream financial suppliers seem to be limited, and
  - in such circumstances, competition on price is limited and there appear to be some suppliers charging higher prices than would be expected.

## **Remedies**

While we note that there are some deep-seated concerns in these markets, we believe that there are some incremental improvements that could be made in these markets within the current economic, financial and social context. We therefore make recommendations within four overarching themes.

### **1. Helping consumers make informed decisions on high-cost credit**

- We recommend that the Government ensures that financial literacy programmes, including but not limited to the Consumer Financial Education Body's Moneymadeclear guidance service, cover high-cost credit products as well as mainstream financial products.
- We recommend that the Government works with industry groups to provide information on high-cost credit loans to consumers through price comparison websites. If this cannot be undertaken on a voluntary basis, the Government should consider the case for introducing legislation to create a single website allowing consumers to compare the features of home credit, payday and pawnbroking loans alongside credit unions and other lenders in their local area.
- We recommend that the Government explores whether there is scope under the European Consumer Credit Directive for a requirement that high-cost credit suppliers must include 'wealth warning' statements on

advertisements for high-cost credit.

- Future legislation and regulations for consumer credit should take into account the needs, preferences, abilities and behaviour of consumers of high-cost credit as well as that for consumers of mainstream credit. We recommend that the Government considers the value of further behavioural research into such consumers when making any future legislative change in this area.

## **2. Increasing the ability for consumers to build up a documented credit history when using high-cost credit**

- We recommend that the Government works with credit reference agencies to explore ways in which payday lenders and rent-to-buy suppliers could provide suitable information to credit reference agencies about the payment performance of their customers, in turn allowing those with good payment records to use mainstream lenders more easily in the future.

## **3. Enhancing understanding of developments in the high-cost credit sector**

- We recommend that the OFT collects essential information on the high-cost credit sector, such as the volume, value and pricing of credit, levels of repeat business and default levels among customers as needed. This will help OFT understand the effect of these recommendations and provide better evidence for future policy making.

## **4. Promoting best practice among suppliers of high-cost credit**

- We recommend that the relevant trade associations for home credit suppliers, payday lenders and pawnbrokers establish a code or codes of practice covering best practice policy in a number of areas. Such a code could include:
  - complaints processes and advice to customers
  - policies on rolling over of loans

- rules of thumb on typical limits for amounts to lend to consumers
- guidance on avoiding misleading consumers through advertisements and
- steps to ensure that consumers are aware of the ultimate owners of brand names.

Implementation of the remedies above could improve the efficiency of the markets for high-cost credit in the medium term, although we note that the likely effect of these remedies in the markets will probably be small. Addressing the more deep-seated concerns would require fundamental changes in approach. In theory, these might include actions by the Government – and potentially others – such as:

- securing a step-change in financial capability in a group of the population that, typically, has lower than average final educational achievement, through, for example, a large scale adult education initiative
- effecting a cultural change in society's and individual consumers' approach to credit
- either subsidising or requiring mainstream financial suppliers to offer loans in these markets that meet consumers needs at reasonable prices, and
- effecting a substantial increase in the direct provision of credit to consumers in these markets though, for example, a much expanded version of the Government's Social Fund.

We note that such actions would have highly significant economic, financial and social consequences, which would need to be considered. Such actions would go well beyond the scope of this review, and judgements about them are outside the remit of the Office of Fair Trading (OFT). The OFT has not therefore evaluated the benefits and costs of such approaches.



## Price control remedies

The limited competition that the review has found in high-cost credit markets leads to questions about the suitability of a range of potential solutions, including price controls.

This review has considered evidence surrounding price controls for pawnbroking, payday loans, home credit and rent-to-buy credit as a solution to the concerns in these markets. We have concluded that introducing price controls would not be an appropriate solution to the particular concerns that we have identified in these high-cost credit markets.

We are aware that price controls can represent an efficient way to address concerns around high profits among suppliers and could, initially, limit the headline prices paid by consumers in the high-cost credit sector. We are, however, also aware that the strategic responses by suppliers to price controls may lead to an outcome in these high-cost credit markets which is unlikely to be of benefit for consumers.

The imposition of price controls in high-cost credit markets creates a risk for suppliers that they would generate lower profit levels. It would be reasonable to expect these suppliers to respond to the imposition of a price control by seeking to regain such lost profit by restricting the type and risk of consumers that they are willing to supply. In an extreme case of a highly restrictive price control for high-cost credit, some suppliers could cease offering a particular product or exit the market entirely.

This potential for reduced access to high-cost credit would be of concern for the following reasons:

- The supply of high-cost credit is already constrained, with many consumers having limited options and in some cases few practical, alternatives to high-cost credit (particularly in the short term).
- Many consumers using high-cost credit are using this for non-discretionary expenditure. Any reduction in access to this would have a significant impact on their ability to manage their finances effectively.

We also consider that the development of a system of price controls for high-cost credit in the UK would be complex, expensive and difficult to administer for the following reasons:

- There are a number of different high-cost credit products available at different prices with different costs based on the product characteristics and target consumers. Imposing price controls would be difficult in these markets, as detailed investigations of the pricing and profits of suppliers would be needed at a product-by-product level.
- The imposition of price controls may lead to suppliers of high-cost credit responding by imposing a more stringent regime for late payments and default. We would be concerned with such an outcome, as these charges are not always transparent to even the most savvy of consumers. The low incomes of many consumers of high-cost credit would also increase the concerns around the impact of such changes if they were to occur.
- Circumvention of price controls is a relatively common problem for jurisdictions that already have a form of price control, and is likely to be the case for high-cost credit. While designing a sophisticated price control with substantial resources devoted to monitoring compliance could reduce the instances of known circumvention, the need for different controls for the range of high-cost credit products would make the possibilities for circumvention difficult to eradicate and manage on a proportionate basis.

# 1 INTRODUCTION AND SCOPE

- 1.1 This is the final report of the review of high-cost credit. The review was launched in July 2009, following a consultation during April 2009 on the scope of a review by the OFT of unsecured consumer credit.
- 1.2 An interim research report was published in December 2009, containing some of the evidence available to the team at that time.
- 1.3 This report presents further primary research undertaken by the review, including:
- the results of a behavioural economics experiment, which examined consumers' understanding of credit products and the information that they use in making decisions
  - further results from surveys of consumers, and
  - an assessment of suppliers, including their business models, profitability and the extent of competition in the sector.
- 1.4 The review team has met with and received information, research and submissions from a wide variety of stakeholders in this sector which have added significantly to the body of evidence on which the conclusions of this report are based. We are very grateful to all the stakeholders that have provided the OFT with their assistance and co-operation throughout the review.
- 1.5 This report also contains analysis and the key issues and findings across all the evidence obtained. This report also provides our conclusions and recommendations for changes to this sector.

## **This report**

- 1.6 The remainder of this report is structured as follows:

- Chapter 2 provides a summary of the further research and analysis conducted in the review which complements the evidence published in the interim research report.
- Chapter 3 identifies the key issues and findings relevant to the review which arise from the research undertaken and evidence submitted to the review.
- Chapter 4 provides the conclusions and recommendations which arise from the review.

## **Annexes**

1.7 There are five annexes to this report which are the following:

- Annexe A: Consumer decision, information and understanding – a behavioural economics perspective
- Annexe B: Price controls – evidence and arguments surrounding price controls and interest rate caps for high-cost credit
- Annexe C: Supplementary analysis from the OFT's consumer survey and other sources of data
- Annexe D: Theories of harm and consumer detriment
- Annexe E: Competition and profitability – detailed analysis.

## **Scope of the review**

### **Markets under consideration**

1.8 The aim of this review has been to establish whether high-cost credit markets are working well for consumers, focusing on the following four areas:

- the level of competition, including the impact of the economic downturn on competition and whether suppliers compete vigorously to deliver benefits for consumers
- the business models of lenders within the sector
- the behaviour and decisions made by consumers when purchasing credit, and
- whether consumers get the information that they need to make good decisions.

