

# Payday Lending

Compliance Review

Final Report



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# Overview

The payday loans market is not working well for many consumers. Our review has found evidence of widespread non-compliance with the Consumer Credit Act and other legislation (see page 35 for links to the annexes setting out our detailed evidence base). Payday lenders are also not meeting the standards set out in our [Irresponsible Lending Guidance](#).

We are particularly concerned by the evidence of irresponsible lending; too many people are given loans they cannot afford, and when they can't repay are encouraged to extend them, exacerbating their financial difficulties. This is causing real misery and hardship for a significant number of payday users.

During the course of our review, debt advisers, complainants and consumer representatives have told us that problems in this market are continuing to grow. We have listened and we are determined to tackle these issues. We have made payday lending a top compliance and enforcement priority. We will use all the powers at our disposal - including, if appropriate, the power to suspend a credit licence - to drive up standards in the sector and to remove those lenders whose actions make them unfit to remain in the market.

## Some of our key findings:

- Around a third of loans are repaid late or not repaid at all.
- 28 per cent of loans are rolled over or refinanced at least once, providing 50 per cent of lenders' revenues.
- 19 per cent of revenue comes from the five per cent of loans which are rolled over or refinanced four or more times.
- Debt advisers reported that borrowers seeking help with payday lending debts had on average rolled over at least four times and had six separate payday loans.
- 30 of the 50 websites we looked at emphasised speed and simplicity over cost – in some cases making claims that, if true, would amount to irresponsible lending.
- 38 of the 50 lenders we inspected failed to comply with at least one of the complaint handling rules of the Financial Ombudsman Service.

## OFT action:

Payday lending is a top compliance and enforcement priority. We are acting now to tackle poor practice across the market:

- We have formal investigations against a number of payday firms and we have more enforcement action in the pipeline.
- We are requiring 50 lenders - accounting for 90 per cent of the market - to take immediate steps to address areas of non-compliance and prove to us that they have done so within 12 weeks - lenders that fail to cooperate risk losing their licence.
- We have set out in this document, for the avoidance of doubt, clear statements about how our guidance applies to payday lenders - we have written to every single payday lender making clear that we expect them to act now to ensure they are meeting these standards.
- We have provisionally decided to refer the payday lending market to the Competition Commission for a full investigation.
- We are continuing to monitor the market and to work with partners such as the debt advice sector to gather evidence which supports our investigations.

Our evidence paints a concerning picture of the payday lending market. It appears that irresponsible lending is not a problem confined to a few rogue traders, but has its roots in the way competition works in this market. The evidence suggests that many consumers are in a weak bargaining position, and that firms compete on speed of approval rather than on price. Firms that invest time and effort in proper affordability assessments may lose out to those that do not. Additionally, firms describe and market their product to consumers as one-off short term loans (costing on average £25 per £100 borrowed for 30 days), but in practice around half of their revenue comes from loans which last longer and cost a lot more because they are rolled over or refinanced. Lenders do not need to compete hard for this source of revenue because by this time they have a captive market. This, and the misuse of continuous payment authorities to reclaim monies owed, may distort incentives for lenders, encouraging them to make loans to people who cannot afford to repay them first time.

The OFT believes that the problems in this market go deeper than a very poor compliance culture, and that a full investigation by the Competition Commission is needed to understand how the

market works and identify lasting solutions.

This analysis will help inform the Financial Conduct Authority's work on payday lending when it assumes responsibility for consumer credit regulation next year.

## What we have found:

Our [Interim Report](#) published in November explained what we had found to date. This final report goes further, concluding our review, explaining our action plan and reiterating what we expect from lenders and trade associations.

Our evidence paints a general picture of poor compliance with the law and guidance across the market and throughout the lifecycle of payday loans, from advertising of loans to debt collection:

- Lenders compete by emphasising speed and easy access to loans, but borrowers are not getting a balanced picture of the costs and risks of taking out a payday loan.
- Across the sector, there is evidence that the majority of lenders are not conducting adequate affordability assessments and their revenue streams rely heavily on rolling over or refinancing loans. Around one in three loans is repaid late or not repaid at all.
- Many lenders are not treating borrowers in financial difficulty with understanding or forbearance. Many are promoting rollovers when borrowers would be better served by a repayment plan. Continuous payment authorities are poorly explained to consumers and their misuse is causing distress to a considerable minority of consumers, in some cases leaving them with insufficient funds to cover their most basic needs.
- A number of firms are using aggressive debt collection practices which fall far below the standards we have set out in our [Debt Collection Guidance](#).
- Across the industry we have seen evidence of poor internal procedures and processes, including a failure to put in place effective complaints handling systems.

This is causing real harm and the problem has grown. In the first quarter of 2009/10 only one per cent of Citizens Advice Bureau debt casework clients had at least one payday loan - in the same quarter of 2012, 10 per cent had at least one payday loan. In November 2012 StepChange Debt Charity reported that the proportion of their clients with payday loan debts had increased from 3.7 per cent in 2009 to 17 per cent in 2012.

We have made payday lending a top priority. We have already revoked the licence of one payday lender and imposed formal requirements on three others (two of these four decisions are still subject to appeal). We are formally investigating a number of payday lenders and are requiring 50 lenders - accounting for 90 per cent of the market - to take immediate action to address the specific concerns we identified with their business practices. They must demonstrate to us within 12 weeks that they are now fully compliant. If they fail to do so, they risk losing their licence. We will name any lenders we impose sanctions on once the enforcement action is complete. We will also publish the results of any other formal action on our website.

We are concerned to find evidence of such widespread problems in a market where many lenders are members of trade associations: the Consumer Credit Trade Association, the BCCA - representing payday lenders and cheque cashers - the Consumer Finance

Association and the Finance and Leasing Association. Firms which are well-established members of trade associations were responsible for many of the unfair practices we observed - including some of the most extreme examples. Trade associations must do more to encourage compliance. They need to act quickly to help ensure their members meet their legal obligations and the standards we expect, and to discipline those that fail to comply.

Citizens Advice is asking people who have taken out payday loans to take part in a national survey to monitor whether payday lenders are sticking to their self-regulating charter. The [Citizens Advice payday loan survey](#) will run until November 2013. We will look carefully at the results of this survey and at



all the evidence provided by consumer groups and debt advisers and use it to support our ongoing investigations.

Several commentators have called for the introduction of a more prescriptive approach to affordability assessments. Given the evidence we have found of significant underlying incentives for firms to lend irresponsibly, we think that requiring lenders to follow particular processes when they assess affordability would be unlikely to completely tackle the problem. That said, we will work closely with the Financial Conduct Authority to consider if there are new market-wide rules which could be brought into effect in this and other areas when regulation is transferred in April 2014. Alongside this, an investigation by the Competition Commission can provide a detailed analysis of how the market works, clearly define any competition problems and identify lasting solutions which get to the heart of the underlying issues. The Financial Services Authority (forerunner to the Financial Conduct Authority) supports our provisional decision to consult on a market investigation reference. The Competition Commission will be able to take account of changes to the regulatory framework and engage actively with the OFT and Financial Conduct Authority as the relevant regulatory authorities. The Competition Commission's analysis can also help inform the Financial Conduct Authority's work to determine whether to use its power to cap the cost or duration of credit once the transfer has taken place.

We have published a consultation to seek views on this provisional decision. The closing date for responses is 1 May 2013 and we expect to announce a final decision in June 2013.

