Financial Conduct Authority

Call for Input: High-cost credit Including review of the high-cost short-term credit price cap

November 2016

Contents

We are asking for comments on this Call for Input by 15 February 2017.

Please email your comments to highcostcreditcfi@fca.org.uk

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We have carried out this work in the context of the existing UK and EU regulatory framework. We will keep it under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Abbreviations used in this document

APR	Annual percentage rate of charge
CCA	Consumer Credit Act 1974
CfI	Call for Input
CMA	Competition and Markets Authority
CONC	Consumer Credit Sourcebook
COND	Threshold Conditions
CP	Consultation Paper
CPA	Continuous payment authority
CRA	Credit reference agency
FCA	Financial Conduct Authority
HCSTC	High-cost short-term credit
MMC	Monthly Maximum Charge
OFT	Office of Fair Trading
PCW	Price comparison website
PRIN	Principles for Businesses
PS	Policy Statement
PSD	Product Sales Data
SYSC	Senior Management Arrangements, Systems and Controls
TAP	Total amount payable

1. Overview

1.1 We are issuing a Call for Input to inform further work on high-cost credit, including a review of the high-cost short-term credit (HCSTC) price cap.

1.2 Since the Financial Conduct Authority (FCA) took over regulation of consumer credit in April 2014, we have focused in particular on products that we believe pose the highest risks to our consumer protection objective. One of the areas on which we have focused is high-cost credit, which includes payday loans, home-collected credit, catalogue credit, some rent-to-own, pawn-broking, guarantor and logbook loans. We have also looked at areas where consumers may face higher costs and charges, for example our market study of competition in the credit card market. We also announced earlier this month that we would use this review to look at arranged and unarranged overdrafts.

1.3 We have already taken many steps to address the risk of consumer harm from the products listed above. These include:

- introduction of the HCSTC cap and new regulation for HCSTC lenders
- restrictions on credit brokers introduced using our early intervention powers
- assessing applications for authorisation from firms formerly licensed by the Office of Fair Trading (OFT) who wish to continue carrying on regulated credit activity, including an assessment of the suitability of their business models and ability to satisfy, and continue to satisfy, our other minimum standards
- undertaking robust risk-based supervision, leading to redress where appropriate, and thematic reviews
- introducing new rules to address the harm we have identified based on detailed evidence gathering and cost benefit analysis, and
- carrying out a market study of competition in the credit card market

1.4 Our new rules apply in particular to high-cost credit broking, guarantor loans and HCSTC, which includes payday loans. For HCSTC we have introduced risk warnings, restrictions on rollovers and how payments are collected, a price cap and new standards for price comparison websites.

1.5 We have also worked with other bodies looking at related issues, including the Competition and Markets Authority (CMA) investigations on competition in the payday lending and retail banking markets, and the Law Commission's review of the Bills of Sale Acts (the legal basis for logbook loans).

1.6 Much progress has been made in reducing consumer harm and there have been significant changes in the high-cost credit sector since 2014. In the HCSTC sector in particular there has been a clearly discernible decrease in acceptance rates and declining default rates. Customers are on average paying substantially less for HCSTC with a notable decline in average charges. There has been an average increase in loan duration.

1.7 We have already committed to reviewing the HCSTC price cap but have decided to expand this work to look at high-cost products as a whole to build a full picture of how these are used, whether they cause detriment and, if so, to which consumers. This will enable us to consider whether further policy interventions are needed, and whether these should be more consistent across the market than they are at present.

1.8 The focus on overdrafts follows a number of competition issues being identified with this product, including poor price transparency and the nature and level of charges, especially for unarranged overdrafts. We want to consider the consumer protection issues arising from this using our full range of powers.

1.9 We are looking for evidence and feedback on the following areas:

- high-cost credit products (Chapter 2)
- overdrafts (Chapter 3)
- the HCSTC price cap (Section 2) and
- repeat and multiple HCSTC borrowing (Section 3)

1.10 The questions on which we want your input and feedback are set out at the end of each section and brought together in Annex 1. Please send us your responses by 15 February 2017.

Timetable

Stakeholder events following Call for Input publication	December 2016 to February 2017
Call for Input response deadline	15 February 2017
Evidence gathering including consumer survey for HCSTC price-cap review.	Q4 2016 – Q2 2017
Review and assess evidence from Call for Input	Q2 2017
Publication of results of HCSTC price cap review.	Mid 2017
Further work if we decide to restructure or recalibrate the cap, including developing proposals for consultation	H2 2017 – H1 2018
Further work on issues relating to high-cost credit and overdrafts identified in this Call for Input	Q2 2017 onwards

Section 1
High-cost credit

2.
High-cost credit: wider issues

2.1 The main types of high-cost credit are HCSTC (including payday loans), home-collected credit, catalogue credit, some rent-to-own, pawn-broking, guarantor and logbook loans. Other credit products – such as motor finance, credit cards and overdrafts – may be high-cost, particularly for less creditworthy customers or depending on how they are used.

2.2 We have decided to look across high-cost products as a whole to build a full picture of how these are used, whether they cause detriment and, if so, to which consumers. This will enable us to consider whether further policy interventions are needed, and whether these should be more consistent across the market than they are at present. For example, risk warnings and limits on the number of times continuous payment authorities (CPAs) and rollovers can be used apply currently only to HCSTC. It will also enable us to consider the potential consequences (including 'waterbed' effects) of taking action on specific high-cost credit products, particularly on firm behaviour, consumer welfare and access to credit.

2.3 Although differentiated in some respects, the customer base for these products shares certain characteristics, including a higher-than-average incidence of vulnerability. In many cases consumers are likely to be using several high-cost products, or switching between them because of difficulties in accessing credit, for emergency borrowing or juggling repayment dates. Different levels of protection may not be fair or transparent.

2.4 We recognise that the nature of high-cost products varies, that the risk of detriment caused by different products may vary, and that different high-cost products may not be closely substitutable. Cost may only be one factor a consumer considers. Other factors may also be important such as speed and convenience in obtaining credit, wanting a loan for a specific item, and in emergencies short-term need may outweigh consideration of relative cost. Different types of high-cost credit meet these different needs, and are reflected in quite diverse business models.

2.5 At this stage in planning our work on this sector we are seeking responses to the following questions, with supporting evidence wherever possible. Depending on the responses received and the evidence we gather, we may be able to publish proposals for consultation in 2017.

Q1: Which high-cost products do you think our review should focus on and do you think a more consistent approach to high-cost products is feasible or desirable?

Q2: To what extent is there detriment from high-cost credit products (other than HCSTC)?

Q3: Where there is detriment, do you consider that it arises from matters not addressed by our rules, or is it mainly caused by firms failing to comply with the rules?

Q4: **If there is detriment arising from matters not addressed by our rules, what sort of interventions should we consider? What would be the impact?**

Q5: **Should some of the HCSTC protections be applied more widely? What would be the impact on the cost of or access to credit?**

3. Overdrafts

3.1 When we took over regulating consumer credit, we identified overdrafts as a priority area, and said we would consider consulting on turning some voluntary industry protections for consumers into FCA rules.[1] However, in the light of the CMA's subsequent decision to investigate competition in the retail banking market, we decided to contribute to its work before considering whether we should use our powers to take action on overdrafts.

3.2 The CMA issued its final report in August 2016.[2] This identified a number of competition issues relating to overdrafts (such as poor price transparency, especially for unarranged overdrafts) and proposed remedies, some of which included recommendations to the FCA.

3.3 On 3 November 2016 we published our response to the CMA's report.[3] We said we would take forward the CMA's recommendations and would carry out further work, including behavioural testing, on certain proposed prompts and alerts (for example, when consumers come close to their arranged overdraft limits). We will also review the Monthly Maximum Charge (MMC) for unarranged overdrafts that the CMA proposes to introduce by order once it has been in force for a sufficient length of time to enable us to undertake a meaningful review to determine whether we ought to propose new rules in relation to the MMC. We also said we would look at bank account opening procedures to see whether improvements could be made to make consumers more aware of the features and costs of overdrafts.