1.9 As we noted in our interim research report, there is no formal and accepted definition of the term 'high-cost credit'. Our research has covered a number of different products, and we have concluded that there is no single economic market for high-cost credit. Rather we have found that markets for high-cost credit include the following products:

- home credit
- short-term small-sum lending including payday loans
- pawnbroking, and
- rent-to-buy retail credit.

1.10 There are some overlaps with some more mainstream financial products, most obviously current account overdrafts. Annexe E to this report provides detailed analysis of the relevant markets, different products and overlaps with mainstream financial products. In addition to the four products above, we have also analysed credit unions, as some customers of high-cost credit have been able to use credit unions. We note that lending from credit unions is not a form of high-cost credit.

## **Issues outside the scope of the review**

1.11 Some of the issues and concerns raised by a number of stakeholders in relation to high-cost credit demonstrate that this sector is closely linked with a number of other important issues. These include:

- access to high-cost credit
- financial exclusion
- low incomes, and
- social policy and public provision.

1.12 These issues are discussed briefly below.

### **Access to high-cost credit**

1.13 Some stakeholders have raised questions about whether it is appropriate for certain groups of consumers to have access to credit. It is not for the OFT to control the supply of credit or access to credit across the sector. Our role is to address behaviour on the part of businesses that harms or may harm consumers. This means that we can address the supply of credit which is irresponsible because of the circumstances in which credit is provided. We cannot determine who is entitled to have access.

### **Financial exclusion**

1.14 There are some consumers in the UK that do not have any access to financial services, or have only very limited access to a small number of financial services. For these consumers, high-cost credit can sometimes represent the only form of borrowing available to them.

1.15 This review is concerned with whether the markets for high-cost credit are working well for the consumers that they serve, rather than seeking explicitly to make them available to a wider range of consumers.

- 1.16 A number of stakeholders have stated that mainstream financial institutions are not involved in the provision of high-cost credit and envisage that expanding the consumers served by mainstream financial institutions would be beneficial.
- 1.17 We have undertaken an assessment of competition for high-cost credit, details of which are in Annexe E. While the OFT often favours an increased number of suppliers within markets, due to the additional competitive constraint this would place on the incumbent suppliers, it is beyond the remit of the OFT to apply pressure on specific organisations to extend the range of consumers that they serve.
- 1.18 While not a matter for this review, the Financial Inclusion Taskforce has a key role in this area. This Taskforce is an independent body appointed by HM Treasury to monitor and influence progress towards the Government's goal that people should be able to manage their money on a day-to-day basis, effectively, securely and confidently.<sup>1</sup>

### **Low incomes**

- 1.19 Many consumers using high-cost credit have low incomes relative to average levels in the UK. In addition, many consumers have limited access to mainstream financial services such as current account overdrafts and credit cards. We are aware that a significant proportion of users of high-cost credit use this to pay regular bills and expenses that their income level is not sufficient to meet.
- 1.20 This review is considering whether the markets for high-cost credit work well for consumers, including whether profits earned by suppliers are reasonable. While some of the recommendations in this report may reduce the cost of credit for some consumers, which would be particularly beneficial for those with lower incomes, it is not part of the OFT's remit to address the issue of low incomes or poverty.

---

<sup>1</sup> Terms of Reference for the Financial Inclusion Taskforce on HM Treasury website: [www.hm-treasury.gov.uk/fit\\_terms.htm](http://www.hm-treasury.gov.uk/fit_terms.htm)

## **Social policy and public provision**

- 1.21 This review has also not sought to make recommendations for changes to social policy and the level of public provision in this sector. This is because it is not the role of this review to determine the nature and extent of a future role for the Government in this sector.



## **2 SUMMARY OF RESEARCH AND ANALYSIS**

### **Introduction**

- 2.1 This chapter provides a summary of the research and analysis undertaken as part of the review of high-cost credit. Details of this analysis can be found in Annexes A to E and the interim research report.
- 2.2 This chapter includes a summary of the markets for high-cost credit including:
- the extent of substitutability between the different products analysed
  - the nature and extent of competition in these markets
  - the pricing practices undertaken and the profitability of suppliers
  - the key characteristics of consumers of high-cost credit and the implications of their behaviour, and
  - price controls for high-cost credit.

### **Markets for high-cost credit**

- 2.3 High-cost credit products are typically small loans borrowed over short periods. The price of such loans expressed as an absolute amount is often proportionate to the costs, but the annual percentage rate (APR) is often high because of the short term nature of the loan and the high relative cost of the loan compared to its value. As noted in Chapter 1, we have found that markets for high-cost credit include the following products:
- home credit
  - short-term small sum lending such as payday loans
  - pawnbroking, and
  - rent-to-buy retail credit.

2.4 We have found that the high-cost credit products that are the focus of this review represent distinct product markets.

### **Substitutability between high-cost credit products**

2.5 There appears to be little substitutability on the demand side between payday lending, pawnbroking and home credit, because of:

- different lending criteria by lenders, which result in different demographics for borrowers of different products, and
- different inherent characteristics of the products, such as the length of the loan period, which limit the choice of products for different groups of consumers, because of affordability constraints.

2.6 On the supply side, substitutability opportunities appear to be limited, since different products require different business models and skills. As a result, most suppliers specialise in offering one product. The most notable exception is the joint provision of payday lending and pawnbroking, which are frequently offered by the same suppliers who take advantage of economies of scope by better utilising their high-street premises to attract a broader range of customers.

2.7 We also investigated whether online provision of a specialist high-cost credit product constitutes a separate market from the in-store lending on the high street of the same product. We consider this issue in detail in Annexe E.

2.8 For the above reasons, we consider that each of the specialist high-cost products within the scope of the review constitutes a separate economic market.

### **Substitutability between mainstream and high-cost credit**

2.9 Due to the small relative size of the high-cost credit sector, the competitive constraint which it can exercise on mainstream markets is likely to be insignificant.

- 2.10 The extent to which mainstream lenders constrain high-cost credit lenders is unclear, not least because some users of high-cost credit will have been rejected by mainstream lenders as unsuitable, or have low limits placed on credit which is made available.
- 2.11 The extent of overlaps between customers of different high-cost credit products and mainstream financial products varies, and is most clear for payday lending. The mainstream products available to at least some payday borrowers can include overdrafts and credit cards. Customers of payday loans often take them out in preference to unarranged overdrafts which can be more expensive (but where the APR is not often publicised). Indeed, many lenders compare their payday loans with unarranged overdraft charges. Further analysis of this issue is provided in Annexe E.

## **Competition analysis**

### **Payday lending**

- 2.12 While the rates charged by payday lenders are high, they can be lower than for some mainstream alternatives such as unarranged overdrafts.
- 2.13 Price does not seem to be a primary driver of competition, with suppliers attracting customers with the convenience and speed of the application process. An increasing number of suppliers are operating in the market and appear to compete with each other with different means to attract the growing demand. However, consumers do not seem to drive competition since they do not usually shop around for the best price.
- 2.14 We are concerned by the confusion that brand proliferation is likely to be causing, in preventing consumers that do shop around from doing so effectively.

## **Pawnbroking**

- 2.15 The number of pawnbrokers across the country, the likely low level of barriers to entry (especially for established jewellers) and the low level of concentration suggest that this is a reasonably competitive market.
- 2.16 Competition on price appears mostly absent however, with customer service being the most relevant driver of competition. Protecting brand reputation and establishing trust with consumers are important competitive factors.

## **Home credit**

- 2.17 The market for home credit is highly concentrated, with one large supplier in the market. This market structure, combined with the lack of price competition, the presence of barriers to entry and expansion (in the form of the need for a network of agents, costs of business acquisition, importance of personal relationship with the agent and word of mouth advertising) imply that competition is limited and not very effective in this market.

## **Credit unions**

- 2.18 At present the effectiveness of credit unions is limited by their number and scale of activities, which prevents them from enjoying economies of scale and improving their services, for example, by offering extended opening hours.