# Our compliance review

## Methodology

The purpose of our compliance review was to establish the extent to which payday lenders are complying with the Consumer Credit Act, and other legislation, and are meeting the standards set out in OFT guidance.

We inspected 50 lenders, which together account for around 90 per cent of the payday market by turnover. The majority of these inspections were completed before revised industry codes of practice and the sector-wide Good Practice Customer Charter came into force in November 2012.

Our independent mystery shopping exercise approached 156 online and high-street lenders, recording the information, advice and service provided to consumers when enquiring about payday loans.

We reviewed over 1,000 questionnaire responses received from lenders, trade associations, consumer representative organisations, debt advisers and trading standards, to help us establish the extent of awareness of and compliance with the relevant law and OFT guidance. 226 of those responses were from payday lenders. We analysed the content of 50 websites and other advertising, and reviewed complaints data from a variety of sources including Citizens

### As part of our review we:

- Inspected 50 leading payday lenders.
- Commissioned a mystery shopping exercise involving 156 online and high-street lenders.
- Analysed the content of 50 lenders' websites.
- Considered 1013 questionnaire responses and submissions, from licensees, trade associations, consumer representative organisations (including debt advisers) and local authority trading standards services.
- Listened to consumers, analysing 686 consumer complaints received directly by the OFT during a six-month review period.
- Conducted a quantitative analysis of the market, drawing on data from 190 firms.

Advice, the Financial Ombudsman Service and consumer complaints made direct to the OFT.

We also conducted a quantitative analysis of the payday market, drawing on data collected from 190 firms, including an in-depth analysis of 21 firms. This looked at loan volumes and values, turnover and whether loans were repaid, refinanced, rolled over or defaulted on.

An overview of our findings is drawn out in the next five sections. Our detailed findings are set out in [the annexes to this report](#), available on the OFT website.

# The payday lending market today

## A summary of our quantitative research

Our quantitative research on the market was based on a detailed data request to 21 payday lenders and a simplified data request answered by 169 other payday lenders. The 21 lenders that provided detailed data account for around 85 per cent of the market by turnover.

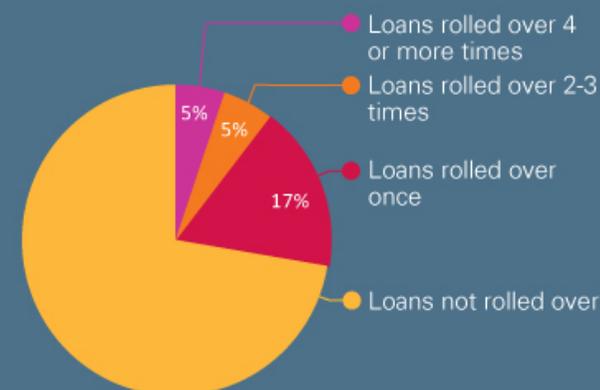
Based on our research:

- We estimate that the market was worth £2.0 to £2.2 billion in 2011/12, which corresponds to between 7.4 and 8.2 million new loans; this is up from an estimated £900 million in 2008/09.
- The average loan is between £265 and £270 and is borrowed over 30 days.
- Firms reported that the average cost of borrowing £100 was around £25, but ranged from £14 to £51.
- The three largest lenders account for 55 per cent of the market by turnover and 57 per cent by loan value.
- 28 per cent of loans issued in 2011/12 were rolled over at least once, accounting for almost 50 per cent of revenue. Five per cent of loans were rolled over four times or more, accounting for 19 per cent of revenue.
- Responses suggested that around a third of loans are either repaid late (18 per cent) or not repaid at all (14 per cent).

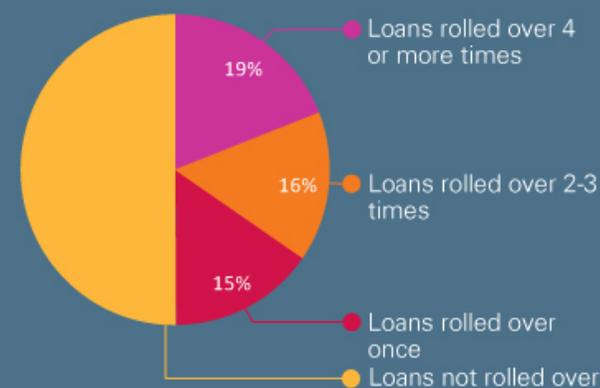
## Loans rolled over or refinanced

as a proportion of loans  
and  
as a proportion of revenue

% of loans rolled over or refinanced



% of revenue from loans rolled over or refinanced



Based on detailed data submitted to the OFT by 21 payday lending companies covering the period 1/4/2011-31/3/2012

# Lending responsibly

## Creditworthiness, affordability and rollovers

The way lenders assess creditworthiness and affordability, and the way rollovers are used, are at the heart of our concerns about the payday lending market. Right across the sector we have seen evidence of poor affordability assessments, borne out by the fact that as many as one in three loans is not repaid on time.

We found that lenders take very different approaches to making these assessments. Most lenders told us that they do undertake an affordability assessment at the initial loan stage - looking at whether the loan is suitable for the individual borrower given his or her financial circumstances, rather than simply assessing the risk that the lender will not get its money back. Yet the vast majority of those we inspected were not able to provide us with satisfactory proof that they had applied such assessments to their customers in practice. We also have serious concerns about whether lenders are gathering enough information to make a reliable assessment of affordability, or properly checking the information they do get.

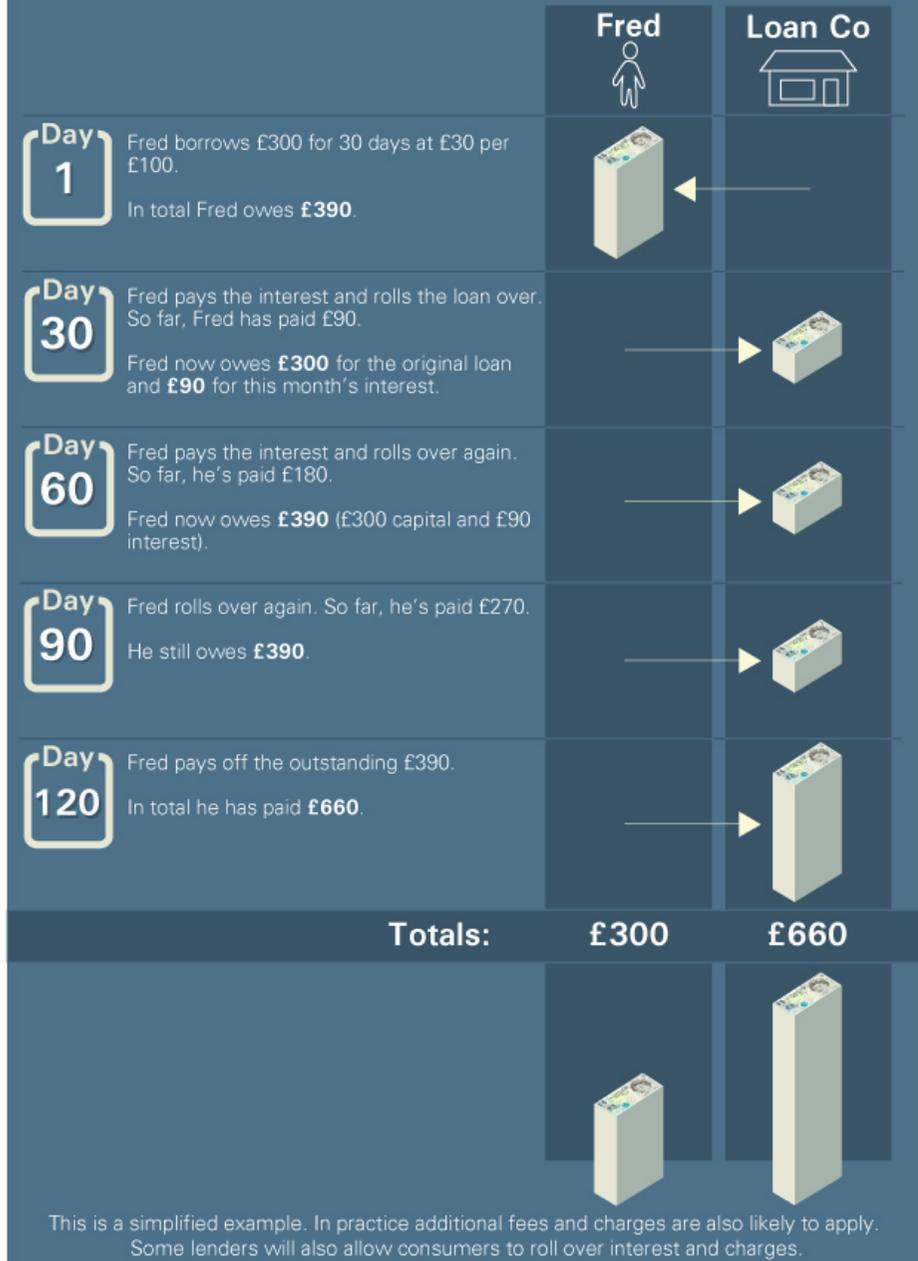
Consumers are being failed in significant numbers by irresponsible payday lending. Complaints evidence showed cases of unsuitable loans being made to consumers with very low incomes and existing credit commitments. For example, one typical complainant said 'most payday lenders lent to me despite some seeing on my file [that] I had loads of outstanding loans ... And some did no checks at all.' One relative of a vulnerable consumer said '[he]

