CMA Competition & Markets Authority

PAYDAY LENDING MARKET INVESTIGATION

Summary of a hearing with Wonga Group Limited held on 4 March 2014

Background

1. Wonga was an equity funded business that operated principally (by lending to consumers) in five countries (South Africa, Poland, Spain, the UK and Canada) and had a call centre in South Africa alongside a technology hub in Ireland. It did not lend in Ireland. The commercial management of the lending business was based in Geneva, which included the management of the UK business. There had been consideration in other jurisdictions of bringing in co-investors, although this would have implications for the capital structure and debt loading of those operations.

2. Wonga was in the process of [✂].

The market

3. The market for unsecured loans in the UK was very dynamic, diverse and competitive. It was a significant market which, unlike many other financial services, had undergone significant change since Wonga's entry in 2006 and was still evolving.

4. The market was originally dominated by US lenders who had lost market share to their competitors. There had been a significant number of new entrants since 2006 including some very well-funded companies (for example, Cash America), all of which competed with Wonga. Whilst competition from other payday lending companies had had an impact on Wonga's business, Wonga did not view them as its main competitors. There was an enormous amount of choice and a tremendous overlap between products of different loan amounts and durations.

5. The customer base was far more sophisticated than people thought, as had been shown by the CMA's own survey. There was a belief that customers were desperate for funds and so would accept any product provided they could access the necessary monies. However, the consumer base was very fluid, with customers electing for products, prices and services that were superior. Wonga had a loyal customer base but it noted that customer relationships, unlike the fund management business, tended to be short term.

Wonga received a large number of applications but refused around [✂]% of first-time applications.

6. Wonga had introduced sliders enabling customers to choose how much they wanted to borrow, the duration of the loan, the upfront cost and the option of repaying early. It had also pioneered the use of faster payments and introduced the concept of customers being able to conduct transactions online (including repayment arrangements), which had made its product more competitive and far more successful. The speed of a transaction was an important competitive variable but did not dominate customers' lending decisions. Banks were now offering sliders and a number of well-funded groups had launched similar products. Wonga thought it would be useful to have a comparison website with a slider which showed the cost of obtaining a loan across a wide range of products, including credit cards and authorised and unauthorised overdrafts.

7. Wonga experienced a great deal of competitive pressure from many different products and considered that unauthorised overdrafts offered by the banks competed with its loans. Wonga's £100 30-day loan was relatively inexpensive when compared with unauthorised overdrafts. It believed that the use of APRs in the market, which the banks were not required to publish, was misleading. Customers needed to see the total cost of credit.

8. A Wonga survey (conducted by Populus) indicated that its customers shopped around regularly, with over [✂]% of those surveyed having viewed other websites (including comparison websites) before choosing a Wonga loan. Wonga thought that the percentage of customers shopping around for loans on the high street might be different. Customers had access to other sources of credit, such as unauthorised overdrafts and credit cards, which competed with payday loan products. Research by Wonga showed that [✂]. Although there was clearly a demand for credit, consumers were moderate with regard to their borrowing. A repeat customer could borrow up to £1,000 with Wonga, but the average sum was in the region of £[✂].

9. There were a number of challenges using lead generators. The first was ensuring that they were properly regulated, which was virtually impossible. Wonga had a very strict policy and so any lead generators it used had to sign an agreement including indemnities, which deterred the greater proportion. Lead generators could close and reopen with alarming regularity. Customers were confused as to whether they were obtaining a loan from a lead generator or a payday lender because the former often did not make this clear on its website. If lead generators were properly policed, more responsible and transparent, then it could become a much larger channel for payday lenders. Wonga had been approached by a large number of lead generators and also

competitors seeking the details of customers it had refused, but it had declined to provide this information.

10. It was easier to assess a returning customer than a first-time customer. Wonga obtained updated credit data from [✄]. Wonga provided details of its customers' performance in relation to their loans to [✄] credit reference agencies (CRAs), as it was required to do. The CRAs had a very rich data base of shared data which could be purchased by companies seeking to enter the market. Wonga had spearheaded the real-time data initiative with Callcredit, announced in January 2014, and which would be going live in 2014. Real-time data sharing would become increasingly valuable as it would provide companies with a more relevant view of the customer, enabling them to make better decisions with regard to affordability.

11. Demand was shifting and instalment loans, which could be repaid early, were becoming increasingly popular, competing with short-term loans such as those provided by Wonga. Data from CRAs indicated that consumers were repaying their instalment loans early. The CMA's own survey revealed that customers were well educated, more likely to be employed and on higher than average salaries and were sophisticated users of these products.