3.4 However, the CMA's competition remedies will take time to change firm and consumer behaviour, especially for unarranged overdrafts which are used intermittently. Some stakeholders have also responded to the CMA's report by citing wider consumer detriment in relation to overdrafts, notably high charges.[4]

3.5 The FCA has a broader set of statutory objectives in relation to financial services, duties, powers and tools than the CMA. We have decided to look in more detail at overdrafts for a number of reasons, and will do so from a consumer protection, as well as a competition, perspective.

3.6 As running-account credit, overdrafts may also, like credit cards, lead some consumers to use them inappropriately for longer-term borrowing.[5] The ability to go into an unarranged overdraft raises other issues, including the nature and level of charges and potential lack of transparency.

3.7 These are complex and inter-related issues on which we need to collect more data and other evidence to assess the extent, nature and causes of detriment. This will help us consider

1 www.fca.org.uk/firms/consumer-credit-research-overdrafts

2 https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf.

3 www.fca.org.uk/publication/corporate/response-cma-final-report-competition-retail-banking-market.pdf

4 For example, see comments made by the Treasury Select Committee (https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2015/retail-banks-overdraft-charges-chairs-statement-16-17/) and (http://press.which.co.uk/whichpressreleases/overdraft-charges-more-expensive-than-payday-loans)

5 We discussed the issue of 'persistent debt' on credit cards in the CCMS Final Findings Report published in July 2016 www.fca.org.uk/publication/market-studies/ms14-6-3-credit-card-market-study-final-findings-report.pdf

appropriate and proportionate ways of addressing harm to consumers that will take account of welfare effects.

3.8 There are a wide range of views among stakeholders on overdrafts. We would therefore welcome input now from as many interested parties as possible to help us scope this work and identify the key issues.

3.9 We are seeking responses to the following questions, with supporting evidence wherever possible.

> **Q6: To what extent do you think overdrafts are a substitute, or alternative, for other high-cost credit products?**

> **Q7: What do you think are the key issues the FCA should consider on arranged and unarranged overdrafts respectively?**

> **Q8: What measures could be taken to address these and what would be the risks and benefits?**

Section 2
HCSTC price cap review

4. Price cap: background

4.1 The price cap on HCSTC came into force on 2 January 2015. We committed to reviewing the cap two years after its implementation, in the first half of 2017.

4.2 In preparation for the review, this section explains how we intend to review the cap and sets out our analysis to date of the changes to the HCSTC market and the experience for users of HCSTC post-cap. We also set out some evidence on the consequences for consumers who failed to get HCSTC loans post-cap. We are seeking evidence from stakeholders on these areas to feed into our review.

The HCSTC price cap

- An initial cost cap of 0.8% of the outstanding principal per day on all interest and fee charges during the agreed loan duration and when refinancing.
- A cap for those in default of: an aggregate total of £15 on fixed charges, interest at the same rate as the initial cost cap calculated per day on the outstanding principal and any fixed default charges.
- A total cost cap of 100% of the amount borrowed applying to all interest, fees and charges. Therefore, the maximum anyone could ever pay on an individual loan in interest, fees and charges would be 100% of the original principal.

Example

The price cap means that if a consumer borrowed £100 for 30 days they would be charged a maximum of £24 during the agreed loan duration. If the loan becomes overdue they would pay a maximum of £15 in fixed charges. The total cost cap means that a consumer who borrowed £100 would never repay more than £200.

The price cap review

4.3 Our aim is to assess whether there is evidence that suggests we should consider changing the price cap. At this stage, it is not a repeat of the process we went through for setting the structure and level of the cap. We expect to publish our findings in the summer of 2017.

4.4 We have a statutory duty to make rules providing for a price cap.[6]

6 Section 137C(1A) of the Financial Services and Markets Act 2000.

4.5 We will decide, in the light of the evidence, whether we will start further work in the second half of 2017 to consider restructuring and/or recalibrating the cap and develop proposals for consultation.

4.6 In assessing whether there is evidence that we should consider changing the cap, we plan to look at the following:

- the current state of the HCSTC market and how it has changed since FCA regulation was introduced
- consumers' experience of using HCSTC post-cap
- consequences for consumers who can no longer access HCSTC post-cap, and
- the definition of HCSTC and the impact on other high-cost products

4.7 Our further work on other high-cost products is discussed in Section 1. We excluded other high-cost products from the definition of HCSTC (and therefore the price cap) because the products and the nature of the problems that they may cause consumers were quite distinct. However, we will consider, as part of the price cap review whether our original assessment holds that there are no close substitutes for HCSTC: that is, if consumers are unable to get HCSTC, they are unlikely to substitute with another high-cost credit product.

4.8 The review will also incorporate the following steps:

- a consumer survey of successful HCSTC applicants, declined applicants, and former applicants who no longer apply for HCSTC
- analysis of latest product sales data and regulatory returns to get an up to date picture of market trends
- discussions with stakeholders including meetings with firms, and consumer and industry round tables

4.9 The rest of this section sets out some preliminary analysis based on detailed data from January 2014 to June 2015, covering a period pre and post cap implementation.

5. The current state of the HCSTC market

Introduction

5.1 When the price cap was introduced in January 2015, the HCSTC market had experienced a year of substantial change: a robust new regulatory regime, significant reductions in demand and major changes to firms' business practices. The changing picture appears to have continued through 2015 and 2016 as firms have continued to assimilate regulatory change, adapted to the price cap, applied for FCA authorisation and responded to reduced demand for their core product. Annex 2 summarises the regulatory changes that HCSTC firms have experienced since we took over their regulation in April 2014.

5.2 Our review needs to take this changed HCSTC market into account. Our preliminary view is that the changes to the market may not yet have stabilised and we can expect further changes in the market over the course of next year. We will consider the implications of the changes for the rationale for setting the price cap structure and levels.

5.3 A significant element in the decision making regarding setting the level of the cap was whether a viable market in HCSTC could continue, including a high-street distribution channel, in order to allow customers who could benefit from accessing such loans to do so. Our preliminary view is that a viable market has been able to continue, including through high-street stores; firms continue to operate in this market and offer HCSTC loans although there is a trend of reducing profitability, on average, across the industry (nearly all firms in our sample were unprofitable in the first half of 2015). Many firms have, however, indicated that they can offer profitable loans under the cap. We will explore this in more depth during the review.

5.4 In this chapter we summarise market trends from 2014 to June 2015 (detail in Annex 3) and explain how changes in the market will be relevant to our thinking in relation to whether or not to change the price cap. We then set out some questions on areas where we would like stakeholders to provide their views and evidence.

5.5 The market analysis is based on application-level data from HCSTC lenders on all (successful and unsuccessful) applications for HCSTC made to the largest HCSTC lenders from January 2014 to June 2015. We also collected lender data on all successful loan applications from a sample of smaller lenders in this market. We gathered credit files of all individuals identified by credit reference agencies (CRAs) including measures of individual-level creditworthiness.[7]

7 See pages 171-174 for description of CRA data
www.fca.org.uk/publication/consultation/cp-14-10-technical-annexes.pdf

Changes to the HCSTC market

5.6 The following section summarises the changes observed in the HCSTC market, based on detailed lending data for the period January 2014 to June 2015 and covering most of the HCSTC market.

5.7 We have been able to observe market trends in 2016 to some extent, as firms have provided substantial amounts of information as part of their applications for authorisation and through our supervisory work on HCSTC firms. While we have received some data through firms' quarterly reporting of product sales data (PSD), we do not yet have a full picture as the requirements only commence when firms are fully authorised. When we do the review, we will have more up to date data on market trends available.

Market size

5.8 Our data show a major contraction in the HCSTC market over the course of 2014 compared with 2012-2013. The number of consumers and the number of loans fell steeply: between January 2014 and June 2015, there were over 800,000 fewer individuals taking out at least one HCSTC loan than between January 2012 and June 2013.

5.9 The biggest factor in decreased lending volumes was a significant drop in the number of applications, suggesting substantially reduced demand for HCSTC. The drivers behind this are as yet unclear. There could be a number of factors contributing to reduced demand, such as negative publicity for HCSTC or consumers no longer applying because they are aware that it is more difficult to get an HCSTC loan. However, the sudden steep decline over a relatively short period suggests that there are also supply-driven factors at work, such as restricting advertising and buying fewer leads. Our interventions in the credit broking market, more information about which can be found in Annex 2, may have contributed to this. The consumer survey that we plan to carry out as part of the review should give us some insight into this; we will survey a group of 2000 consumers, including consumers who previously applied for HCSTC but no longer do so.