### Background

The Consumer Credit Act requires lenders to assess **creditworthiness** before issuing a loan. This must be based on sufficient information, obtained from a borrower where appropriate and from a credit reference agency where necessary.

The Irresponsible Lending Guidance makes clear that we also expect lenders to assess **affordability** - that is, each borrower's ability to repay a specific loan in a sustainable manner and without experiencing financial difficulties

# What happens when a loan is rolled over?



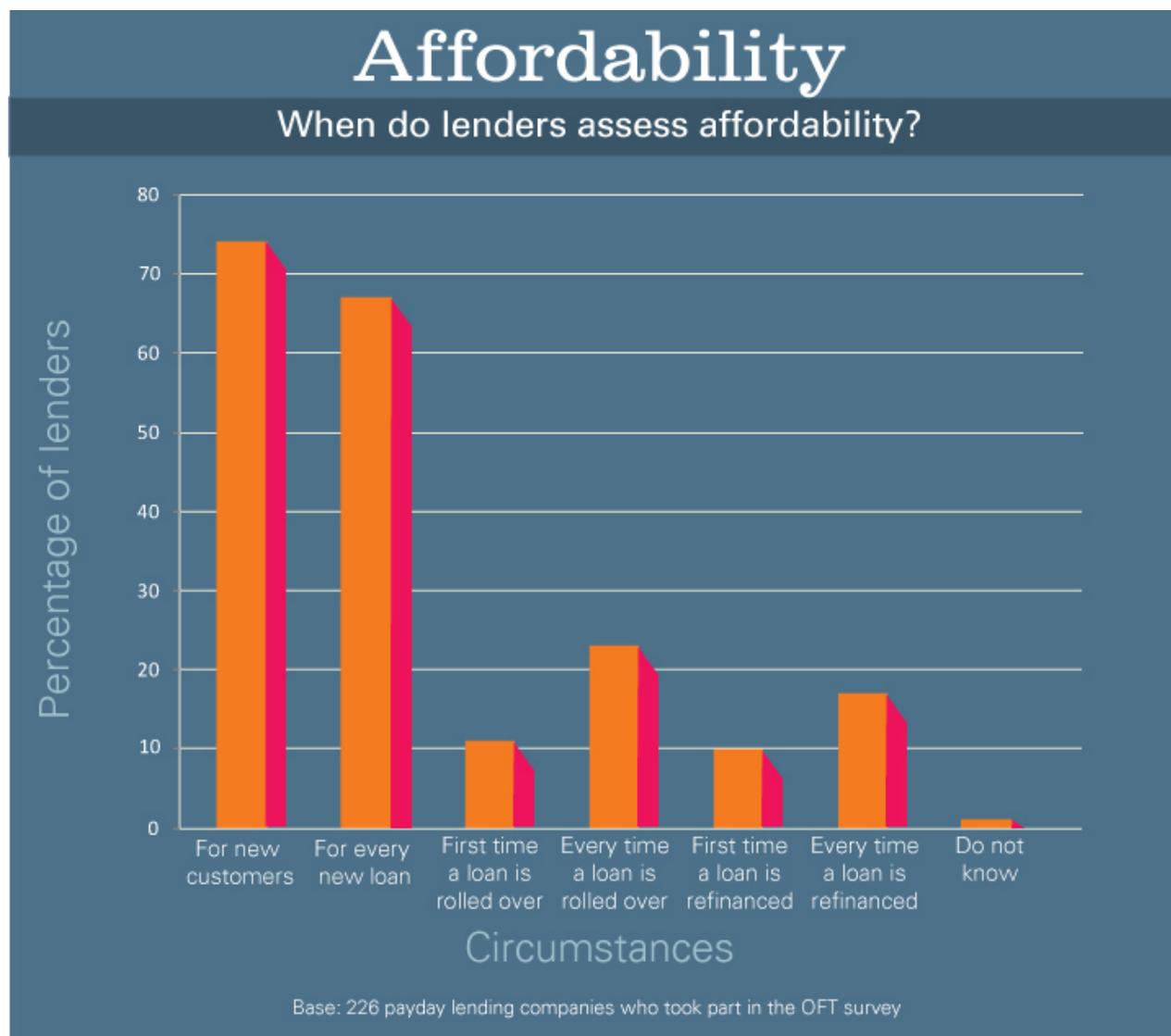
should never have been given a loan, he owes thousands to several banks and finance companies and also filed for bankruptcy'.

One in three loans is rolled over or refinanced, accounting for almost 50 per cent of revenues. Yet, as noted above, lenders are not competing for these revenues. Customers in this position are largely captive and the evidence suggests that lenders are slow to make them aware of the alternatives available to them. In our view, it is not acceptable to sell a loan with the expectation that a consumer will need to rollover. However, we saw at least a third of lenders actively promoting rollovers at the point of sale. Although some lenders specifically ruled this out, a number will agree to roll over loans even after the borrower has missed a repayment, even though this would be, in our view, prima facie evidence that a customer was in financial difficulties. Our evidence suggests that encouraging rollovers is a deliberate commercial strategy for some firms. For example, staff in two large high-street firms told us that rollovers were regarded as key 'profit drivers' and that staff were encouraged to promote them - in one case this was even written into their training manual. In extreme cases, our inspectors found examples of customers having 12 or more consecutive rollovers.