12. Wonga, which had been losing share to instalment loans, had recently launched an instalment loan. This product was being piloted on its website [✄]. The cost of its instalment loan was nearly half that of its products charged on a daily basis (at 1%) and there were no hidden charges. Wonga was convinced that this product, [✄], would be popular with consumers. It was also starting to offer an instalment-type amortising longer-term loan to small businesses.

13. Wonga thought it would have to look at other products in response to the changing market, such as instalment loans, [✄]. Wonga had always put the customer at the heart of its product design but the customer was now at the forefront of Wonga's business. For example, [✄]. Wonga was continuing to invest heavily in and increase the number of services it provided, which included: the contact centre, which was available 24 hours a day seven days a week, making Freephone lines available for customers suffering from hardship or financial difficulty, providing non-premium-rate telephone numbers, offering a live chat service on its website so that customers who preferred to work online could still have human contact to answer their specific questions, and the introduction of digital repayment arrangements before the due date designed to avoid the customer being pressured (eg by a collections agent) during negotiations. Wonga also allowed its customers to process its income and expenditure form themselves and to assess their own disposable income, their ability to pay and what would be affordable for their

own personal situation. Wonga wanted to ensure that its customers not only valued its products but the service and treatment they received, so that they continued doing business with Wonga.

14. Wonga said that [✄]. Wonga's competitors were cannibalising their own businesses, with instalment loans replacing short-term products, [✄].

15. [✄] Wonga reiterated that the duration of these payday lending products meant that the APRs were not what customers would consider to be a normal rate. Wonga also observed more generally that APR was misleading for customers and that a total cost of credit served customers better.

16. The instalment product combined with regulatory changes had very much changed the dynamic of a market that had initially experienced enormous growth but which had very much slowed down. It was now a far more competitive market and Wonga had lost market share to its competitors. Wonga had a lot to do to remain competitive in terms of new technologies, new models and new pricing and noted that its costs had increased.

17. The volume of Wonga's business provided helpful customer data, especially for repeat business. [✄]

Barriers to entry

18. Wonga thought there would be an increasing number of different companies entering the market. Entry, building a brand and developing a customer base was easier today because of the breadth and depth of the data available. The availability of data was a huge advantage, enabling a new entrant to build its business quickly. In terms of finance and technology, venture capital groups were now more aware of the payday lending industry and it was possible to build an IT system relatively quickly.

19. Wonga advertised on digital channels and media, including radio and television. It also used lead generators, but the trade generated through these comprised a very small percentage of Wonga's business. It did not use the majority of the leads it obtained from lead generators because the credit quality of the leads was generally very poor. The conversion rates for lead generation was materially lower than for the other channels Wonga used. Wonga thought that if it was entering the market today it would use social media and websites more than it did on entry. Some new entrants, for example Satsuma Loans, were using television advertising extensively. Wonga did not think that the smaller companies would be able to survive the regulations being introduced by the Financial Conduct Authority (FCA) and so future competition would come from well-funded companies such as 118 118

and Think Finance, which were investing heavily in this sector. It did not consider that its brand had created a significant barrier to entry because customers were price sensitive and looked around for the best deal.

Pricing

20. There was already a great deal of price competition in the market and this would become more pronounced with further entry. The introduction of instalment loans would lower the cost of some products for customers.

21. The pricing of Wonga's products was different from that of its competitors, Wonga charged 1% a day for its loans (the average length of which was around 17 days). The traditional payday model was based on 30 days. Wonga did not consider that the price for a £100 loan clustered around the £30 mark. There might have been clustering early on in the market but companies were now offering different, cheaper products and there were more instalment products available. In setting the price of a loan, companies had to consider the revenue required to cover their costs and the level of risk that they bore and ensure that there was a reasonable enough profit to remain in business. Wonga thought that there might be different niches within the customer base that different companies were seeking to target. Wonga did offer promotions but these were not the primary driver of its business changes. It did not offer risk-based pricing as it wanted to operate transparently so that every customer knew upfront how much their loan would cost and not discriminate between customers.

22. A great deal of work was being undertaken internally by Wonga in relation to pricing. The combination of some of the changes negotiated with the Office of Fair Trading (OFT), allied to the effects of competition, had impacted on Wonga's UK revenues, [✄]. Wonga was looking at how it could become more efficient in its processes, services and corporate overheads so that it could pass savings to customers.

23. Research by Wonga indicated that [✄].

24. Wonga thought that some customers with more expensive loans with other lenders might not be switching to Wonga due to the APR on some of its (short-term) products. APRs misled customers into thinking that the company with the highest APR had the highest-priced credit. The reason why Wonga's APR was higher than many of its competitors was not that its prices were higher (in many cases its total cost of credit was lower) but because the term of the loans in its portfolio were on average shorter than its competitors and so on an annual basis the cost looked higher.