## **Retail credit**

- 2.19 Retailers offering credit often advertise these facilities as 'interest-free' or at a relatively low APR but this can be misleading since it does not take into account that the bundled price may already include a premium (compared to other high-street prices). The possibility for suppliers to allocate the cost of credit either (implicitly) to the retail price or (explicitly) to the APR figure may lead consumers to make a suboptimal choice, if they focus on the explicit cost of credit offered.

- 2.20 This is particularly a risk for customers with high search costs, low levels of financial literacy, who are not aware of cheaper alternatives or who struggle to compare offers with different pricing structures.

## **Consumers of high-cost credit**

### **Consumer characteristics**

- 2.21 The consumers of high-cost credit are difficult to characterise, as they include a variety of different demographic groups which vary by product, and each product has a variety of different types of user. However, it is possible to draw some conclusions.
- 2.22 In many cases, consumers of high-cost credit have lower than average incomes. There are instances of lower levels of final educational achievement and lower social classes among consumers of home credit, with many home credit consumers noting that they would find it difficult to find a small amount of money without increased borrowing.
- 2.23 There is more variation in the customers of payday lending, and little overlap between these and customers of home credit. Payday lending customers are employed, with a typical customer being male, earning more than £1,000 monthly and living in rented accommodation. They are often unmarried and have no children.
- 2.24 A typical customer for pawnbroking was described by Collard and Kempson,<sup>2</sup> and corroborated by some research by suppliers as being a woman in her twenties or thirties, with children, and in low paid work or unemployed and receiving benefits. There is anecdotal evidence that customers typically pawn and redeem the same item on more than one occasion.

---

<sup>2</sup> Collard and Kempson, Pawnbrokers and their customers, University of Bristol, 2003.

## Implications from consumer behaviour

2.25 We have found from our behavioural experiment that there are a number of factors that affect consumers' abilities to make good decisions about high-cost credit, including the following:

- the simplicity of presentation of material generally, and specifically in relation to cost, such as the total repayment amount rather than an APR assists consumers
- the presentation or framing of the information presented to consumers is key to their understanding, with consumers being sensitive to font sizes and layout and whether information is presented in a table or an advertisement
- previous purchase experience makes consumers more likely to purchase high-cost credit again
- consumers are affected more by negative than positive media stories about suppliers, and
- comparability of and referencing information was important to good decisions.

2.26 We are aware that in practice there are a number of characteristics and behaviours exhibited by consumers of high-cost credit that imply they are not effective in driving competition among suppliers. For instance:

- having a lower than average income
- having lower than average educational backgrounds – and worse than average financial capability in at least some respects
- having poor or damaged credit ratings in many cases, or no credit history in other cases, and
- many consumers not being aware of the options open to them and the limited availability of advice.

- 2.27 The behavioural traits of consumers include:
- tending not to shop around when considering loan agreements
  - valuing the speed with which a loan can be arranged
  - focusing on the weekly or monthly repayment rather than the total cost of a loan, and
  - often valuing the flexibility offered by products that allow repayments to be missed.
- 2.28 These issues are examined in more detail in Annexes A and C, as well as in the interim research report.

### **Price controls**

- 2.29 This section summarises the nature of the arguments in relation to price controls and high-cost credit. Further details in relation to these arguments can be found in Annexe B, while details of international approaches to this issue can be found in the interim research report.

### **Arguments about price controls**

- 2.30 The arguments about price control can be split into a number of different issues, which are summarised as the following:
- **Protection from usury and exploitation:** This issue looks at whether price controls provide access to credit at reasonable cost, or whether they reduce access to credit as lenders limit access to their products in response.
  - **The use of APR as a measure:** Some have argued that price controls are necessary to address the high APRs which are charged for short-term small sum loans. Others note that the APR is a misleading way of measuring the cost of short-term lending. However, there is some agreement that the APR is not the most suitable method to use to control prices of credit.

- **The true cost of lending:** This issue relates to the debate on whether the charges from suppliers of high-cost credit reflect accurately the costs of lending, or whether these are inflated beyond this level.
- **Legitimising payday lending:** In some countries, including parts of Canada, the adoption of price controls has been opposed on the grounds that this legitimises high-cost products which some in Canada have argued should be criminalised.
- **Protecting the public interest:** Arguments on this point have focused on whether it is in the public interest that consumers with impaired credit histories continue to have access to credit whatever the cost.
- **Competition and regulatory intervention:** The debate around whether price controls are necessary has often included arguments that these are more difficult to justify in well-functioning markets and easier to justify in markets where a significant market failure exists.
- **Unintended consequences:** Some opponents of price controls have argued that these lead to a number of unintended and negative consequences. Price controls can be seen as over-inclusive as not all high-cost credit is damaging for consumers. However, some consumers underestimate the effects and risks of using high-cost credit.
- **Circumvention and enforcement:** Arguments about the possibilities and scope for circumvention are significant, but depend on the nature of the price control and specific context.
- **Over-generalising arguments:** This covers the breadth of applicability of arguments on both sides of the debate to the different types of price controls.



- **Practical matters:** This covers arguments over the necessity for legislation, the level at which a price control could be set and the implications for this on its effectiveness.
- **Interface with other remedies:** Both sides of the debate on price controls note that the debate should take place in the context of a wider debate on other remedies and policies in relation to high-cost credit. Proponents of price controls have argued that these are complementary to other policies, while opponents have argued that price controls are substitutes for other policies in this area.

## Summary

2.31 This chapter has drawn together the key elements of the research conducted within the review of high-cost credit. This has included our analysis of competition within the various high-cost credit markets, as well as research on the consumers of high-cost credit, their characteristics and behaviour. We have also summarised the extensive arguments in relation to price controls in this sector.

### **3 FINDINGS FROM THE REVIEW**

#### **Introduction**

- 3.1 This chapter provides details of the findings from the review. These are presented together with a summary of the key evidence that supports the findings.
- 3.2 This is followed by a summary of the applicability of the findings and the overlaps between high-cost and mainstream credit, and details of other work taking place in this area.
- 3.3 We also present a summary analysis of the scale of potential detriment in this sector from some of the practices found.
- 3.4 This is followed by a summary of the Competition Commission's investigation into home credit and the remedies put in place following this investigation.

#### **In some respects these markets work reasonably well**

- 3.5 There are a number of factors in relation to these markets that underpin the finding that, in some respects, these markets can be seen to be working reasonably well:
- suppliers have met the demand for easier access to their products
  - they fill a gap in the market not fully served by mainstream financial suppliers
  - there is evidence with some products that lenders show forbearance with repayment difficulties and do not penalise borrowers when payments are late or missed, and
  - the level of complaints from consumers is low.
- 3.6 Moreover, in the absence of mainstream financial suppliers, the likely counterfactual to the existence of this sector would be that significant

groups of people are denied access to legitimate and licensed credit in the UK.

### **The OFT has some concerns in relation to these markets arising from this review**

- 3.7 While we consider that these markets are operating reasonably well in some respects, we do have some concerns with the effectiveness of competition in these markets that have arisen from this review:
- on the demand side, there is relatively low ability and effectiveness of consumers in driving competition between suppliers, given their low levels of financial capability
  - on the supply side, sources of additional supply such as mainstream financial suppliers seem to be limited, and
  - in such circumstances, competition on price is limited and there appear to be some suppliers charging higher prices than would be expected.
- 3.8 These findings are explored in more detail in the following section with a summary of the evidence in support of these findings.

#### **Demand side concerns**

Many consumers are not aware of the options open to them and the limited availability of advice

- 3.9 This finding arises from our survey and behavioural experiment, which examined the issue of consumer awareness of products. This showed that awareness of home credit and payday loans was lower than that for pawnbroking. This is likely to reflect the longer time period over which pawnbroking has been available in the UK, compared to the more recent developments such as payday lending.