5.10 In addition to reduced applications, there is also a clearly discernible decrease in acceptance: rates dropped from 50% to 30% from the start of 2014 to the middle of 2015. There was no discernible drop in lending volumes immediately preceding the implementation of the price cap in January 2015. However, the proposed structure and level of the price cap were first published in July 2014 and confirmed in November 2014, so firms are likely to have been changing their approach in response. Given the scale of regulatory change across 2014, it seems likely that firms changed their appetite for lending as part of an overall strategy to prepare for the full range of new regulatory requirements, the authorisation process and increased supervisory focus on compliance, particularly in relation to creditworthiness assessments.

Number of firms

5.11 As of November 2016, 144 firms are fully authorised to carry out HCSTC lending. However, a number of these firms do very little HCSTC lending; the number of firms whose main focus is HCSTC is much smaller.

5.12 188 firms which originally applied for HCSTC permissions withdrew their applications, often after a direction from the FCA following consideration of the firm's authorisations application and where it was clear that the firm did not meet the standards expected by the FCA.

Firm revenues and profitability

5.13 Changes in firm revenues have followed a similar pattern to the drop in lending: the lenders in our sample earned revenue of £409m in the first half of 2014 which reduced to £225m by the second half of 2014 and £110m in the first half of 2015.

5.14 Profitability has also decreased: combined losses in the first half of 2015 were larger than the combined losses in the whole of 2014. The profitability of all the firms in the 2014 to June 2015 sample decreased, with some previously profitable entities becoming unprofitable, although some were still profitable. It is plausible that the decrease in profitability that accelerated in the first half of 2015 is due to the price cap. We will look into this further during the review, for example, whether this is affected by large one-off payments.

Default rates

5.15 Default rates declined through 2014 to June 2015: the proportion of loans being charged a late payment fee has steadily decreased from 16% in January 2014 to below 8% in April 2015 (with some firms no longer charging late payment fees). The proportion of loans entering arrears for seven days or more similarly reduces from 16% to 12%.

5.16 Our analysis suggests that firms' behaviour – specifically, changing their lending policies and declining more higher-risk applicants – has contributed to this decrease in arrears rates. There was a decrease in arrears rates for successful applicants across the range of credit scores, suggesting that firms are rejecting the highest risk applicants and that tightened lending criteria have had an impact on the risks of default for borrowers. We consider this further in the next section.

Changes to products

5.17 Our examination of business models during the authorisation process and in our supervisory activity indicates a shift away from the traditional 30-day 'payday loan' product towards longer-term instalment products. This is borne out by our detailed loan data: the average initial loan duration in 2012-2013 was 30 days; at the beginning of 2014, it was 40 days; by June 2015, it had increased to 80 days.

5.18 We have not seen, however, a corresponding increase in average loan size – this has remained around £250.

Lower costs for customers

5.19 From the start of 2014 to April 2015, our data show that customers were on average paying substantially less for HCSTC.

5.20 There was a notable decline in average revenue customers were charged, despite an average increase in loan duration (Figure 9, Annex 3). Loans originating at the start of 2014 typically resulted in the customer being charged around £100 in interest and fees. This declined over 2014 to around £80. Once the price cap was introduced, there was a further sharp drop to around £60.

5.21 Firms have reduced their prices to comply with the cap and in some cases withdrawn products. There has also been some pricing under the cap, including in the form of risk-based pricing. The new rules on price comparison websites coming into force on 1 December 2016 are intended to stimulate price competition and we anticipate further examples of pricing under the cap as a result.

Implications for the price cap

5.22 Such a significant change in the HCSTC market over a relatively short period of time suggests it was driven, to a large extent, by regulatory change. Firms changed their approach in anticipation of, and as a response to, the new regulatory environment. Our observations and discussions with trade associations suggest that firms have been focused on addressing compliance issues and gaining FCA authorisation and so have not been actively pursuing new sales strategies and product development. We see some signs of increasing lending volumes in the PSD data received in 2016, but do not have a full picture of the market or a sufficiently long period of data collection to establish a pattern. We will have a more complete set of PSD data when we do the review next year which will give us an updated view.

5.23 The indications are that firms are still going through a period of change in response to regulatory change and we expect this to continue as firms have turned their attention to their new strategies post-authorisation. It could be argued that the changes triggered by regulatory change including the price cap have not yet stabilised and, as such, changing the price cap would be inappropriate before this has fully worked through.

5.24 The modelling work, which we carried out to help set the cap, anticipated reduced profits for firms (noting that only the largest lenders made significant profits) and a subsequent reduction in the number of firms. We expected that firms would take action to limit the impact of the price cap through changes to their business models, and we were confident that a viable market in HCSTC would remain, including a high-street distribution channel, at the level of cap selected.

5.25 At present, this appears to be the case, borne out by the number of firms that are now FCA-authorised with permission to provide HCSTC.

5.26 During the authorisation process, firms set out strategies for returning to profitability, such as diversifying their product and customer base, and firms are now implementing strategies to adapt their business models to accommodate a drop in revenue. There are also a large number of firms providing a very small number of HCSTC loans – it may be that these firms would prefer to continue providing them, despite a lack of profitability, as part of a package of products that they offer to attract people to their firm.

5.27 While we see the continuation of the provision of HCSTC and some pricing under the cap, the price cap does appear to have had an impact on profitability; as such, we should probably be cautious about interpreting the number of firms in the market as a sign that the price cap could be set lower. We will look further at the issue of viability of HCSTC provision during the review.

5.28 Average loan duration appears to be moving towards the optimum revenue generating position for firms that they are able to achieve under the price cap, of around three to four months. When structuring and setting the cap, we considered that this struck the right balance in allowing firms to offer longer-term loans, while limiting excessive charges accumulating from loans longer than three to four months.[8] Firms would need to price under the cap if they want to offer HCSTC for longer periods. We are interested in views and evidence on the impact of the price cap on the development of products of longer duration (within the definition of HCSTC).

Q9: Please provide evidence and/or views on:

8 The 100% total cost cap prevents firms from charging the maximum allowable 0.8% interest per day for longer than around 4 months.

- **the reasons for the substantial reduction in applications from consumers for HCSTC and the reduction in acceptance rates by firms**
- **whether this decline will continue, plateau, or lending will increase**
- **the impact of the price cap on the viability of HCSTC and how this might differ for online and high-street, and**
- **the impact on loan duration and product development more generally of the structure and level of the price cap**

6. Consumers and HCSTC use

Introduction

6.1 The impact on consumers was of central concern in designing and setting the price cap, and will be a key focus of the review.

6.2 The price cap was designed to strike the right balance between the benefits of protecting borrowers who continue to use HCSTC from excessive charges and excluding customers who would be harmed by using HCSTC. We judged that the risks of default, or of other financial detriment as a result of using HCSTC, were too high for borrowers who were only just eligible for a loan prior to the price cap due to their low credit score and that, on average, these borrowers would be better off not using HCSTC. The level of price cap was intended to exclude the riskiest borrowers because of the amount of detriment to them from using HCSTC, but allow firms to continue offering loans to lower-risk borrowers.

6.3 The review will consider if evidence suggests that matters have changed in ways or to the extent that we need to reconsider the risks and benefits of using HCSTC. We will look at evidence of the impact on people who apply for, but are declined, HCSTC post-cap. An important means of evidencing consumer outcomes will be the results of a consumer survey that we will carry out in the first half of 2017. This will be similar to the survey we conducted in 2014 to help us design and set the cap, and will gather evidence on the outcomes for users of HCSTC and for declined applicants. We will also survey consumers who previously used HCSTC but no longer do so, to help us understand why there has been a significant drop in the number of applications for HCSTC and what are the consequences for those consumers.

6.4 We expect to see improvements in outcomes for consumers using HCSTC, given new regulatory requirements and increased levels of supervisory scrutiny.

6.5 We are not proposing to re-run the quantitative analysis we used to set the price cap. However, we have already carried out some analysis of detailed loan and credit reference agency (CRA) data for 2014 to June 2015, covering the period during which firms were preparing for and implementing regulatory changes and including a six-month period after the introduction of the price cap. This has given us some important insights into outcomes for consumers of using HCSTC and those who were declined HCSTC. These are summarised in this chapter, with detailed results of the analysis set out in Annex 3.