# Creditworthiness and affordability

## What did we find?

- 74 per cent of lenders who responded to our questionnaire said they conduct affordability assessments for all new customers. 67 per cent said they do so for every new loan but only 23 per cent said they do so for each rollover.
- The policies and procedures we inspected were often incomplete and lacked essential information, such as the loan acceptance criteria or how consumer data should be used to reach lending decisions. We also saw inconsistencies in approach between policies and procedures and the actual practices observed, for example cases where customers were issued with loans even though they did not fit within the lender's written criteria.



## Example consumer complaints:

'I was told not to worry [about paying it back by my next payday] as most people extended their loans – I feel I was encouraged to extend rather than pay back the full amount'.

'...the girl suggested I consider the rollover option before I'd even been given the loan'.

'I eventually asked how I could go about paying the original loan off in instalments instead of extending the loan as I was having difficulty paying this off, and further credit wasn't helping me'.

- Lenders' record keeping was poor - only six of the 50 lenders we visited were able to provide documentary evidence that they assessed consumers' likely disposable income as part of their affordability assessments.
- Although most lenders ask for a bank statement, this appears 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 month's statements. We witnessed loan officers approving loans despite the fact that our inspectors could see evidence on bank statements that borrowers were already making payments to other payday lenders; the borrowers were not asked about this.
- Our mystery shopper exercise showed that in six per cent of cases lenders were prepared to offer a loan immediately, without mentioning the need for any affordability assessment at all.
- Debt advisors reported that their typical client has six separate payday loans at the time they seek advice.

### What standards do we expect from lenders?

- Lenders must, by law, assess creditworthiness before issuing a loan, and our Guidance makes clear that they should also assess affordability - that is, each borrower's ability to repay in a sustainable manner. This must include consideration of the potential for that specific credit commitment to impact adversely on the individual borrower's financial situation.

- Lenders must ensure that the policies that set out their affordability criteria are adequate, and should keep these under review. The policies should be supported by clear written procedures which are properly implemented - staff must be trained in how to apply them and firms should regularly check that they are being adhered to.
- Lenders must train staff to properly assess the information they see - for example, to spot signs of possible over-indebtedness, such as payments to other lenders, in bank statements.
- Lenders must draw on enough data sources to be able to form a sufficiently rounded picture of affordability. For example, a credit reference check alone is unlikely to be sufficient. Equally, it is unlikely to be sufficient just to ask borrowers to self-declare their income, without verifying it or seeking evidence of outgoings to determine levels of disposable income.
- Lenders must validate and cross-check information where practicable - for example, comparing recent bank statements and pay slips to verify income and employment data.
- In our view, it is good practice to ask borrowers how they plan to repay the loan, and to self-declare income and expenditure including other payday loans and credit commitments.
- Procedures must be adequate to identify and prevent possible fraud, particularly where repayments are to be taken using a third party's debit card.

## Rollovers

### What did we find?

- We estimate that across the industry 28 per cent of loans are rolled over or refinanced, accounting for almost 50 per cent of revenue. Around 20 per cent of revenue derives from the one in 20 loans that are rolled over or refinanced more than four times.
- 44 of the 50 lenders we inspected allowed rollovers.

- 17 lenders actively promoted rollovers in marketing material or at the point of sale as a 'feature' of the loan.
- 15 lenders proactively alerted customers to the rollover option prior to the loan due date and we saw some evidence of lenders deliberately encouraging borrowers to roll the loan over rather than repay.
- Although some lenders specifically ruled this out, a number will agree to roll over loans even after the borrower had already missed a repayment - in our view, this should be prima facie evidence that the customer is in financial difficulties and the lending is unsustainable.
- Debt advisers told us that clients that come to them with debt problems have on average rolled over their payday loans at least four times before seeking independent advice.
- Only 23 per cent of payday lenders said, in response to our questionnaire, that they assess affordability each time a loan is rolled over, with 11 per cent only doing so the first time it is rolled over. Only 14 of the 44 lenders we inspected that allowed rollovers said they conducted an affordability assessment on all rollovers.
- Inspecting officers saw examples of loans that had been rolled over repeatedly, sometimes more than 12 times - only 28 of the 50 lenders we inspected operated a rollover limit (the Consumer Finance Association's Code of Practice has since introduced a limit of three per customer).
- One lender offered a loyalty membership scheme, with discounts available on interest charges after 13 loans including rollovers.

### What standards do we expect from lenders?

- Lenders must ensure that borrowers understand what a rollover is - in particular whether it amounts to a new agreement and whether payments will reduce the capital, or only cover interest and charges.
- In our view, a fresh affordability assessment ought to be conducted each time a rollover is granted - the fact that the customer is seeking a rollover is new information which should prompt lenders to reassess. Where the rollover legally amounts to a new

agreement, this must be properly documented and fresh creditworthiness and affordability assessments must always be undertaken.

- If lenders advertise or promote the possibility of rollovers, they must accompany this by providing clear explanation of how they work and the associated costs and risks.
- Lenders must not use rollovers as a substitute for forbearance towards borrowers in financial difficulty. Where a borrower is unable to repay in full on the due date, lenders must consider whether this is evidence of financial difficulty and whether, therefore, they should freeze or suspend interest and charges, or offer a repayment plan, instead of refinancing or extending the loan.

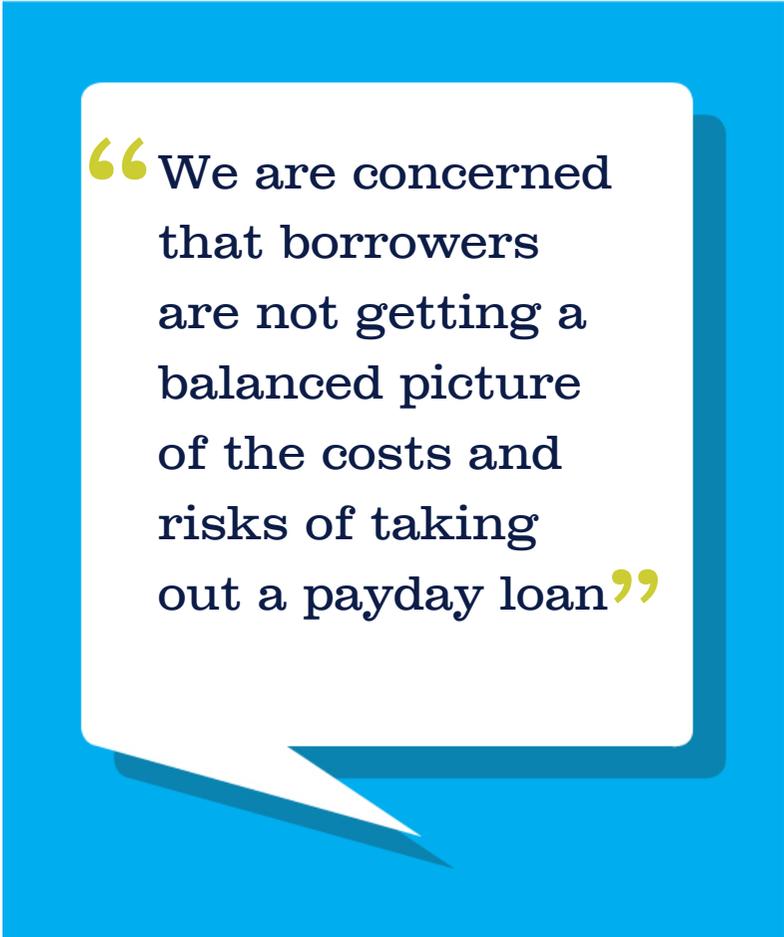
# Selling responsibly

## Advertising and information provided before a loan is granted

Lenders are legally required to observe certain standards when advertising loans. This is to ensure that consumers are not misled, that they get all the information they need to make an informed decision about taking out a loan, and so they can shop around for the best deal. Before a loan is made, lenders are required to give prospective borrowers a form containing certain prescribed information (pre-contract credit information) that sets out the key costs and implications of taking out the loan. Lenders are also required to provide an explanation of the key features of the loan and associated risks.