25. Some customers opted for Wonga's Little Loans product rather than cheaper alternatives because Wonga had a very high net promoter score. Evidence from surveys indicated that customers liked dealing with Wonga, trusted them and had had a good experience with them in the past. Wonga offered a particular quality of service. Customers were able to interact with Wonga, received clarity on price, could go online, set up their own repayment arrangements and could repay their loan early if they wanted without incurring any fees.

26. Wonga's default fee was based on the actual cost of collections and managing defaults, which was set at £30. [✂] As a result of regulatory moves over the last year from continuous payment authority (CPA) to other means (for example, telephone and debt collection agencies), the actual cost of collection and default costs was increasing. Wonga operated on a transparent basis, whereas some of its competitors applied hidden charges. While Wonga had increased its default fee (from £20), it had not adopted the approach of credit card companies which charged a fee of £12 every month. Wonga was portrayed as having the highest default fee but only charged its default fee once. Wonga's customers selected their own repayment dates, the deadline for which was 5pm.

27. Wonga's ethos was to make its money when customers repaid on time. Wonga considered that back-end fees were unattractive because they penalised customers who could not repay their loan and raised questions as to the effectiveness of a company's affordability checks. [✂] Wonga needed to recover its monies and relend. It noted that in Australia default and other charges had been capped at 200%, with a charge of 4% a month thereafter.

28. Part of the problem of late payments could be attributed to the UK banking system, as lenders did not have visibility with regard to a customer's bank account and specifically the payments being made to and from it which could occur at different times of the day. This was one of the reasons why Wonga used CPA several times on the due date. Wonga thought that there were risks associated with the new CPA rules which would limit the number of times it could attempt to obtain payment on the due date. Wonga noted that some of its competitors imposed a repayment date based on the date when they thought they would most likely be able to withdraw money from a customer's bank account.

29. Wonga sent its customers a reminder three days and then 24 hours before their repayment date by email and SMS asking them to contact Wonga if they envisaged any problems in making payment. Its customers could also set up a repayment date prior to the agreed due date using the repayment arrangement online option and thereby avoid being charge a default fee. If customers

informed Wonga that they were going to be a day late in repaying their loan, Wonga would not charge a default fee. Wonga continued to try and contact customers after the repayment deadline to set up payment arrangements. It was currently in the process of considering a proposal to refund default fees for accounts up to three days after the due date.

Profitability

30. Payday lending companies that had entered the market early and had been able to build scale had been able to achieve a good level of profitability. However, the profitability of the industry had suffered during the last 12 to 24 months. The future profitability of the industry would not be clear until the proposed OFT and FCA changes had taken effect, probably during the second half of 2015 or early 2016. Wonga thought that the end result of these changes would be lower prices for consumers and the exit of some businesses from the market.

Regulation

31. Regulation would have a significant impact on the sector. Wonga was in favour of raising standards but thought that the FCA regime would be more invasive than the OFT's, requiring significant expenditure on systems and people including the development of significant compliance and monitoring functions. The cost of ensuring that Wonga was compliant with the FCA's regulations would be significant, running into millions of pounds a year. It thought that the cost of regulation, combined with the added costs of competition, might result in companies exiting the market. Only those companies with a healthy balance sheet would find the payday loans market an interesting business. Wonga did not believe that activity in the market would increase until the FCA had concluded its regulatory process. It would rather invest money in marketing to customers than acquiring a competitor. There were low barriers to switching and good companies would find it easier to acquire new customers.

32. The effect of the FCA limiting the number of times companies could use CPA and rollovers to two would have a very small effect on Wonga because less than [✂] of its customers extended their loan. Customers who did opt to extend their loan could select the amount of the loan they wanted to carry over and the duration. With regard to the reduction in the number of CPAs, Wonga indicated that it would supplement the two CPAs with other methods, eg telephone and email (prior to the rule change it had used CPA on average [✂] times per customer). As soon as it had statistical data on the effects of this change in relation to default rates, it would consider whether it might need to reject some customers and consider amending its underwriting. Wonga

believed that the FCA wanted to tighten the regulations on CPA because payday lenders had been abusing the system. Wonga thought that limiting CPAs to two, and eliminating partial payments which helped reduce the balance of a customer's loan and thereby the interest accruing it on it, would result in more customers defaulting on their loans which would in turn impair their credit history.

33. Wonga supported the tightening of affordability checks and was continually refining its own affordability processes. It thought that real-time data sharing would help in this regard, especially if the banks entered their data on a real-time basis. Wonga did not know what effect the FCA imposing a cap on the cost of lending would have on the market and its business.

34. Wonga hoped the investigations being conducted by the FCA and CMA would show that there was a need for payday lending products and that these could be properly run and marketed. The harsh criticism the industry received had had an impact on every aspect of Wonga's business. The development and structure of the industry in the future was unclear.