6.6 The consumer survey that we will conduct for the review will give us an updated insight into the outcomes for users of HCSTC, declined applicants and consumers who no longer use HCSTC.

Profile of consumers applying for HCSTC

6.7 Our original research on the 2012/2013 population of HCSTC applicants showed that when they applied for HCSTC loans, many consumers[9] were in a difficult, and deteriorating, financial situation. There are indications that this continues to be the case: the 2014 to June 2015 data shows that in the 12 months prior to applying for HCSTC, applicants were on a steady trajectory of increasing their debts and were at increasing risk of arrears on at least one of the credit products they hold. The consumer survey that we will carry out for the review will provide further insight on the profile of consumers, but the indications are that use of HCSTC comes at a point when consumers are under pressure from their deteriorating financial circumstances.

6.8 This suggests that, despite the significant decline in lending and a move away from the traditional 30-day HCSTC product to longer-term HCSTC, the target market and the nature of the demand for HCSTC is similar pre- and post-cap.

Consumers using HCSTC

Lower risk of default

6.9 Analysing the data for the period January 2014 to June 2015 shows some significant improvements in outcomes for users of HCSTC. The high risk of being unable to repay HCSTC on time or at all was an important factor in our assessment of the risks and benefits of using HCSTC: there have been notable declines in the risk that a consumer using HCSTC for the first time would fall into arrears or default, benefiting customers in a substantial portion of the market. However, declines in the risks for customers are not uniform across the market and the overall picture is of a slight decline.

6.10 The data shows a clear improvement in arrears rates across the market for repeat borrowers. The risk of falling into arrears for repeat applicants in the highest credit risk group (the riskiest 10% of accepted applicants by credit score) reduced from around 26% at the beginning 2014 to around 18% by June 2015. This suggests that when firms have evidence that customers are unable to pay back on time, they are less inclined to lend to them again.

Continuing risk of experiencing arrears on other credit products

6.11 When we conducted the original analysis for designing and setting the price cap, we applied a technique that allowed us to identify whether applicants who were marginally accepted or declined for HCSTC were better or worse off afterwards, looking at a wide range of financial indicators from CRA files and survey data. We found that these 'marginal' users of HCSTC were, on average, more likely to miss payments or not fully pay back other non-HCSTC debt, or to exceed their overdraft limits. Our analytical technique allowed us to identify that HCSTC was the cause of these increased risks.

6.12 This analysis relied on having a large data set composed of first-time users of HCSTC. Due to the substantial reduction in lending volumes since the beginning of 2014, most HCSTC users in the January 2014 to June 2015 data set have previously had at least one loan. We are therefore not able to repeat this analysis in order to make causal links between first-time HCSTC use and future financial outcomes. We can, however, make some observations about the financial outcomes for HCSTC users in the 12 months after taking out HCSTC, although we are unable to identify whether use of HCSTC is the cause.

9 For more detailed information on this please see p.17 CP14/10

6.13 The January 2014 to June 2015 data shows that, in the 12 months before applying for HCSTC, consumers were at increasing risk of experiencing arrears on their credit file on non-HCSTC credit products, with an increased tendency to exceed their overdraft limit. This increase continues after taking out HCSTC and shows a slight tendency to accelerate. While we cannot isolate completely the cause of these increased risks as being solely attributable to HCSTC use, we do not observe any improvement in financial circumstances after using HCSTC. Given our previous analysis establishing a causal link, it is plausible that HCSTC is a contributing factor to these increased risks.

Declined applicants

6.14 As noted in the previous chapter, acceptance rates have declined and it is now more difficult to get HCSTC. Across a wide range of observable outcomes[10] constructed from credit file data, consumers are not increasingly suffering adverse consequences after being declined HCSTC.

6.15 In common with HCSTC users, declined applicants were on a trajectory of increasing their debts at the time they applied for HCSTC. This continues at a steady pace after they were turned down for HCSTC; there is no acceleration in the increase of their indebtedness.

6.16 We do not find initial evidence that declined applicants for HCSTC turn to other high-cost credit products when they fail to get HCSTC, although this is an issue that we will test in the review. Within 30 days of individuals being declined for HCSTC, between 8% and 13% took out a new credit product. These were most likely to be new credit or store cards or personal loans. This is consistent with our previous findings for declined applicants in 2012 and 2013 and suggests that other high-cost credit products are not experiencing increasing uptake because more applicants are being declined for HCSTC.

6.17 An important input to our judgement on the balance of risks and benefits was that exclusion from HCSTC due to the price cap was unlikely to result in those consumers turning to illegal money lenders. Our 2014 survey found that there was no statistically significant increase in people turning to illegal money lenders after having their application for HCSTC rejected.[11] Despite these findings, this was probably the area of greatest concern for stakeholders. We have therefore been monitoring this area through our contacts with the Local Authority Illegal Money Lending teams and other consumer facing stakeholders.

6.18 The consumer user group in this market is particularly hard to reach and reluctant to talk, and the lenders operate below the radar. This makes it challenging to establish the actual scale and scope of activity. But by working with frontline staff we have gained valuable insight into the consumer experience of illegal money lending and the complex issues which may put them at risk. We hosted a series of eight round tables from June-August 2016 in areas where unauthorised lending had previously been reported, supplemented by questionnaires for those unable to attend and data available on this subject from partners in our network. We identified a range of drivers which may prompt people to turn to illegal money lending, including social and economic factors: there is no one clear consumer journey. Nevertheless, this is an issue that we will probe further in our consumer survey to see if there is any evidence of consumers turning to illegal money lenders directly as a result of being excluded from HCSTC because of the price cap and would be interested to hear of any new evidence available on this point.

10 Some outcomes are not observable from CRA data such as cutting back on essentials, although we would expect to see this impacting on other indicators to an extent such as missed payments on household bills.

11 Our 2014 consumer survey found that 3.3% of consumers who were marginally accepted for a loan said that they considered borrowing from a loan shark, compared with 4.7% of consumers who were marginally rejected from loans. p.89 CP14/10

Implications for the price cap

6.19 The declines in arrears rates show real benefits to consumers from the new regulatory regime to which HCSTC firms have been subject. Although we cannot isolate the impact of the price cap from other regulatory changes, we believe the price cap forms an important part of the overall picture of firms becoming more risk averse. The review will give further consideration to the factors behind the uneven reduction in arrears rates across the industry, and why firms have continued to make loans with default risk levels that have a higher risk of being unprofitable due to the price cap.

6.20 We will use the consumer survey to gather further evidence on the consequences for those consumers whose applications for HCSTC are declined but our initial analysis suggests that those consumers are not increasingly suffering adverse consequences based on a range of indicators from credit file data. This may signal that a price cap set at current levels has not caused problems with consumers being inappropriately excluded from accessing HCSTC in a way that has caused poorer outcomes. We would be interested to hear views and evidence on this issue.

Q10: Do you have views and evidence on the risks for consumers of using HCSTC post-cap? Do you agree with our initial assessment that risks of falling into arrears have reduced?

Q11: Do you have any evidence of adverse consequences for consumers as a result of being declined for HCSTC?

Q12: Do you agree that consumers do not generally move to other high-cost credit products as a result of being declined for HCSTC?

Q13: What are the implications for consumers of increasing loan duration for HCSTC?

7. Scope of the price cap

7.1 The review will look at whether consumers have moved to use other high-cost products as a result of the price cap. We will also consider whether the definition of HCSTC is still capturing the products that we intend, and that firms have not been able to create products that share features of HCSTC and cause similar problems for consumers but fall just outside the definition of HCSTC.

Other high-cost products

7.2 The review will focus on HCSTC because the cap structure was designed around the main features of HCSTC products and the levels were set with regard to the estimated impact on consumers using those products and the firms selling them.

7.3 It is important to understand whether the price cap (and the package of regulatory interventions that apply to HCSTC) has caused consumers to migrate to other high-cost products (the 'waterbed effect') and whether consumers are worse off as a result. As noted in the previous chapter, our initial analysis of declined applicants indicates that this is not the case and there is limited take up of new high-cost credit products in the month after a consumer is declined for HCSTC.