Our evidence suggests varying degrees of compliance with these requirements. In general, compliance levels were higher when a prescriptive statutory obligation exists but, even in such cases, we still found a minority of lenders that failed to comply.

We found that most sites made claims we considered to be potentially misleading. We saw a pattern of advertising that emphasised speed and easy access to cash, at the expense of giving customers balanced information about the cost of lending, the risks if things go wrong and the consequences of non-payment (including the operation of continuous payment authority). Overall, we found that the majority of lenders do not give consumers important information about the total cost of the loan or detailed terms and conditions until after their application is approved. This means consumers may not be able to make informed decisions about the suitability of the loan for their individual circumstances or to shop around for the best deal.



“We are concerned that borrowers are not getting a balanced picture of the costs and risks of taking out a payday loan”

# Advertising

## What did we find?

- Most websites made claims we consider potentially misleading.
- 30 of the 50 websites we looked at emphasised the speed and simplicity of loan applications - sometimes to the extent that, if the claims were true, this would imply irresponsible lending and encourage irresponsible borrowing (see box for examples).
- 14 sites failed to show either a representative example or APR where required - which illustrate for the borrower how much their loan could cost them. In 12 cases the examples were included but were not prominent enough and in 12 cases the APR was not prominent enough.
- 20 sites either omitted or downplayed important information about the costs and risks to the borrower.

## What standards do we expect from lenders?

- Lenders must not suggest that credit is available regardless of the borrower's circumstances. Statements such as 'no credit checks' or 'extension guaranteed' are either misleading or evidence of irresponsible lending.
- Lenders must only use speed of process as a selling point where such claims are true and not misleading.

Slogans that might be misleading or indicative of irresponsible lending:

**'No credit checks'**

**'No Credit? No Problem!'**

**'Loan guaranteed'**

**'No questions asked'**

**'Applications processed 24/7'**

**'Instant cash'**

**'Borrow up to £750 instantly'**

- Lenders should be aware that emphasising speed may amount to an 'incentive' triggering the requirement to show a representative APR.
- Where a representative example or APR is triggered, this must be more prominent than the information triggering it - this means that it must stand out more, so it is likely to be seen by consumers and have an impact.
- Lenders should be aware that emails or texts to borrowers, encouraging them to take out a loan or to rollover, may amount to an advertisement and so must comply with the Consumer Credit (Advertisements) Regulations.
- Lenders must not specifically target loans at vulnerable consumers.

# Pre-contract credit information and explanations

## What did we find?

- Nine of the 50 lenders we inspected did not provide pre-contract credit information in the prescribed form.
- 43 of the 50 lenders did not explain all the matters required by the Consumer Credit Act, such as the total amount payable and the consequences of failure to repay on time.
- 15 lenders made it possible for consumers to enter into an agreement online without first being clearly presented with the pre-contract credit information and an adequate explanation of the key features and risks.
- 28 of the 40 lenders using continuous payment authority failed to explain how it operated or that borrowers have the right to cancel.
- 22 per cent of the 226 lenders that responded to our questionnaire said they did not explain the effect of rolling over a loan.



## What standards do we expect from lenders?

- Lenders should ensure that it is not possible for borrowers to enter into an agreement online without first passing through screens clearly displaying the pre-contract credit information and explanation.
- All of the required information must be explained to consumers and for all loans, even repeat borrowers. The explanation given must highlight any aspects which may make the credit unsuitable for, or would have a significant adverse effect on, that borrower. It must also include the main consequences of failing to repay on time, including any default charges.
- Lenders must provide a meaningful opportunity for borrowers to ask questions - advice on how to do this should be prominently displayed. An FAQ document on a website may provide a useful starting point, but is not an adequate substitute for providing borrowers with the ability to ask their own specific questions.
- Lenders must provide the pre-contract credit information in good time before a credit agreement is made - borrowers must be able to take the information away if they want to, in order to reflect on it or use it to shop around if they wish.

### **Continuous payment authorities (CPAs)**

are payment mechanisms involving debit or credit cards that:

- Allow business to take regular payments from a customer's bank account, within the terms of the agreed authority, without having to seek express authorisation for each payment.
- Unlike direct debt, are not subject to a common scheme or set of rules, and there is no CPA 'guarantee'.

CPAs have been the subject of a substantial number of consumer complaints such as:

- The consumer was not aware that they had signed up to a CPA, or how it would work.
- Lenders taking frequent part payments over several days or weeks, often leaving the consumer facing significant hardship.

# Fair treatment when things go wrong

## Forbearance and debt collection

We believe that many of the problems associated with debt collection could be avoided if affordability was properly assessed at the outset. In any event, we expect lenders to treat borrowers fairly, and with understanding and due consideration, when they are in financial difficulty.

Overall, we found that attitudes to forbearance varied - only a fifth of the lenders we inspected had specialist teams in place to deal with financial hardship. Debt advisors told us that lenders tended to focus on recovering the debt rather than on negotiating an alternative repayment plan, freezing or reducing interest and charges or suspending collection activity. Furthermore, lenders may be promoting rollovers or using continuous payment authority excessively when borrowers would be better served by a repayment plan.

The majority of complaints received by the OFT during a six-month monitoring period related to aggressive or unsatisfactory debt collections practices. Whilst the complaints generally related to a small minority of firms, these firms account for a significant share of the market, and some of the practice and behaviours we are seeing fall very far below the standards we expect. For example, we have seen cases of consumers being bombarded by phone calls on their mobiles and work phones, sometimes up to 16 times a day.

## What did we find?

- Our inspections found that 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.
- 27 of the 50 lenders we inspected had dedicated collections teams in place, but only ten had set up specialist teams to deal with financial hardship and other complex cases. 34 lenders failed to signpost customers in financial difficulty to not-for-profit debt advice services.
- Most lenders we inspected said they would consider negotiating repayment plans, freezing or reducing interest or suspending collection activity, but debt advisers - both not-for-profit and fee-charging - reported that lenders typically refused to respond and were often uncooperative, obstructive and difficult to negotiate with.
- We saw a number of examples of egregious practices such as call scripts instructing staff to say 'your problem is not our problem'.
- During one inspection, officers found 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.
- We found that some lenders were using aggressive debt collection practices by subjecting customers to repeated and intensive contact over short periods, often in conjunction with the use of continuous payment authority.
- Of the 686 complaints received during a six-month monitoring period, 61 per cent related to aggressive or unsatisfactory debt collection practices

Example complaints:

**'This company refused a repayment plan and calls me between two and 20 times a day'**

**'I called them to let them know that I had lost my job... They offered me a completely unaffordable repayment plan and bombarded me with emails, texts and phone calls'**

## The Debt Collection Guidance states:

- Debtors should not be subjected to aggressive practices, inappropriate coercion, or conduct which is deceitful, oppressive, unfair or improper, whether unlawful or not.
- Putting undue pressure on debtors [...] is considered to be oppressive and an unfair or improper practice.