- 3.10 Due to the different ways in which this issue was examined in the separate research projects, there are some differences in the absolute levels of awareness. Despite this, it is clear that there are a significant group of consumers unaware of a number of high-cost credit products.
- 3.11 In relation to the finding on advice above, much of the advice available is focused on consumers that are experiencing difficulty with existing debt, rather than for consumers considering taking out high-cost credit. Due to the small size of many high-cost loans, it is not proportionate to seek advice through normal channels used for larger loans and investments, as the cost of this will often be similar to the size of the loan. This is borne out by the fact that less than four per cent of users of high-cost credit from our survey used professional advice as part of their decision-making process.<sup>3</sup>
- 3.12 There are a number of sources of advice on the internet, although these are disparate and offer varying coverage of high-cost credit. In addition, a number of consumers of high-cost credit will have limited or no access to the internet. Our survey showed that seven per cent of users of home credit used the internet as a source of information, while the figure was 18 per cent for credit card users repaying part of their balance.<sup>4</sup>

Consumers do not typically spend much time or effort looking for different suppliers or products.

- 3.13 The above finding arises principally from the OFT's consumer survey. This showed that 62 per cent of high-cost credit users surveyed did not consider any other options when taking out their credit agreement. Only 15 per cent said they actually considered and investigated alternatives.<sup>5</sup>

---

<sup>3</sup> See table 4.15 from Annexe A from the Interim Research Report on high-cost credit.

<sup>4</sup> Ibid.

<sup>5</sup> See Annexe A from the Interim Research Report on high-cost credit, p41.

3.14 20 per cent of high-cost credit users in the survey said they took less than a few days to decide which type of credit to use and only 12 per cent took more than a month to decide.<sup>6</sup>

Many consumers make decisions quickly and value the availability of funds and speed of arrangement from suppliers, rather than focusing on the cost of credit.

3.15 The above finding arises from consumer research in this area. 43 per cent of high-cost credit consumers surveyed by the OFT said that speed of arrangement was a reason they chose their credit product. This was more important than other key factors such as low interest rates (25 per cent) and affordable repayments (24 per cent).<sup>7</sup>

Some consumers purchase high-cost credit based on the short-term affordability or size of repayments, without considering the long term costs or total repayment amount.

3.16 The above finding relates to the OFT's consumer survey. In this, respondents were asked to assume that they needed to take out a loan of £250 and state which of the loans features/costs were most important to them. Overall, the APR emerged as the most important aspect with 41 per cent of respondents choosing that ahead of other factors such as the total or monthly repayments. However, for those respondents in the lowest income group (less than £6500 p.a.), the monthly repayment amount was more important than the APR – 39 per cent of respondents rated monthly repayments as the most important factor while 25 per cent chose the APR.<sup>8</sup>

---

<sup>6</sup> Ibid, p37.

<sup>7</sup> See Annexe A from the Interim Research Report on high-cost credit, p42.

<sup>8</sup> See Annexe A from the Interim Research Report on high-cost credit, p24-25.

Consumers of high-cost credit have lower levels of financial literacy than users of mainstream financial products.

- 3.17 The above finding relates to the OFT's behavioural experiment (described in Annexe A). This indicated that high-cost credit users are less financially literate than mainstream credit users. The participants were asked a range of general financial questions<sup>9</sup> and users of high-cost credit answered fewer questions correctly than mainstream credit users or those that did not use credit at all.<sup>10</sup>
- 3.18 When the experiment's participants were asked to interpret information from a test advertisement for a credit product<sup>11</sup> the level of understanding of the test product was high. However where a calculation was required to derive a value (such as average weekly interest cost) consumers that used a greater number of high-cost products performed poorly relative to mainstream users.<sup>12 13</sup>
- 3.19 The OFT's consumer survey, also provides further evidence of this as a greater percentage of those earning under £6500 per year agreed that

---

<sup>9</sup> For the list of questions asked see p13 of Annexe A to this report.

<sup>10</sup> Ibid, p13-14.

<sup>11</sup> See Annexe A, specifically Chapter 6, for a more detailed account of the experiments results on product understanding.

<sup>12</sup> See Annexe A p20.

<sup>13</sup> Through regression analysis, the experiment further showed that a key driver of financial understanding was the frequency of credit product use. That is, the more a consumer used high-cost credit products the lower their financial literacy level. Interestingly, the opposite was true of mainstream credit use – the more mainstream credit products a consumer used the higher their financial literacy level was likely to be.

they generally find loans and credit agreements' complex and confusing.<sup>14</sup>

- 3.20 The OFT's consumer survey also showed that fewer than two per cent of respondents that used home credit held a degree or higher qualification, while over 60 per cent had no formal qualifications or held only GCSE level qualifications.<sup>15</sup>

Many consumers find APRs a confusing measure of cost and find the total repayment amount a simpler and more understandable measure.

- 3.21 The above finding arises from discussions with stakeholders and from the OFT's behavioural experiment. In the experiment, participants' understanding of loan information was tested. Participants were presented with a hypothetical loan and those administering the experiment were able to vary the cost information presented to each participant to determine which information was most useful. Overall, consumers' understanding of a loan was highest when they were presented with the total repayment amount. The APR also improved understanding but only half as much as the total repayment figure.<sup>16</sup>
- 3.22 This finding is linked with that of consumers not considering the long term costs or total repayment amount (see page 29). The lack of understanding of measures of long-term cost is one reason why this is not considered by some consumers.

---

<sup>14</sup> See Annexe A from the Interim Research Report on high-cost credit, p55.

<sup>15</sup> See Annexe C.

<sup>16</sup> See Annexe A, p20.

## Supply side concerns

None of the mainstream financial suppliers provides high-cost credit in the form of home credit, payday loans, pawnbroking or rent-to-buy products directly to consumers.

- 3.23 The above finding arises from our research on the recession and suppliers business models in the review. We are aware that many mainstream financial products are not well suited to the needs of consumers of high-cost credit, and therefore there would be costs for mainstream suppliers in adapting their products to suit customers of high-cost credit.
- 3.24 High-cost credit markets are not new. If these markets were attractive to mainstream financial suppliers, it would be reasonable to expect that at least one would already have attempted direct entry.
- 3.25 The OFT contacted a range of high-cost credit suppliers about their business models and financing. Many suppliers relied on loans or lines of credit from mainstream financial suppliers to lend to consumers.<sup>17</sup> Despite providing wholesale funding for high-cost credit suppliers, mainstream suppliers appear unwilling to provide high-cost credit products directly to consumers.
- 3.26 It may be more profitable and pose less risk for mainstream financial suppliers to supply funds in this indirect way, as they are less exposed to the risk of default, and their brand is not being linked explicitly to high-cost credit products.

There have been few significant entrants to these markets recently.

---

<sup>17</sup> More information on high-cost credit supplier business models and the wholesale credit market is available in the interim research report (chapter 4), published by the OFT in December 2009.



3.27 The above finding arises from our competition analysis and contact with stakeholders in the high-cost credit sector. This finding applies to both home credit and pawnbroking. Both of these markets have a large number of small, local suppliers. Entry on a small scale is possible within these margins. However, no new entrant to either market has had sufficient scale to challenge the supremacy of the main suppliers and affect their prices (and thus the price paid by most customers) recently.<sup>18</sup>

3.28 Developments in the short-term small sum or payday loan sector, however, run counter to this trend. New significant entrants have entered or are looking to enter the UK. In many cases these are US companies seeking international expansion.<sup>19</sup>

Some payday loan suppliers own a number of different brands where the ultimate parent company is not always clear, and this can reduce the ability for consumers to gain the benefits from shopping around.

3.29 In addition to the above finding, we are aware that there are a number of lead generator websites for high-cost credit and payday loans in particular. The presence of these and the variety of different brands can make the market appear more competitive than it is in practice. This may be magnified by the difficulties in comparing prices for credit products, as many suppliers only provide pricing details once an application form has been completed.

3.30 While we are aware that consumers are not particularly active in shopping around for different suppliers, it is concerning if those consumers that do consider alternative suppliers do not know whether those they compare are owned by different parent companies or not.