7.4 This area needs further exploration during the review. For example, it has been suggested that levels of guarantor lending have recently increased in response to the constraints on HCSTC. This may not have been picked up by our preliminary analysis as it only covered the period 2014 to June 2015.

7.5 We will also look at consumers who no longer apply for HCSTC to see whether there has been consumer migration to other high-cost credit products because they are aware it is more difficult to get HCSTC than previously.

7.6 This will help inform the broader work on high-cost credit we are planning. Whilst there may be aspects of the HCSTC regime that can usefully be applied to other high-cost products where we see consumer harm, it is important to understand the particular features of those products, how harm might arise and consider the most appropriate way of dealing with that harm with reference to the full range of regulatory tools available to us.

Definition of HCSTC

7.7 The price cap covers HCSTC as defined in our Handbook of Rules and Guidance. Broadly, this is a regulated credit agreement where:

- the APR is equal to or exceeds 100%, and
- the credit is due to be repaid or substantially repaid within 12 months

7.8 The definition was designed to ensure it captures payday loans and variations of payday loans that have shorter or longer repayment periods. We also intended the definition to prevent firms from designing products with broadly the same features as HCSTC but that were technically falling just outside the boundaries of the definition: for example, by increasing the terms of their loans. The APR threshold was set at a level considerably below any payday product available in the market at the time.

7.9 We are aware that firms are exploring the boundaries of the HCSTC definition. This is an area that we have been keeping under close review and have intervened where we have seen firms attempt to introduce products, which we believe should have been defined as HCSTC, without applying the HCSTC regime.

7.10 The review will consider if the APR threshold and repayment period continue to be appropriate in the light of product innovation and firms' interpretation of the rules.

7.11 Home-collected credit, bills of sale (log book loans), arranged or unarranged overdrafts, and loans by community finance organisations are excluded, as are loans secured by a mortgage, charge or pledge. As noted above, we will consider our approach to other high-cost credit products separately.

Q14: Do you have views or evidence that the HCSTC price cap has had an impact on other high-cost products: e.g. because consumers use those products as an alternative?

Q15: Do you have evidence that the definition of HCSTC is providing opportunities for firms to evade the HCSTC price cap (and HCSTC regime more generally)?

Section 3
HCSTC repeat and multiple borrowing

8. Repeat and multiple borrowing

8.1 In this section, we present our analysis to date of the changes in repeat and multiple borrowing in the HCSTC market and seek views from stakeholders on these areas.

Background

8.2 Repeat and multiple borrowing[12] were discussed in the price cap Consultation Paper (CP14/10, page 44)[13], with a suggestion that it could indicate patterns of dependency on HCSTC that may be harmful to the borrower: repeatedly paying high prices to access loans in order to make up shortfalls in income. A short-term loan can often incur high costs as a result of persistently borrowing over the longer term and not improving the consumer's financial situation.

8.3 Respondents to CP14/10 expressed strong concerns about repeat and multiple borrowing, outlining various options for tackling this problem. We therefore committed in the Policy Statement (PS14/16, page 52)[14] to carry out further analysis on this issue.

8.4 Our previous analysis showed that many consumers were frequent users of HCSTC: on average, consumers took out six loans a year in 2012/13, but 10 loans or more a year were not uncommon.

8.5 As set out in Annex 2, there have been significant regulatory changes and changes implemented by firms themselves that have had an impact on this sector and their customers.

8.6 We have now analysed data from January 2014 to June 2015 to establish how repeat and multiple borrowing have changed over this period. We summarise the results here and seek comments and any additional evidence.

8.7 In considering the issues of repeat and multiple borrowing, we are conscious of the balance of consumer protection and the impact on firms and competition, as well as the need to consider the most proportionate way to minimise harm to consumers. The wide range of types of intervention proposed by respondents to the price cap consultation and long-standing international debates and reforms to tackle the issues highlight the difficulty in this area.

12 Repeat borrowing is the number of times a borrower borrows from the same or a different lender in a given period of time; multiple borrowing is holding multiple 'payday' loans simultaneously.

13 www.fca.org.uk/publication/consultation/cp14-10.pdf

14 www.fca.org.uk/publication/policy/ps14-16.pdf

Summary of findings

8.8 The latter part of Annex 3 details our findings on repeat and multiple borrowing from January 2014 to June 2015. We have compared this with transaction level data from HCSTC lenders during the period from January 2012 to December 2013.

8.9 The overall level of repeat borrowing has decreased markedly. For example, fewer than 85,000 individuals took out six or more loans during the first six months of 2015, compared with approximately 275,000 individuals during the first six months of 2014. The rate of decline in the number of consumers who are repeat borrowing is greater than the decline in the overall lending volumes in the market.

8.10 Looking at the effects of repeat borrowing and arrears does not clearly show that individuals who persistently borrow are more likely to enter arrears on any of their HCSTC loans. We also know from the account level data that arrears rates for repeat customers have improved significantly over this period, suggesting that firms are reluctant to lend again if the initial loan is not repaid.

8.11 The majority of HCSTC users did not hold multiple HCSTC loans at the same time, suggesting that the increased use of CRA data and sharing of information in real time is having an impact. However, the more loans held by an individual at one time, the more likely it is that one of those loans would enter arrears. The link with entering default is less marked. The increased likelihood of entering arrears on at least one loan if holding multiple loans at the same time is perhaps unsurprising, and is higher than for single loans. This is something that we intend to continue monitoring.

8.12 HCSTC remains an expensive form of borrowing (even taking into account that the price is now capped) and frequent customers are the most sought after by firms, particularly when they repay in full.

8.13 Two measures stemming from the CMA's payday lending market investigation should help consumers to make better choices.

- The CMA's order requiring that online and high street payday lenders provide existing customers with a summary of their cost of borrowing, (including the total cost of their most recent loan, as well as the cumulative cost of their borrowing with that lender over the previous 12 months and how late repayment affected their cost of borrowing) should encourage consumers to think carefully as to whether another HCSTC loan is the right product for their needs.

- The CMA order requiring online lenders to appear on an FCA authorised PCW[15] is intended to improve competition, enabling consumers to compare HCSTC products and shop around more effectively.

8.14 In addition, some firms are offering more risk-based pricing products for repeat customers, with lower rates of interest. Therefore, although the cost may still be relatively high, competition should grow for repeat borrowers.

15 www.fca.org.uk/publication/policy/ps16-15.pdf

Views we are seeking

8.15 The data we have collected does not show a clear detriment from repeat and multiple borrowing. The number of individuals who borrow repeatedly or hold multiple loans at the same time has significantly decreased and there is no clear relationship of consumers who repeatedly borrow always ending up in arrears.

8.16 We intend to keep monitoring this aspect of the HCSTC market and will look at the data from regulatory returns to see whether the trends observed from January 2014 to June 2015 have continued or changed. We will also continue to monitor progress in relation to real-time data sharing, and will be separately consulting on proposed changes to our rules on creditworthiness (including affordability).

8.17 In the meantime, we would like any further input you can provide.

Q16: What are your views on our analysis of the data and market with regard to repeat and multiple borrowing?

Q17: Do you have any further evidence on repeat and multiple borrowing?

9.
Next steps

9.1 Please send us your responses to this Call for Input by 15 February 2017. Please email highcostcreditcfi@fca.org.uk or write to the address below:

David Malcolm
Strategy & Competition Division
Financial Conduct Authority
25 The North Colonnade
London E14 5HS

9.2 It is important that we receive responses on the HCSTC price cap review by this deadline so we can complete our work within the first half of 2017. Please let us know if you would like more time to respond to the questions in Section 1 on high-cost credit more generally, including overdrafts.

9.3 We will consider all responses to this Call for Input and also plan to hold some stakeholder events, in particular relating to the HCSTC price cap review. We intend to publish the outcome of that review next summer, and will be announcing the timetable for our work on high-cost credit.

Annex 1
List of questions

Section 1: High-cost credit

Q1: Which high-cost products do you think our review should focus on and do you think a more consistent approach to high-cost products is feasible or desirable?

Q2: To what extent is there detriment from high-cost credit products (other than HCSTC)?