The Guidance sets out examples of unfair and improper business practices including:

- Contacting debtors at unreasonable times and/or at unreasonable intervals.
- Pressurising debtors to pay more than they can reasonably afford without undue difficulty or to pay within an unreasonably short period.

- Fees and charges for arrears and default can be very high, and can significantly exacerbate the consumer's financial situation. In its response to our questionnaire, one lender said it applies an average of £179 in fees during the 35-day period following the repayment due date. This includes an initial missed payment fee, a further non-payment fee after seven days, a default fee after 35 days and additional charges for issuing debt collection letters.

### What standards do we expect from lenders?

- Lenders must have adequate policies and procedures in place to enable them to take appropriate action if a borrower falls into financial difficulty.
- Lenders must review their debt collection practices and policies and ensure they are fully compliant with OFT guidance including the revised [Debt Collection Guidance](#), which was published last November.
- We expect all lenders to be fully compliant with our revised guidance on continuous payment authority, part of the [Debt Collection Guidance](#).
- The nature and extent of continuous payment authority, how it operates and the right to cancel must be clearly explained. Lenders must not use continuous payment authority in a way which is unreasonable, disproportionate or excessive and fails to have regard to the possibility that a borrower is in financial difficulty.
- Fees and charges levied on accounts in arrears or default should reflect actual and necessary costs.

# Competence and complaints handling

Market research suggests that the majority of payday customers are happy with the product and the service that they receive. However, when things go wrong the impact on consumers can be significant. Our inspections identified a lack of clear complaint handling policies or failure by lenders to consistently apply those policies that do exist. Both complaints data and our inspections indicated that there are inadequacies in the way complaints are handled. We are concerned that borrowers are often not getting fair or prompt responses to their complaints.

## What did we find?

- 38 of the 50 lenders we visited failed to comply with at least one of the complaint handling rules set by the Financial Ombudsman Service.
- A lack of awareness of the Financial Ombudsman Service's rules was commonplace. The Financial Ombudsman Service told us that it has found it difficult to deal with certain payday lenders as

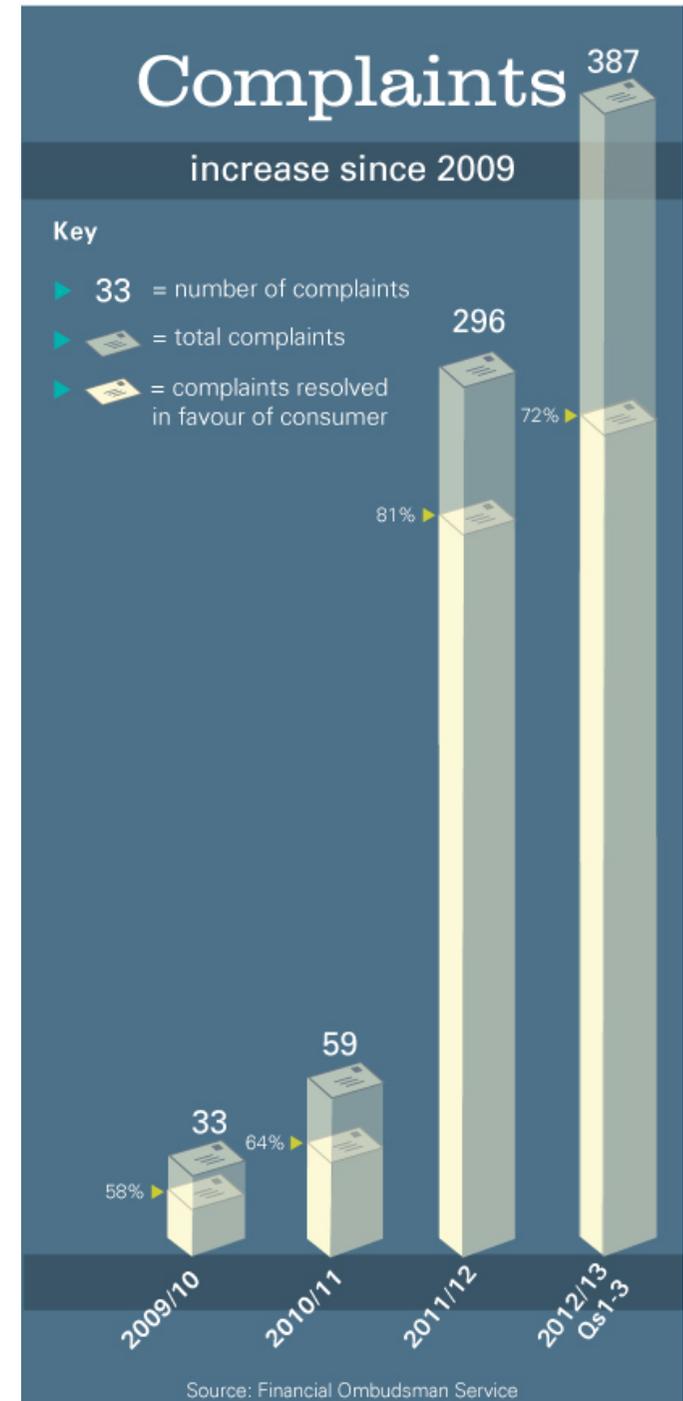
“I have been calling every day, receiving the same response that someone will call me back and I have not received one back... the lack of customer service I received is beyond a joke”

they are very slow to respond to complaints and do not appear to fully understand the Financial Ombudsman Service' role or approach.

- We found that the more significant failings had their root causes in either a) the lack of clear complaint handling policies and procedures or b) failure to implement these consistently and to provide adequate staff training.
- Complaint handling teams were often inadequately resourced and staff were insufficiently skilled to deal with the more complex queries.
- Consumer complaints have highlighted inadequacies in the complaint handling procedures used by lenders.

#### What standards do we expect from lenders?

- Lenders must make clear to consumers how they can complain if they are unhappy.
- Lenders should ensure that policies and procedures are properly documented, and that they are adequate to ensure compliance.
- Staff must be adequately trained and supervised.
- Lenders must handle complaints promptly and fairly, in accordance with Financial Ombudsman Service rules, and should monitor complaint levels and issues raised and adjust policies and procedures where necessary.



# Identity fraud

We are receiving a growing number of complaints about problems caused by identity fraud in relation to payday loans. In January 2013 Action Fraud - the UK's national fraud reporting centre, run by the National Fraud Authority - issued a warning to consumers to be vigilant in checking their bank transactions regularly so that they can find out at the earliest point if money has been taken from their account to repay a fraudulent payday loan.

Complaints are typically of two sorts: first where a consumer is pursued by debt collectors for a loan fraudulently taken out in his or her name, and second, where a continuous payment authority has fraudulently been set up against the consumer's debit card. This can be extremely distressing for the victim, particularly where large sums are debited from their account. We are aware of a number of cases where it has taken a considerable time for the individual to be refunded and where consumers have had to go to significant lengths to prove that they are not liable for the debt.

In August 2012 we revoked the licence of online payday lender MCO Capital Ltd and imposed a fine of £544,505 for unfair practices and a failure to make adequate identity checks on loan applicants in line with the Money Laundering Regulations 2007. MCO's lending was subject to more than 7000 instances of fraud. The lender compounded this problem by using unfair debt collection practices, including against consumers who they were aware may not have taken out the loans in the first place. The company has exercised its right of appeal against both the revocation of its licence and the imposition of a financial penalty.