---

<sup>18</sup> See Annexe E for details.

<sup>19</sup> Ibid.

## Pricing concerns

Competition on price appears mostly absent for pawnbroking and home credit, while there is limited price competition for payday loans.

- 3.31 In these markets, where suppliers are of different sizes and have different business models, competitive pricing with prices equal to marginal costs may be expected to lead to a variety of prices present in the markets.
- 3.32 In these markets we have found little variation in pricing between suppliers. We found that the price of borrowing £100 from the pawnbrokers we contacted varied by around £1 and that suppliers of home credit offered near identical products.<sup>20</sup>
- 3.33 The price differential for borrowing £100 from online payday lenders also appeared to be low. However, there appears to be some competition between high street payday lenders with the price of borrowing £100 varying up to £8.<sup>21</sup>
- 3.34 These findings are indicative of limited competition, with consumers not driving competition on price among suppliers.

Some of the incumbent suppliers of high-cost credit appear to be earning high profits.

- 3.35 The above finding is the result of our analysis of competition and profitability among suppliers in the high-cost credit sector. While there may be several other sectors in the economy where profits are high, in this case, given the limited number of suppliers and the lack of significant sustained entry in many markets, continued high profits show

---

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

that some consumers are paying an unduly high price for high-cost credit.

- 3.36 We have undertaken a limited assessment of profitability of some suppliers of high-cost credit. This can provide at best an indication as to whether the profit levels among providers of each type of high-cost credit are higher than might be expected in a competitive market.
- 3.37 We have found some evidence that levels of profit among pawn-brokers and providers of home credit are higher than those that might be expected in a competitive market. However, due to the small size of our sample in both cases, this conclusion can only be very tentative. Profit levels among payday lenders are more variable: some established providers appear to be making relatively high profits, but there is evidence of losses among new entrants. In the retail credit market, the majority of firms appear to be making returns on the credit they offer below those that might be expected in a competitive market. This result appears to support the view that firms providing both goods and credit may recover some of the cost of providing credit through increased levels of retail prices for the goods sold.

### **Mainstream and high-cost credit**

- 3.38 While this review has undertaken a relatively broad examination of products in the credit sector, as evidenced through the interim research report published in December 2009, the findings in the review relate to a narrower group of high-cost credit products and to specialist suppliers. It may appear to some commentators that the findings of this review should have more broad applicability. We consider that mainstream credit markets operate in different ways to those for high-cost credit, with both a wider range of consumers and mainstream suppliers. Consequently, while there are some overlaps between mainstream and high-cost credit, we consider these to be limited. We consider that the findings reached in relation to high-cost credit do not therefore have wider applicability due to the different nature of these markets.

3.39 Despite the limits of our findings, we do note below two areas where there is some overlap between mainstream and high-cost credit. These are where there is some evidence of co-use of mainstream and high-cost credit, and instances where mainstream products can be high-cost in their effect.

### **Co-use of products**

3.40 Consumers that use high-cost credit could split into the following categories in relation to their use of mainstream credit:

- consumers that have concurrent access to both high-cost and mainstream credit and choose to use both
- consumers that have access to mainstream credit, but do not like the products available, or the risk of significant debt that is posed by the amounts of credit available
- consumers that previously had access to mainstream credit and have either exhausted their mainstream access or no longer qualify for mainstream credit, and
- consumers that have no access to mainstream credit through either a poor or absent credit history.

3.41 In this review, we are most concerned by consumers that have limited options for using mainstream credit, either through their own choice, or through constraints on lenders' willingness to lend to them.

3.42 The products where the scope for overlap is most significant include current account overdrafts and credit cards. We are aware that there are a number of users of high-cost credit, particularly but not exclusively payday lending, that have also used overdrafts and credit cards. There are however fewer consumers that are able to choose between these products at a single point in time. More consumers that are able to use this range of products over an extended period of a number of years, as their incomes and credit ratings change over time. Moreover, while some consumers hold credit cards and have overdrafts, these may be

sufficiently close to the imposed limit that further borrowing on them is not possible. The detailed elements of access to products is difficult to analyse from research in this area.

### **When mainstream products become high-cost in effect**

- 3.43 We are aware that in some cases, the use of mainstream credit products in certain ways will give rise to a cost to consumers similar to that of some high-cost credit products. One example of this would be a mainstream credit card. Using this and repaying quickly creates a relatively low cost for the credit obtained. However, where the consumer builds up debt and is unable to afford significant repayments, and therefore repays the debt on the basis of the minimum repayment amount this can make a mainstream credit card more expensive. When this extended repayment time is combined with a typical level of missed payments and related charges, the total cost can be similar to that for a home credit loan.

### **Focus of our review**

- 3.44 While we are aware that, for some customers of high-cost credit, there are a wider set of options available, our concerns lie with the significant group of consumers who have a more limited set of options, and who are limited in some cases to using specialist suppliers of high-cost credit.
- 3.45 Those consumers that have a wider set of options will be likely to be more easily able to drive competition among suppliers in mainstream credit markets.

## Other work relevant to high-cost credit

- 3.46 We are aware of a need to avoid this review overlapping with the OFT's work on personal current accounts and overdrafts<sup>22</sup> and the OFT's recent work on developing guidance on irresponsible lending.<sup>23</sup>
- 3.47 In addition we are aware of wider work in this area, including the recently published outcome of the BIS credit and store card review,<sup>24</sup> the follow-up to the BIS consultation on Post Office Banking<sup>25</sup> and the Department for Work and Pension's proposals for reform of the Social Fund.<sup>26</sup>
- 3.48 As a result of these and other activities, we have sought to ensure that this review does not overlap with the other initiatives underway.

## Analysis of detriment in high-cost credit

- 3.49 In this section, we summarise our analysis of the scale of potential consumer detriment from high prices in the high-cost credit sector. Further information can be found in Annexe D.
- 3.50 In assessing the level of consumer detriment, we first considered how much money (in aggregate) consumers could save if they all used the best available product that was appropriate for their needs. Second, we

---

<sup>22</sup> Further details can be found on the OFT's website ([www.offt.gov.uk](http://www.offt.gov.uk)) in relation to the market study on personal current accounts.

<sup>23</sup> This was published on 31 March 2010 and is available on the OFT website.

<sup>24</sup> A Better Deal for Consumers: Review of the Regulation of Credit and Store Cards: Government Response to Consultation, March 2010.

<sup>25</sup> Department for Business, Innovation and Skills (BIS), Post Office Banking: Government Response to Consultation, March 2010, [www.bis.gov.uk/postofficebanking](http://www.bis.gov.uk/postofficebanking)

<sup>26</sup> Social Fund Reform: Debt, Credit and Low-Income Households, Cm 7750.

considered the situation where competition among lenders was driving prices lower than current levels.

### **Picking the best deal**

- 3.51 To work out the savings achievable from consumers picking the best deal, we analysed products in the pawnbroking, payday lending and home collected credit markets. We created a database of a sample of these products available in the market in 2008 and, for each product, calculated the total amount that consumers would have to pay over the lifetime of the loan.<sup>27</sup> We constructed a counterfactual scenario by picking what we considered to be the best deal available (lowest cost loan) and calculated the potential savings if all consumers had chosen the best deal available, or if suppliers had all offered the same low price.<sup>28</sup>
- 3.52 The comparison of actual data with the counterfactual data provided us with an indication of the potential savings that consumers could have made by choosing the best deal price, and thus of the potential benefits from remedies aimed at improving consumer awareness and attitudes towards switching products. We found that consumers could have saved around £120 million<sup>29</sup> in 2008 by choosing the best deal price. This amounted to about five per cent of total repayments made by consumers for loans issued in 2008. Once scaled up to account for the size of the

---

<sup>27</sup> See Annexe D.

<sup>28</sup> For this counterfactual to be meaningful, it was necessary that the benchmark/best deal product was widely available to the majority of consumers. Hence, we decided that only products that had a reasonable take-up (for example, at least 10 per cent of the sample by value of loans issued) could qualify as a minimum APR deal.