Q3: Where there is detriment, do you consider that it arises from matters not addressed by our rules, or is it mainly caused by firms failing to comply with the rules?

Q4: If there is detriment arising from matters not addressed by our rules, what sort of interventions should we consider? What would be the impact?

Q5: Should some of the HCSTC protections be applied more widely? What would be the impact on the cost of or access to credit?

Q6: To what extent do you think overdrafts are a substitute, or alternative, for other high-cost credit products?

Q7: What do you think are the key issues the FCA should consider on arranged and unarranged overdrafts respectively?

Q8: What measures could be taken to address these and what would be the risks and benefits?

Section 2: HCSTC price cap review

Q9: Please provide evidence and/or views on:

- the reasons for the substantial reduction in applications from consumers for HCSTC and the reduction in acceptance rates by firms

- whether this decline will continue, plateau, or lending will increase

- the impact of the price cap on the viability of HCSTC and how this might differ for online and high-street, and
- the impact on loan duration and product development more generally of the structure and level of the price cap

Q10: **Do you have views and evidence on the risks for consumers of using HCSTC post-cap? Do you agree with our initial assessment that risks of falling into arrears have reduced?**

Q11: **Do you have any evidence of adverse consequences for consumers as a result of being declined for HCSTC?**

Q12: **Do you agree that consumers do not generally move to other high-cost credit products as a result of being declined for HCSTC?**

Q13: **What are the implications for consumers of increasing loan duration for HCSTC?**

Q14: **Do you have views or evidence that the HCSTC price cap has had an impact on other high-cost products: e.g. because consumers use those products as an alternative?**

Q15: **Do you have evidence that the definition of HCSTC is providing opportunities for firms to evade the HCSTC price cap (and HCSTC regime more generally)?**

Section 3: HCSTC repeat and multiple borrowing

Q16: **What are your views on our analysis of the data and market with regard to repeat and multiple borrowing?**

Q17: **Do you have any further evidence on repeat and multiple borrowing?**

Annex 2
Recent regulatory changes affecting the HCSTC market

1. Since we took over responsibility for regulating consumer credit markets on 1 April 2014, the HCSTC market has been subject to significant regulatory scrutiny and change. The main regulatory developments that have had an impact on this sector, and its customers, are summarised below.

Background

2. In March 2013, the Government consulted on transferring responsibility for consumer credit regulation from the Office of Fair Trading (OFT) to the FCA.[16] At the same time, the Financial Services Authority (FSA), the FCA's predecessor, consulted on high-level proposals for an FCA regime.[17] These consultations took place against a backdrop of increased public and regulatory scrutiny of the HCSTC market and 'payday' lenders in particular.

3. In October 2013, we consulted on detailed proposals for an FCA consumer credit regime.[18] In that paper, we explained that we would put the spotlight on the HCSTC sector as we considered it posed a potentially high risk to consumers in financial difficulty. We proposed specific rules restricting certain practices by HCSTC firms that were harming consumers. Our approach was confirmed in a Policy Statement published in February 2014.[19]

4. In December 2013, Parliament gave the FCA a duty to introduce a price cap (to be in force by 2 January 2015) to secure an appropriate degree of protection from excessive charges for borrowers of high-cost short-term credit.[20]

Summary of regulatory developments

Authorisation

5. HCSTC lenders with interim permission[21] were required to apply for full authorisation by 28 February 2015, with firms being required to demonstrate, among other things, that they satisfy at the time of authorisation, and will continue to satisfy as long as they are authorised, minimum standards called the Threshold Conditions (COND). As we considered HCSTC lenders

16 www.gov.uk/government/uploads/system/uploads/attachment_data/file/221913/consult_transferring_consumer_credit_regulation_to_fca.pdf.
17 www.fsa.gov.uk/static/pubs/cp/cp13-07.pdf.
18 www.fca.org.uk/publication/consultation/cp13-10.pdf.
19 www.fca.org.uk/publication/policy/ps14-03.pdf.
20 www.gov.uk/government/news/government-to-cap-payday-loan-costs
21 Transitional arrangements set out in legislation for OFT licence holders to continue undertaking regulated credit activity until FCA authorisation granted or their interim permission lapsed.

to be higher-risk firms, they were also subject to intense scrutiny, particularly in respect of the processes they have in place to make suitable lending decisions and the fair treatment of customers in arrears.

Supervision and enforcement

6. Our supervisory regime was one of the most noticeable changes for consumer credit firms in the FCA's approach to regulation. Our supervisory approach is risk-based and proactive to allow us to quickly identify consumer harm. Where we find evidence of consumers suffering due to poor services and products, we have powers of intervention, which we will use to take action.

7. Through our supervisory work, we increased scrutiny of HCSTC firms' business models and compliance with our rules and high-level principles leading to firms in this sector overhauling their affordability assessments and their forbearance and collection practices. Some of our investigations also led to us taking action against a number of HCSTC lenders, resulting in the establishment of redress schemes to compensate consumers.

8. In 2014 we carried out our first thematic review into the consumer credit market, which examined how HCSTC lenders collect debts, how they deal with customers in arrears, and whether they treat their customers fairly.[22] This found unacceptable practices by many lenders and, in January 2015, a Dear CEO Letter was issued to all HCSTC lenders, setting out our expectations of them.[23] We published the findings of our review in March 2015.

9. We will continue to use our powers to protect consumers and tackle firms who cross the line and senior managers whose failures have caused or contributed to the firm's failures, as evidenced by our recent action against Andrew Barry Hart, the sole director, controller and ultimate owner of Wage Payment and Payday Loans Limited (WPPL).

Handbook requirements

10. From 1 April 2014, all consumer credit firms have been required to comply with the standards in our Handbook including the Principles for Businesses (PRIN), rules on senior management arrangements, systems and controls (SYSC), and some general provisions including rules on setting out firms' regulatory status. They are also required to comply with requirements under the Consumer Credit Act 1974 (CCA) and the Consumer Credit Sourcebook (CONC), which includes rules on pre-contractual explanations, creditworthiness assessment and payment difficulties.

11. Since authorisation, HCSTC lenders are also subject to quarterly product sales data reporting (PSD) and annual regulatory reporting requirements.

12. Given particular concerns we had about the HCSTC sector posing a potentially high risk to consumers in financial difficulty, we introduced additional rules for HCSTC lending aimed at increasing consumer awareness and enhancing protections. These rules, most of which came into force on 1 July 2014, include:

- requiring advertisements for HCSTC to carry a risk warning (this came into effect for electronic media on 1 April 2014 and for television and radio on 1 July 2014)

- prohibiting firms from refinancing or rolling over a loan more than twice

22 www.fca.org.uk/publication/thematic-reviews/tr15-3.pdf.
23 www.fca.org.uk/publication/correspondence/dear-ceo-letter-hcstc-firms.pdf.

- requiring firms to provide HCSTC borrowers with an information sheet, with details of free debt advice, when refinancing or rolling over a loan; and
- prohibiting firms from making more than two unsuccessful attempts to seek payment using a CPA and from using a CPA to collect part payments

13. In January 2015, we introduced a price cap on how much HCSTC lenders can charge consisting of three components:[24]

1. An initial cost cap of 0.8% of the outstanding principal per day on all interest and fee charges during the agreed loan duration and when refinancing.
2. A cap for those in default of: an aggregate total of £15 on fixed charges. Interest can continue to be charged but at no higher rate than the initial cost cap (calculated per day on the outstanding principal and any fixed default charges).
3. A total cost cap of 100% of the amount borrowed applying to all interest, fees and charges. Therefore, the maximum anyone could ever pay on an individual loan in interest, fees and charges would be 100% of the original principal.

14. At the same time, we reported on the outcome of our work with HCSTC lenders and credit reference agencies (CRAs) to deliver real-time data sharing in this market to enable better informed creditworthiness assessments. This resulted in 90% of lenders by market share meeting our expectation to share data in real time by November 2014.

15. We have also intervened in the credit broking market tackling the widespread issues that were causing significant detriment to consumers searching for HCSTC online. In addition to taking action on specific firms (including over 25 brokers agreeing to close to new business), we also introduced new rules for all credit brokers from 2 January 2015. These new rules included additional requirements that must be met before payment or payment details can be taken from a consumer. Since taking action, the number of complaints relating to the relevant practices has fallen dramatically.