It is difficult to quantify how much fraud the sector is subject to, but the growing incidence of complaints is a matter of significant concern to us. It calls into doubt the quality of identity checking in the sector, particularly by online lenders. Many of the complaints we have seen describe circumstances which we believe are indicative of significant failures - for example cases where the loan has been paid into a bank account which is in a different name to that of the loan applicant.

Our [Irresponsible Lending Guidance](#) and [Debt Collection Guidance](#) set out clear standards lenders must meet when conducting credit checks and when pursuing debts. Where relevant, we are highlighting this issue in the warning letters we are sending to the 50 lenders we inspected, pointing out specific concerns we have about their individual approaches to identity checking and evidence we have received in relation to fraudulent applications. Where we have found concerns, we are requiring lenders to demonstrate that they have

fully addressed them within 12 weeks. We have also written to all 240 payday lenders of which we are aware setting out our findings and specifically highlighting this issue.

Consumers who are pursued by a lender for a debt they do not owe should write to the lender and, where appropriate, the debt collection agency, making it clear why payment is being refused. If they do not receive a satisfactory response, they can complain to the Financial Ombudsman Service which provides free and independent dispute resolution. Consumers can also report instances of fraud to [Action Fraud](#), either through their website or by calling 0300 123 2040.

### **What standards do we expect of lenders?**

- Lenders must have procedures in place to verify identity which are adequate and effective in identifying and preventing possible fraud.
- This applies particularly where repayments are to be taken using a third party's debit card. Lenders must not set up a continuous payment authority on a third party card unless they are satisfied that the third party has expressly authorised such use.
- Lenders must not put the speed of processing applications ahead of their legal duty to perform adequate and effective checks.
- Lenders must not accept a high incidence of identity fraud as a cost of doing business, regardless of the impact on innocent victims.
- Lenders must respond promptly and sympathetically to complaints by consumers who believe they have been a victim of identity fraud, suspend action against the individual pending investigation of their case, and act quickly to provide full redress to victims.
- Lenders must not send demands for payment to an individual if they are uncertain whether he or she is the actual debtor.

# Getting to the heart of the problem

## Is payday lending a properly functioning market?

Our evidence paints a concerning picture of the payday lending market. It appears that irresponsible lending is not a problem confined to a few rogue traders, but has its roots in the way competition works in this market. The evidence suggests that many consumers are in a weak bargaining position, and that firms compete on speed of approval rather than on price. Firms that invest time and effort in proper affordability assessments may lose out to those that do not. Additionally, firms describe and market their product to consumers as one-off short term loans (costing on average £25 per £100 borrowed for 30 days), but in practice around half of their revenue comes from loans which last longer and cost a lot more because they are rolled over or refinanced. Lenders do not need to compete hard for this source of revenue because by this time they have a captive market. This, and the misuse of continuous payment authorities to reclaim monies owed, may distort incentives for lenders, encouraging them to make loans to people who cannot afford to repay them first time.

### Benefits of a Competition Commission investigation:

- If needed, the Competition Commission can use evidence gathering powers to get to the heart of what is happening in the market.
- Where it finds a competition problem, the Competition Commission can impose remedies directly which have the force of law.
- The Competition Commission's powers to impose remedies are broad - ranging from requiring firms to provide consumers with better information to interventions which ban or limit certain features of the market or the product.
- The Competition Commission can impose remedies directly itself, or it can make recommendations to other bodies.

The OFT believes that the problems in this market go deeper than a very poor compliance culture, and that a full investigation by the Competition Commission is needed to understand how the market works and identify lasting solutions. This analysis will help inform the Financial Conduct Authority's work on payday lending when it assumes responsibility for consumer credit regulation next year.

Several commentators have called for the introduction of a more prescriptive approach to affordability assessments. Given the evidence we have found of significant underlying incentives for firms to lend irresponsibly, we think that requiring lenders to follow particular processes when they assess affordability would be unlikely to completely tackle the problem. That said, we will work closely with the Financial Conduct Authority to consider if there are new market-wide rules which could be brought into effect in this and other areas when regulation is transferred in April 2014. Alongside this, an investigation by the Competition Commission can provide a detailed analysis of how the market works, clearly define any competition problems and identify lasting solutions which get to the heart of the underlying issues. The Financial Services Authority (forerunner to the Financial Conduct Authority) supports our provisional decision to consult on a market investigation reference. The Competition Commission will be able to take account of changes to the regulatory framework and engage actively with the OFT and Financial Conduct Authority as the relevant regulatory authorities. The Competition Commission's analysis can also help inform the Financial Conduct Authority's work to determine whether to use its power to cap the cost or duration of credit once the transfer has taken place.

We have published a consultation to seek views on this provisional decision. The closing date for responses is 1 May 2013 and we expect to announce a final decision in June 2013.

# Actions

## What needs to happen now?

### OFT action:

- Enforcement action is underway and we have more in the pipeline.
- We are requiring 50 lenders to take immediate steps to address areas of non-compliance and prove to us that they have addressed the issues raised - we will revoke the licence of any lender that fails to cooperate.
- We have made clear what we expect of all payday lenders - this is reiterated in this report. We have written to every single payday lender setting out our expectations.
- We have launched a consultation on a market investigation reference to look at wider market issues.

### Lenders must:

- Prove to us within 12 weeks that they have addressed all identified areas of non-compliance.
- Act now to ensure they are meeting all the standards set out in this report and in our wider guidance.
- Engage with trade associations to help raise standards across the industry.

### Trade associations must:

- Act now on our findings.
- Review their codes of practice.
- Engage constructively with us - we want to help the industry to raise standards.
- Show leadership to their members.
- Put in place procedures to monitor their codes effectively and impartially.
- Discipline members that don't comply.

### Consumers should:

- Think carefully before taking out a payday loan.
- Be aware of their rights and where to go for help if they have a problem.
- Contact the Money Advice Service for impartial advice on credit and debt.
- Contact Citizens Advice or another not-for-profit debt advice agency if they are struggling to make repayments and need help.

# How can consumers help themselves?

If you are thinking about taking out a payday loan, or are struggling to pay back a loan, you may find the advice set out below helpful.

## Payday loans

Payday loans are short-term loans for small amounts of money. They are available from high street shops and internet sites. Payday loans can be easy to get but interest rates are very high. There may be other ways to sort out your short-term money problems so think about the alternatives before you borrow. If you decide to get a payday loan, shop around and compare the costs before you borrow. Make sure you are clear about what will happen if you can't pay it back.

## Paying back a payday loan

Usually you'll be given up to a month to pay back the money you borrowed, plus interest. The most common way to pay back a payday loan is through your bank debit card. When you get the loan you agree to let the lender take the money from your bank account. This is called a continuous payment authority (CPA). If there isn't enough money in your account to repay the loan on the agreed date, the lender may keep asking your bank for all or part of the money. Charges are likely to be added if payment is late.

## Citizens Advice Bureau

Citizens Advice Bureau provides borrowers with the information they need to solve their problems through its self-help website [Adviceguide](https://www.citizensadvice.org.uk/).



## Stopping the payment

If you can't afford to repay the loan, you can instruct your bank or card provider to stop the payment being taken. You must do this before the day when payment is due.

If you are struggling to pay back what you owe or to manage on your money, get advice from your local Citizens Advice Bureaux.

## Other ways to borrow short-term

Payday loans are an expensive way to help people over temporary problems. They are not suitable for longer-term difficulties:

- A loan from a credit union is more affordable - check if there's a credit union in your area.
- If you have a bank account, you may be able to agree an overdraft. But be careful of going overdrawn without permission as it can be very expensive.
- If you're on a low income and need money in an emergency, you may be able to get help from the [Social Fund](#).