<sup>29</sup> The figures for total potential savings were around £80,000 for pawnbroking: around £21 million for payday lending, and around £99 million for home credit, making an overall total of around £120 million.

market relative to our sample, this produced a figure of around £150 million.<sup>30</sup>

### **Greater price competition**

- 3.53 To ascertain the potential benefits from more price competition, we introduced the notion of a fictional new product that undercut existing suppliers. We assumed that this new product was the same as the existing best deal in all respects except being priced at five per cent lower price than the existing best deal.<sup>31</sup> Using our data on loans for 2008, and scaling this figure up according to the estimated size of the market, we estimated that a five per cent lower price increased our estimate of achievable savings to around £190 million.

### **Limitations of this analysis**

- 3.54 The analysis above represents at best a partial analysis of the theoretical detriment that might be seen in the sector. This assumes that the best available deal, or a more competitive deal, would be available to all consumers in that particular market. This does not consider the potential response from suppliers, and whether wholesale funds are available to support loans at such cost to all consumers in these markets. Consequently, the figures of savings of £150 and £190 million can be seen as the maximum theoretical amounts that consumers might be able to save in these markets. It is likely that the correct figures for this detriment lie between zero and the above figures, although it is not possible within this analysis to determine where within that range the level of detriment is more likely to lie. It is not possible with the data

---

<sup>30</sup> These figures represent at best a partial analysis of the theoretical detriment which may exist in this sector. See paragraph 3.55 below for details.

<sup>31</sup> We did this to take account of the cellophane fallacy. This cellophane fallacy notes that undercutting prices on the best deals that currently exist in the market might not take account of the possibility that these prices could have started at artificially high levels.



available within this review to be more precise about the scale of detriment taking place in practice.

## **The Competition Commission's remedies in its Home Credit inquiry**

### **Genesis of the inquiry**

3.55 The OFT made a market investigation reference of the home credit market to the CC in December 2004. This followed consideration of a super-complaint made by the National Consumer Council<sup>32</sup> pursuant to section 11 of the Enterprise Act 2002, and a subsequent consultation by the OFT. This work led the OFT to conclude that competition among home credit lenders was restricted, with lenders having limited incentives to compete on price or to attempt to win business by taking over other lenders' loans.

### **Main findings**

- 3.56 The main findings from the CC's investigation included the following:
- Assessing the price of a home credit loan was complicated by the absence of a single measure of price and by the weakness of the APR as a measure of price for home credit loans.
  - Prices paid by customers who repaid their loans early were high.
  - Profits have been persistently and substantially in excess of the cost of capital for suppliers that represented a substantial part of the market.
  - There were modest levels of switching between lenders, and little variation in market shares over time.
  - Customers were generally satisfied with the service they received.

---

<sup>32</sup> The National Consumer Council (NCC) is now part of Consumer Focus

- There was no evidence that any alternative credit products were good substitutes for home credit.
- While there were few barriers to small-scale entry to home credit, there were significant barriers to large-scale entry or expansion.
- Neither competition on availability nor any other form of competition between lenders could compensate for the weakness of price competition.

### **CC remedies**

3.57 To address the adverse effects arising from the above findings, the CC made the Home Credit Market Investigation Order 2007. The various provisions of the Order came into force between September 2007 and October 2008. The Order requires, among other things:

- lenders to publish details of money loans on the lenders compared website<sup>33</sup> where customers can compare prices and terms
- in relation to money loans, all lenders to include the above web site address in all advertisements and payment books and to indicate in advertisements delivered to individuals and in payment books the right to free quarterly statements
- all lenders to ensure that those customers who repay money loans early (around a third of all customers) get more favourable terms than those required by the Consumer Credit (Early Settlement) Regulations 2004, and
- large lenders to share data on customers' payment records in relation to both money loans and voucher loans.

---

<sup>33</sup> [www.lenderscompared.org.uk](http://www.lenderscompared.org.uk)

## **Market developments and the CC's remedies**

- 3.58 Since the Order came into force, the UK economy has experienced a deep recession, which has had a significant effect on many financial services companies, including both suppliers of specialist and mainstream products. Further details of the effects of the recession on this sector can be found in the interim research report of this review, including details of financial problems experienced by London Scottish Bank, a former owner of Morses Club Ltd, a home credit supplier, and Cattles, which provides home credit through its Shopacheck business.
- 3.59 As noted in our interim research report, the turmoil among some suppliers of home credit appears to have been unrelated to their home credit businesses, and more closely related to other factors such as the widespread problems of raising wholesale finance during the recession.
- 3.60 The remedies put in place following the CC's investigation are designed to enhance competition and help the operation of the market. The recession has neither affected the overall structure of the home credit market, nor has it appeared to affect the way in which loans are provided. We have not found evidence that home credit companies are any less willing to comply with the Order. Indeed, the OFT's monitoring of the Order suggests that home credit lenders are keen to have details of their loans posted on the lenders compared website. This is encouraging and augers well for the improved transparency and competition that OFT and the CC sought.
- 3.61 The OFT will continue to monitor and enforce compliance with the Order and monitor its effectiveness in line with its duty under section 162 of the Enterprise Act 2002.

## **Summary**

- 3.62 This chapter has provided the key findings for the review, specifically that, while these markets appear in some respects, to be working reasonably well, we do have some concerns: namely that consumers do not drive competition among suppliers in this sector, that sources of

additional supply to the market, such as mainstream financial services, seem to be limited, and that in these circumstances, there is limited price competition in these markets and prices are high.

- 3.63 We have discussed the scope of the findings in this review and the issue of the extent of overlaps between mainstream financial services and high-cost credit. We have also analysed the potential scale of detriment that can be attributed to these markets. In addition, we have presented a summary of the work of the CC in its investigation of home credit, and provide a brief description of the developments since the CC reported in 2006.

## **4 CONCLUSIONS AND RECOMMENDATIONS**

### **Introduction**

- 4.1 This chapter provides the conclusions from the OFT's review of high-cost credit, and provides some detail of the challenges and constraints that face the OFT in considering how to improve the effectiveness of these markets.
- 4.2 We highlight that where government is not content with the current operation of these markets, in order to effect significant change, a number of fundamental issues would need to be addressed.
- 4.3 The OFT can effect only a limited improvement in these markets. Despite these limitations, we propose recommendations under the four themes below.

### **There are some deep-seated issues in this sector**

- 4.4 Following our assessment of these markets above, we consider that there are some relatively deep-seated causes of concern within these markets which it is beyond the scope of this review to address. We consider that these are difficult issues which cannot simply be addressed by controlling prices in the sector.
- 4.5 Tackling these concerns would require fundamental changes in approach. In theory, these might include actions by the Government – and potentially others – to:
- secure a step-change in financial capability in a group of the population that, typically, has lower than average final educational achievement, through, for example, a large scale education initiative
  - effect a cultural change in society's and individual consumers' approach to credit

- either subsidising or requiring mainstream financial suppliers to offer loans in these markets that meet consumers' needs at reasonable prices, and
- a substantial increase in the direct provision of credit to consumers in these markets through, for example, a much expanded version of the Government's Social Fund.

4.6 The potential changes outlined above would be likely to be either costly or difficult to achieve, or both of these in some cases. For example, changing the culture, attitude and behavioural traits of consumers in this market could give rise to significant benefits in the market, while being both difficult and expensive to achieve in practice, and being likely to take many years of persistent effort before a significant improvement would be seen. We note that such actions would have highly significant economic, financial and social consequences, which would need to be considered. Such actions would go well beyond the scope of this review, and judgements about them are outside the competences of the OFT. We have not therefore evaluated the benefits and costs of such approaches.

4.7 Such theoretical changes are highlighted to indicate the limited possibility for the OFT, through this review, to make a significant improvement to the functioning of these markets.