16. In May 2016, following recommendations from the Competition and Markets Authority (CMA) as a result of their market investigation into payday lending, we introduced new rules and guidance for price comparison websites (PCWs) comparing HCSTC products.[25]

17. The new rules and guidance, coming into effect on 1 December 2016, aim to help ensure PCWs act in a fair and transparent way, enabling consumers to compare HCSTC products and shop around more effectively. Our rules will mean that the following:

- The order or prominence in which HCSTC products are displayed on PCWs must not be affected by commercial relationships that the PCW may have with lenders or intermediaries.
- PCWs must allow users to search by amount and duration of the loan.
- PCWs must return relevant results based on the search criteria and display all HCSTC products in ascending order of price by the total amount payable (TAP).

24 www.fca.org.uk/publication/policy/ps14-16.pdf.
25 www.fca.org.uk/publication/policy/ps16-15.pdf.

- Additional financial promotions such as sponsored links should not appear in or among the rankings so as not to distract customers from the results.
- PCWs must list the brand names of lenders that they compare in one place on their website.

Annex 3
Technical annex: HCSTC market analysis January 2014 to June 2015

HCSTC market: January 2014 to June 2015

Introduction

1. This annex summarises data analysis for how the high-cost short-term credit (HCSTC) market has changed between January 2014 and June 2015. This analysis looks at changes in the overall market and consumer outcomes of successful and unsuccessful applicants for HCTSC.

Data collected

2. We collected application-level data from HCSTC lenders on all (successful and unsuccessful) applications for HCSTC made to the largest HCSTC lenders between January 2014 to June 2015. We also collected lender data on all successful loan applications from a sample of smaller lenders in this market. This differentiation was designed to ensure the data gathering was proportionate to the size of firms and we did not unnecessarily gather data from a large number of firms. This sample of lenders covered 99% of the 2013 market, based on firm revenues assessed for our price cap analysis. We are able to track the same individuals across firms using credit reference agency identifiers. This dataset is referred to as 'Lender data'.

3. We gathered credit files of all individuals identified by credit reference agencies (CRAs) including measures of individual-level creditworthiness.[26] This credit file data includes individuals' records of HCSTC products with other firms not in our lender data. Credit file data also enable us to understand consumers' overall financial obligations across different product types and over time.

4. We create a 'Consolidated data' combining 'Lender data' with credit files to provide a broad view of the market. However, these data do not include HCSTC loans by lenders who do not report to CRAs or appear in our Lender data. It also excludes individuals who did not have an application in our lender data; however, given the concentration of this market we expect this to be a small number of individuals and therefore this data to be representative of the market.

Market size

5. Along with a decline in the number of consumers taking out HCSTC loans we also observe a decline in the number of HCSTC loans in total. Between January 2014 and June 2015 there were 8.7 million HCTSC agreements which is over 6.8 million fewer than there were during a comparable period in 2012 – 2013. Figure 1 displays how the number of HCSTC loans originated each month declined sharply during 2014.[27]

26 See pages 171-174 for description of CRA data
www.fca.org.uk/publication/consultation/cp-14-10-technical-annexes.pdf

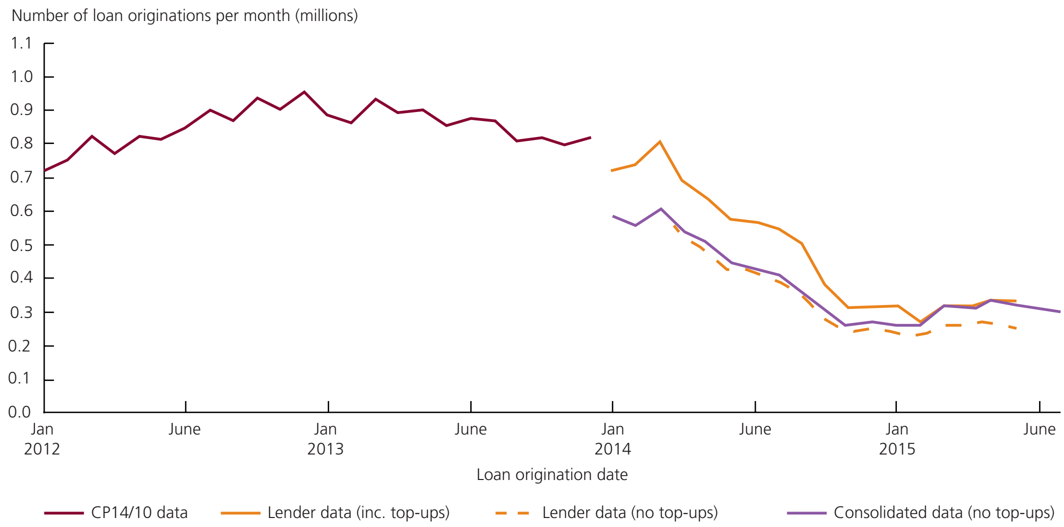
27 CP14/10 data uses data from across 33 lenders collected as part of the price cap analysis. 'Lender data' covers data collected from HCSTC lenders and 'Consolidated data' combines credit file data on HCSTC loans with lender data and does not count top-ups (where additional credit is granted to an existing loan agreement) separately.

6. Table 1, shows significantly fewer individuals taking out HCSTC loans in 2014-15 than in 2012-13. Between January 2014 and June 2015 there were over 800,000 fewer individuals taking out at least one HCSTC loan than there were between January 2012 and June 2013.[28]

Table 1: Market size

Time period	Number of consumers	Number of loans
Jan 2012 – June 2013	2.2m	15.5m
Jan 2014 – June 2015	1.3m	8.7m
2012	1.7m	10.1m
2013	1.7m	10.3m
2014	1.2m	6.8m (5.3m excluding top-ups)

Figure 1: Loan originations



7. In the period before 2014 the HCSTC market saw 800,000 loans issued per month. A marked decline in lending occurred during early 2014. Lending volumes continued to decline throughout 2014 before stabilizing at around 300,000 loans per month in 2015. A notable part of this decline is in the use of top-ups, where a lender increases the amount lent on an existing loan (typically by a small amount relative to the initial borrowing amount). There were significant changes to the regulation of HCSTC during 2014, including limits on the use of CPAs and rollovers, supervisory scrutiny and consultation on and finalisation of the price cap. There is little change in lending volumes around the time of the price cap introduction in January 2015.

Changes in HCSTC demand and supply

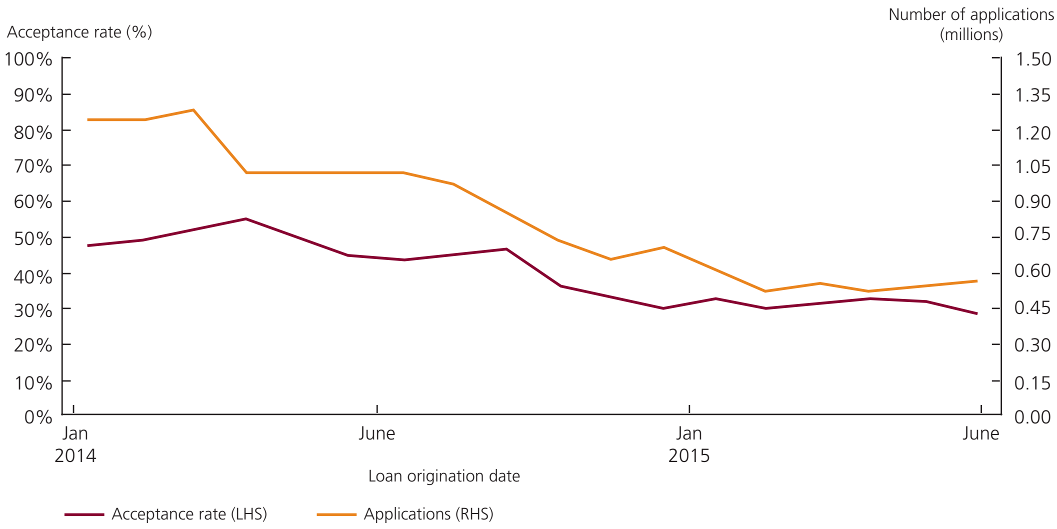
8. Our data show that both demand and supply reduced throughout 2014. Examining applications for HCTSC made to large, online lenders shows that there was a large decline in consumer demand for HCSTC from January 2014 to June 2015. The number of monthly HCSTC applications decreased from a peak of 1.29 million in 2014 to a trough of 520,000 in 2015.