## Extending a payday loan

If you are having problems paying back the loan the lender may offer you longer to pay. This is known as a loan extension or rollover. Beware of doing this. If you extend the loan you will have to pay more interest and there may be extra fees.

If you are struggling to pay back what you owe or to manage your money, get advice.

## Making a complaint

Most payday lenders are supposed to follow a [Good Practice Customer Charter](#). If they don't follow the Charter, you can complain. You should first contact the lender and try to sort things out.

If you are still not satisfied, you can make a complaint to the [Financial Ombudsman Service](#). If the lender is a member of a trade association, you can also make a complaint to them.

For the latest advice go to: [www.adviceguide.org.uk/england/debt\\_e/pay\\_day\\_loans](http://www.adviceguide.org.uk/england/debt_e/pay_day_loans)

### **Holding payday lenders to account**

The use of payday loans is increasing, payday loans are used by 1.2 million people a year. The Citizens Advice service has seen a ten-fold increase in the proportion of clients receiving casework help with multiple debts which included a payday loan debt in the last four years. In the first quarter of 2009/10 only one per cent of Citizens Advice Bureau debt casework clients had at least one payday loan and in the same quarter last year this had risen to four per cent. In the same quarter of 2012, ten per cent had at least one payday loan.

Citizens Advice are continuing to see an increasing number of issues with payday loans and are keen to contribute to initiatives which reduce the consumer detriment associated with this form of borrowing, including the good practice customer charter introduced in 2012 by the four main trade associations representing payday and other lenders.

Citizens Advice is asking people who have taken out payday loans to take part in a national survey to monitor whether payday lenders are sticking to their self-regulating charter. The survey will run until November 2013 and asks payday loan customers questions including:

- Did the lender ask you to provide documents about your personal finances and general situation to check that you could afford to pay back the loan?
- Did the lender tell you that a payday loan should not be used for long-term borrowing or if you are in financial difficulty?
- Did the lender offer to freeze interest and charges for you if you make payments under a reasonable repayment plan?

The survey is on the Citizens Advice Adviceguide website at: [www.adviceguide.org.uk/dialogue\\_payday\\_loan\\_survey](http://www.adviceguide.org.uk/dialogue_payday_loan_survey)

Throughout the year, Citizens Advice will be discussing the emerging findings of the survey with lenders, trade associations and regulators, identifying issues and making recommendations for change.

# Where to find out more:

## Annexes

### The payday market

[Annexe A: Quantitative findings](#)

[Annexe B: Regulatory framework](#)

### The compliance review

[Annexe C: Background and methodology](#)

[Annexe D: Compliance inspections](#)

[Annexe E: Advertising sweep](#)

[Annexe F: Questionnaires and submissions](#)

[Annexe G: Mystery shopping](#)

[Annexe H: Consumer complaints](#)

[Annexe I: Glossary of terms](#)

[Annexe J: Ipsos MORI mystery shopping report](#)

### MIR consultation

[Annexe K: MIR consultation document](#)

## Useful links

### Consumer advice

Citizens Advice Bureau - [www.adviceguide.org.uk](http://www.adviceguide.org.uk)

Citizens Advice Payday Lending survey -

[www.adviceguide.org.uk/dialogue\\_payday\\_loan\\_survey](http://www.adviceguide.org.uk/dialogue_payday_loan_survey)

Money Advice Trust - [www.moneyadvicetrust.org](http://www.moneyadvicetrust.org)

Step Change - [www.stepchange.org](http://www.stepchange.org)

### Trade associations

Consumer Credit Trade Association - [www.ccta.co.uk](http://www.ccta.co.uk)

BCCA - [www.bcca.co.uk](http://www.bcca.co.uk)

Consumer Finance Association - [www.cfa-uk.co.uk](http://www.cfa-uk.co.uk)

Finance and Leasing Association - [www.fla.org.uk](http://www.fla.org.uk)

### Previous OFT reports:

Compliance Review Interim Report -

[www.oft.gov.uk/OFTwork/credit/payday-lenders-compliance-review](http://www.oft.gov.uk/OFTwork/credit/payday-lenders-compliance-review)

High Cost Credit Report -

[www.oft.gov.uk/OFTwork/credit/review-high-cost-consumer-credit](http://www.oft.gov.uk/OFTwork/credit/review-high-cost-consumer-credit)

### OFT Guidance

Debt Collection Guidance -

[www.oft.gov.uk/shared\\_of/consultations/OFT664Rev\\_Debt\\_collection\\_g1.pdf](http://www.oft.gov.uk/shared_of/consultations/OFT664Rev_Debt_collection_g1.pdf)

Irresponsible Lending Guidance

[www.oft.gov.uk/shared\\_of/business\\_leaflets/general/oft1107.pdf](http://www.oft.gov.uk/shared_of/business_leaflets/general/oft1107.pdf)

# References

A list of the weblinks included in this report

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OFT's Irresponsible Lending Guidance

[www.offt.gov.uk/shared\\_offt/business\\_leaflets/general/oft1107.pdf](http://www.offt.gov.uk/shared_offt/business_leaflets/general/oft1107.pdf)

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OFT's Payday Lending Compliance Review Interim Report

[www.offt.gov.uk/shared\\_offt/business\\_leaflets/consumer\\_credit/OFT1466.pdf](http://www.offt.gov.uk/shared_offt/business_leaflets/consumer_credit/OFT1466.pdf)

OFT's Debt Collection Guidance

[www.offt.gov.uk/shared\\_offt/consultations/OFT664Rev\\_Debt\\_collection\\_g1.pdf](http://www.offt.gov.uk/shared_offt/consultations/OFT664Rev_Debt_collection_g1.pdf)

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Citizens Advice payday loan survey

[www.adviceguide.org.uk/dialogue\\_payday\\_loan\\_survey](http://www.adviceguide.org.uk/dialogue_payday_loan_survey)

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Action Fraud

[www.actionfraud.police.uk](http://www.actionfraud.police.uk)

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Citizens Advice Adviceguide

[www.adviceguide.org.uk](http://www.adviceguide.org.uk)

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Citizens Advice social fund page

[www.adviceguide.org.uk/england/benefits\\_e/benefits\\_help\\_if\\_on\\_a\\_low\\_income\\_ew/help\\_for\\_people\\_on\\_a\\_low\\_income\\_-\\_the\\_social\\_fund.htm](http://www.adviceguide.org.uk/england/benefits_e/benefits_help_if_on_a_low_income_ew/help_for_people_on_a_low_income_-_the_social_fund.htm)

Citizens Advice information on the Good Practice Customer Charter

[www.adviceguide.org.uk/england/news/whats\\_new\\_dec12\\_payday\\_loans\\_new\\_rules\\_for\\_lenders.htm](http://www.adviceguide.org.uk/england/news/whats_new_dec12_payday_loans_new_rules_for_lenders.htm)

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Financial Ombudsman Service

[www.financial-ombudsman.org.uk](http://www.financial-ombudsman.org.uk)

Citizens Advice on Payday loans

[www.adviceguide.org.uk/england/debt\\_e/pay\\_day\\_loans](http://www.adviceguide.org.uk/england/debt_e/pay_day_loans)

Citizens Advice Payday loans survey

[www.adviceguide.org.uk/dialogue\\_payday\\_loan\\_survey](http://www.adviceguide.org.uk/dialogue_payday_loan_survey)