### **The OFT does consider that there are some improvements which could be made to the sector**

4.8 We recognise that in the absence of such changes as those listed above, the markets for high-cost credit will continue to operate similarly to currently. However, we do believe that there are some incremental improvements that could be made in these markets within the current economic, financial and social context. The OFT is therefore making the following recommendations within four themes for changes to this sector:

- helping consumers make informed decisions on high-cost credit

- increasing the ability for consumers to build up a documented credit history when using high-cost credit
- enhancing understanding of developments in the high-cost credit sector, and
- promoting best practice among suppliers of high-cost credit.

## Helping consumers make informed decisions on high-cost credit

- **We recommend that the Government ensures that financial literacy programmes, including but not limited to the Consumer Financial Education Body's Moneymadeclear guidance service, cover high-cost credit products as well as mainstream financial products.**

- 4.9 We would like to see more information and advice in financial literacy materials and programmes on high-cost credit products. Our research has shown that consumers of high-cost credit understand it less well than consumers of mainstream credit, yet are more likely to purchase it, and that they lack awareness of some lower cost products.
- 4.10 We are aware that much of the financial literacy material has focused on mainstream financial products and other elements of financial literacy and capability and we are keen to ensure that the needs and interests of lower income, higher risk consumers with limited access to mainstream credit and an urgent need for credit are equally well addressed. We think that organisations providing information and advice direct to consumers should have relevant information on the high-cost credit products available, as well as information on mainstream products. This will help to ensure consumers are aware of the full range of credit products available.
- 4.11 One effect of this will be to increase product awareness and boost the likelihood that, where consumers have choices, they are able to make them with full knowledge of the consequences of their decisions. This in turn is likely to increase the chances that consumers will drive

competition in the markets for high-cost credit, putting downward pressure on prices.

- 4.12 A wide range of financial literacy initiatives exist throughout the country<sup>34</sup> and in order to avoid confusion in this important area we would not recommend the development of further, separate, initiatives.

- **We recommend that the Government works with industry groups to provide information on high-cost credit loans to consumers through price comparison websites. If this cannot be undertaken on a voluntary basis, the Government should consider the case for introducing legislation to create a single website allowing consumers to compare the features of home credit, payday and pawnbroking loans alongside credit unions and other lenders in their local area.**

- 4.13 This will help consumers make informed decisions about high-cost credit and drive competition in the sector. We are aware that not all consumers of high-cost credit will have access to internet resources, therefore our previous recommendation should include the provision of information in a variety of different methods to address those consumers.

- 4.14 Our behavioural economics experiment found that comparability and referencing of information content were important for consumers to make correct, informed choices. It is also important for consumers to have a reference point in terms of the cost of loans.

- 4.15 We are aware that following its investigation into home credit, the CC required home credit lenders to 'provide specified information on the

---

<sup>34</sup> These include the DWP 'now let's talk money' and 'financial inclusion champions' campaign, Consumer Direct, the OFT Save Xmas Campaign, the Lenders Compared website, the FSA/CFEB MoneyMadedclear money guidance service and a wide variety of local government initiatives on financial inclusion and financial literacy. In addition, a report from the National Audit Office (NAO) in February 2010 found that the Government's over-indebtedness strategy consisted of more than 50 different projects, a number of funding streams, and diffuse responsibilities. The NAO report can be accessed online at [www.nao.org.uk/publications/0910/over-indebtedness\\_report.aspx](http://www.nao.org.uk/publications/0910/over-indebtedness_report.aspx)



price and other terms of their cash loans to an independent website operator appointed by the CC, who will publish the information'.<sup>35</sup>

- 4.16 This remedy led to the creation of the Lenders Compared website<sup>36</sup> which allows consumers to compare home collected and other cash loans in their postcode area.
- 4.17 We fully support the Lenders Compared website. In the event that a market solution to our recommendation above proved not to be possible, we would be supportive of initiatives to build on this development in line with our recommendation to provide customers with information about a variety of high-cost credit products and suppliers in their local area.
- 4.18 In considering such developments, it will be important to ensure that users are still able to compare the key features of loans in an easy, clear and transparent manner in line with current and future consumer credit legislation. This legislation is likely to act as a constraint on what information can be required of lenders and how it is presented.
- 4.19 We considered recommending specifically that the Lenders Compared website should be expanded on a voluntary basis, but found that this would be likely to raise problems in relation to funding, as this website is funded currently by home credit suppliers. There would also be some suppliers required to participate and others participating on a voluntary basis. We considered that such a proposal had the potential to be detrimental overall to the Lenders Compared website.
- 4.20 We are aware that not all consumers shop around for high-cost credit, and not all will have access to a website such as the one proposed. However, while it is difficult to change the behaviour of consumers, we

---

<sup>35</sup> Competition Commission, Home credit market investigation, Final Report, 30 November 2006, available at [www.competition-commission.org.uk/inquiries/current/homecredit/](http://www.competition-commission.org.uk/inquiries/current/homecredit/) Para 9.155

<sup>36</sup> [www.lenderscompared.org.uk](http://www.lenderscompared.org.uk)

can put in place websites to ensure that those consumers that are able to and do shop around find the information they seek easily.

- **We recommend that the Government explores whether there is scope under the European Consumer Credit Directive for a requirement that high-cost credit suppliers must include 'wealth warning' statements on advertisements for high-cost credit.**

4.21 We make this recommendation to allow potential consumers to be reminded of the possible consequences of taking out such credit and/or advising them to examine all the options available to them before taking out this type of product. We consider that such warnings could play an important role in helping consumers to make informed decisions about these products and to reduce levels of consumer detriment. We are aware from our research that presenting information in an advert format can cause confusion and reduces consumer understanding of the key facts of a product.<sup>37</sup>

4.22 Moreover, where warning statements have been adopted, both in the financial services sector and in other sectors, there is evidence to suggest that they have been quite effective. In the Netherlands, since 1 April 2009, all advertisements about loans must state the warning: 'Caution! Borrowing money costs money' ('Let op: Geldlenen kost geld'). This rule applies to television, radio, internet and printed media.<sup>38</sup>

---

<sup>37</sup> Compared to the same information presented in a plain table. See Annexe A.

<sup>38</sup> The mandatory warning for loan advertisements is one of the measures taken by the Dutch government to handle increasing problems related to debts. Six months after the introduction of these 'wealth warnings', a survey by the Netherlands Authority for the Financial Markets (AFM) suggested that a total of 87 per cent of the Dutch population was familiar with the warning sentence, and nearly three quarters of consumers indicated that the sentence made them think about the negative consequences before concluding a loan.

Netherlands Authority for the Financial Markets (AFM), 'AFM: 'Be careful! Borrowing money costs money' is a success' [www.afm.nl/en/professionals/afm-actueel/nieuws/2009/dec/kredietwaarschuwingszin-succes.aspx](http://www.afm.nl/en/professionals/afm-actueel/nieuws/2009/dec/kredietwaarschuwingszin-succes.aspx)

- **Future legislation and regulations for consumer credit should take into account the needs, preferences, abilities and behaviour of consumers of high-cost credit as well as that for consumers of mainstream credit. We recommend that the Government considers the value of further behavioural research into such consumers when making any future legislative change in this area.**

4.23 We consider there to be merit in further behavioural economics research on consumers of credit including high-cost credit. We consider that this form of research would be very helpful for considering future changes in legislation (within the limits of harmonised European consumer credit law) to help consumers make better decisions.

4.24 We are aware that the current legislation prescribes a large number of documents and a large volume of information that must be provided to consumers in relation to loans that they purchase.

4.25 It has been beyond the scope of this review to consider the effects of all the documents and descriptions of products and features of credit products. However, we have examined some of the key variables presented to consumers, including cost information. While there is currently limited scope for changes to legislation around cost information, we did find that the total repayment amount (TRA) had more of a positive impact on consumers' perception, understanding and decision quality, while the APR was found to be a less important driver of good decisions.

4.26 We recommend that further research is considered in relation to the drivers of good decisions so that future legislative change (within the limits of harmonised European consumer credit law) can provide consumers with the features and tools to understand the implications of credit products while the burden of information which is not helpful can be reduced.

4.27 This recommendation is broader than just high-cost credit, due to the nature of the regulation of consumer credit in the UK. We are aware that

similar problems of information and understanding are likely to affect mainstream credit as well as high-cost credit.

### **Increasing the ability for consumers to build up a documented history when using high-cost credit**

- **We recommend that the Government works with credit reference agencies to explore ways in which payday lenders and rent-to-buy suppliers could provide suitable information to credit reference agencies about the payment performance of their customers, in turn allowing those with good payment records to use mainstream lenders more easily in the future.**

4.28 We want consumers of high-cost credit to be able to build up a documented credit history. This will enable them to demonstrate to a range of different lenders their proven ability to repay loans on previous occasions. We consider this to be a useful development for two reasons. First, this would give consumers more confidence in shopping around, as a greater range of lenders would be aware of their credit history. Second, it would allow consumers to gain access to more mainstream credit once they have built up a proven history of being able to repay loans on time.

4.29 We are aware that the CC imposed a similar remedy on home credit suppliers, and we consider that there would be benefits for other suppliers of high-cost credit to be involved in contributing information on the payment performance of their customers.

### **Enhancing understanding of developments in the high-cost credit sector**

- **We recommend that the OFT collects essential information on the high-cost credit sector, such as the volume, value and pricing of credit, levels of repeat business and defaults among customers as needed. This will help OFT understand the effect of its recommendations and provide better evidence for future policy making.**

- 4.30 We wish to collect essential information to ensure that future policy decisions taken by the OFT are made in the light of up-to-date evidence and an enhanced understanding of the high-cost credit sector. Collecting this information will also allow us to understand the effect of all our recommendations on the high-cost credit sector.
- 4.31 The OFT does not currently collect information of this nature about any consumer credit business. Therefore, we will be seeking to engage with stakeholders to ensure that we obtain the necessary information in the most efficient manner possible which minimises the burden on suppliers in this sector.

### **Promoting best practice among suppliers of high-cost credit**

- **We recommend that the relevant trade associations for home credit suppliers, payday lenders and pawnbrokers establish a code or codes of practice covering best practice policy in a number of areas. Such a code could include:**
  - **complaints processes and advice to customers**
  - **policies on rolling over of loans**
  - **rules of thumb on typical limits for amounts to lend to consumers**
  - **guidance on avoiding misleading consumers through advertisements, and**
  - **steps to ensure that consumers are aware of the ultimate owners of brand names.**

- 4.32 We are aware of some examples of best practice among suppliers and trade associations in this sector, as well as some examples of poorer practices. We are also aware of the image attributed to high-cost credit in the media which tends to focus on the high APRs associated with short term loans.

- 4.33 We would like industry representatives for high-cost credit to promote best practice throughout the markets for high-cost credit by developing a suitable code of practice.
- 4.34 The development of such a code would be a positive step by such industry representatives to demonstrate that these suppliers value their customers and help to ensure that the markets for high-cost credit are seen as responsible industries which are able to address concerns without the need for additional regulation. This would also allow the Financial Ombudsman Service to ensure firms comply with the provisions of the code to the benefits of consumers of high-cost credit.
- 4.35 In addition, If such a code were to be approved by the OFT's consumer codes approval scheme, this would allow participating suppliers to differentiate themselves from others in the market with the use of the OFT approved code logo.

### **Summary**

- 4.36 In summary, we consider the above recommendations to be well balanced and based on a sound foundation of evidence and research from this report and our interim research report from December 2009.
- 4.37 The implementation of the recommendations listed above could improve the efficiency of the markets for high-cost credit in the medium to long term, although we note that the likely effect of these remedies in the markets will be limited by the constraints outlined previously.

### **Price controls in high-cost credit**

- 4.38 As noted in the previous chapter, we found evidence of limited competition in high-cost credit markets, including high prices and profits. This finding made it appropriate for the OFT to consider price controls as a potential remedy. Our assessment of the research in relation to price controls is summarised in Chapter 2 and in more detail in Annexe B. Further details on international approaches to this issue can be found in our interim research report.

- 4.39 We are aware that there are numerous different variants of price control that have been discussed in literature and suggested as beneficial for a number of different credit markets. Some stakeholders have suggested that the use of a price control set at a very high level could prevent consumers from entering into credit agreements with suppliers that charge extremely high interest or charges unjustified by the costs of provision. However, we have received no evidence from stakeholders regarding instances of suppliers of high-cost credit pricing at such levels.
- 4.40 While a price control for high-cost credit set at such a high level may not suffer from some of the difficulties below, this does not mean such a control would be necessarily be justified. The UK already has a mechanism for controlling prices or charges for credit agreements that might be regarded as unfair. The Consumer Credit Act (CCA) 2006 introduced the unfair relationships provisions set out in sections 140A – 140D of Consumer Credit Act (CCA) 1974.
- 4.41 These provisions allow the court to re-open credit agreements and make certain orders where the court determines that the relationship between the creditor and the debtor is unfair to the debtor. In a December 2003 White Paper, the then Department for Trade and Industry explained that the objective of this reform was 'to target any unfair credit transaction, widening the scope of the current 'extortionate' definition, to ensure account is taken of unfair practices as well as the cost of the credit'.<sup>39</sup>
- 4.42 This review has considered explicitly price controls as a measure to limit the prices and profits earned by suppliers of high-cost credit and the issue of a price control set at a very high level is not considered further.

### **Conclusions on price controls for high-cost credit**

- 4.43 We do not consider that price controls for pawnbroking, payday loans, home credit and rent-to-buy credit would be an appropriate solution to

---

<sup>39</sup> Department for Trade and Industry, Fair, Clear and Competitive: The Consumer Credit Market in the 21<sup>st</sup> Century, [www.berr.gov.uk/files/file23663.pdf](http://www.berr.gov.uk/files/file23663.pdf) Para 3.33.

the particular concerns which we have identified in these high-cost credit markets.

- 4.44 We are aware that price controls can represent an efficient way to address concerns around high profits among suppliers and can, initially, limit the headline prices paid by consumers in the high-cost credit sector. We are, however, also aware that the strategic responses to price controls among suppliers may lead to an outcome in these high-cost credit markets which is unlikely to be of benefit for consumers.
- 4.45 The imposition of price controls in high-cost credit markets creates a risk for suppliers that they would generate lower profit levels. It would be reasonable to expect these suppliers to respond to the imposition of a price control by seeking to regain such lost profit by restricting the type and risk of consumers they are willing to supply. In an extreme case of a highly restrictive price control for high-cost credit, some suppliers could cease offering a particular product or exit the market entirely. This potential for reduced access to high-cost credit would be of concern for the following reasons.
- The supply of high-cost credit is already constrained, with many consumers having limited options and in some cases few practical, alternatives to high-cost credit (particularly in the short term).
  - Many consumers using high-cost credit are using this for non-discretionary expenditure. Any reduction in access to this would have a significant impact on their ability to manage their finances effectively.
- 4.46 We consider that the development of a system of price controls for high-cost credit in the UK would be complex, expensive and difficult to administer for the following reasons.
- There are a number of different high-cost credit products available at different prices with different costs based on the product characteristics and target consumers. Imposing price controls would be difficult in these markets, as detailed investigations of the



pricing and profits of suppliers would be needed at a product-by-product level.

- The imposition of price controls may lead to suppliers of high-cost credit responding by imposing a more stringent regime for late payments and default. We would be concerned with such an outcome, as these charges are not always transparent to even the most savvy of consumers. The low incomes of many consumers of high-cost credit would also increase the concerns around the impact of such changes if they were to occur.
- Circumvention of price controls is a relatively common problem for jurisdictions that already have a form of price control, and is likely to be the case for high-cost credit. While designing a sophisticated price control with substantial resources devoted to monitoring compliance could reduce the instances of known circumvention, the need for different controls for the range of high-cost credit products would make the possibilities for circumvention difficult to eradicate and manage on a proportionate basis.