28 The period January to June is used in order to have the same total duration in both datasets with the same calendar months to account for seasonal fluctuations.

Fewer applications indicates lower consumer demand for HCSTC from these firms; however, it does not pick up 'potential' demand from consumers who are deterred from applying.

9. Along with these changes in consumer demand for HCSTC there are also changes in supply, with acceptance rates decreasing from around 50% at the start of 2014 to around 30% by the middle of 2015.

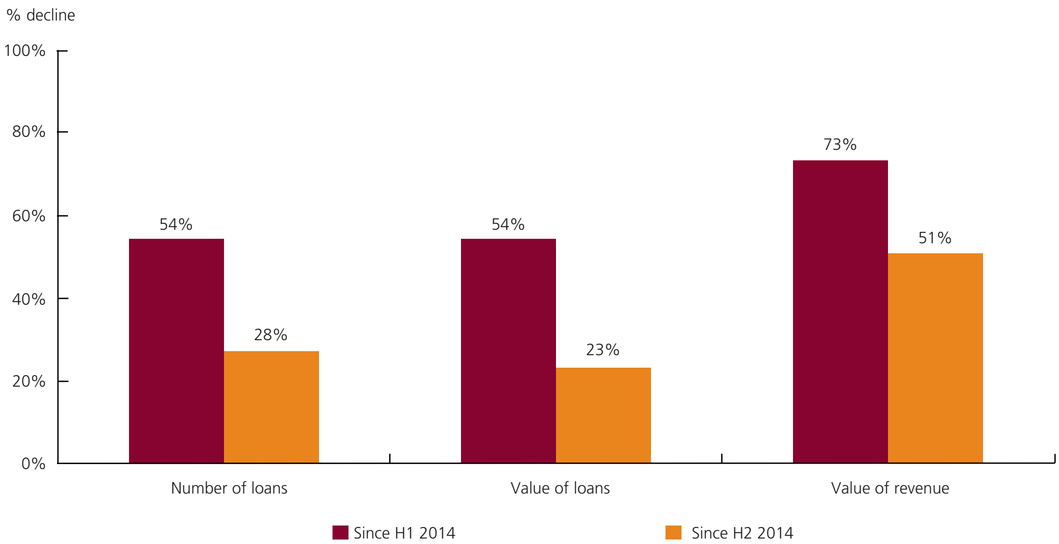
Figure 2: Acceptance rates and number of applications



Firm revenues

10. The value of lending follows a similar pattern to the changes in lending volumes between January 2014 to June 2015. The lenders in our sample accrued HCSTC revenue of £409 million during the first half of 2014 which reduced to £225 million by the second half of 2014 and £110 million in the first half of 2015.

Figure 3: Decline in number and value of loans and their revenue during H1 2015 compared H1 and H2 2014

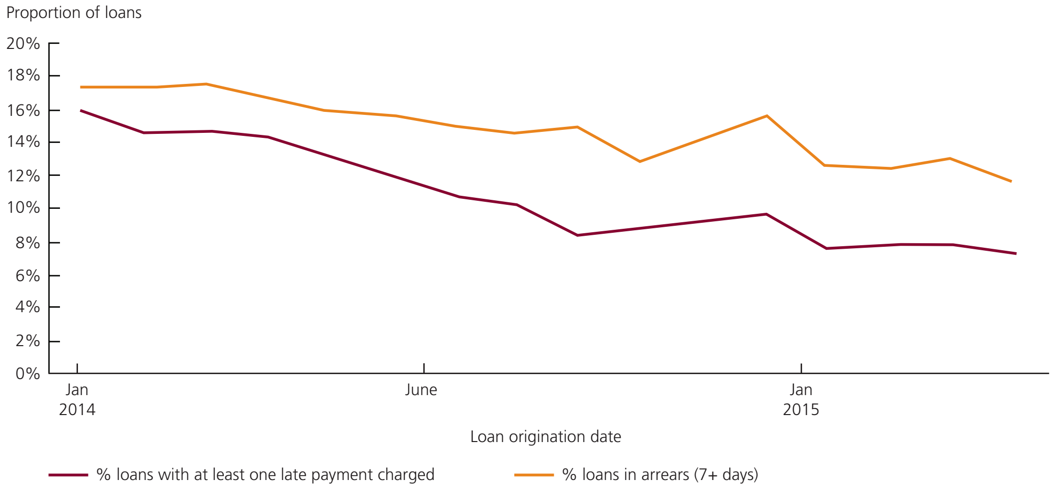


11. Examination of lenders' management accounts shows the lenders in our sample made a combined loss in the first half of 2015 which was larger than the combined loss during the calendar year 2014. A number of firms were unprofitable before 2014. The profitability of all firms in our sample has decreased, with some previously profitable entities becoming unprofitable. Some firms remain profitable.

Delinquency

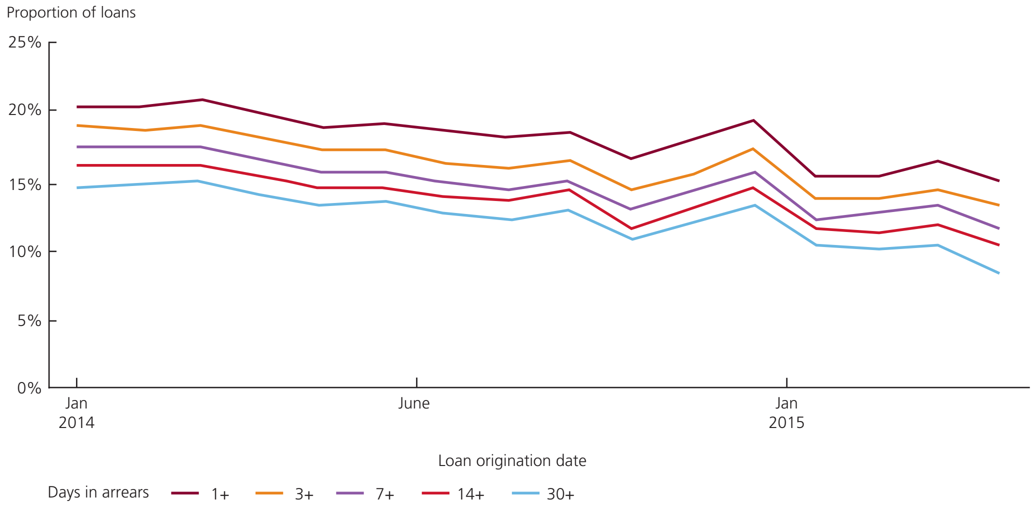
12. Examining a variety of measures of delinquencies shows that these decreased through the period 2014 to 2015. The proportion of loans being charged a late payment fee has steadily decreased from 16% in January 2014 to below 8% in April 2015.[29] Part of the reason for changes in this over time is that some HCSTC products no longer charge consumers late fees. The proportion of loans entering arrears for 7 or more days similarly reduces from 16% to 12%. Similar patterns of declining delinquencies are observed using different durations of time in arrears.

Figure 4: Delinquency rates



29 Arrears data for May and June 2015 not used as insufficient time passed to assess whether loan enters arrears.

Figure 5: Sensitivity of delinquency rates by number of days in arrears



Changes in lender credit risk

13. We examined lenders' risk appetite by constructing groups using standardised HCSTC-specific credit risk scores for all loans across the market. This allowed measurement of credit risk consistently across all lenders. The highest risk group score includes individuals without a credit score due to not having a credit file (or a very thin one) at the time of making a loan application. Arrears rates – measured by whether an individual was 30 or more days in arrears – for the highest credit risk group of customers who are first time applicants to firms slightly declined over time whereas the declines were much larger for repeat applicants. Examining other groups of customers shows similar declines over time – for example there was a clear decline in arrears rates of both first time and repeat customers in the median credit score group.

14. We have found variation across firms in the levels of default, with some firms showing significant and sustained declines in arrears rates over the period.

Figure 6: Arrears rates of first time applicants by credit risk group

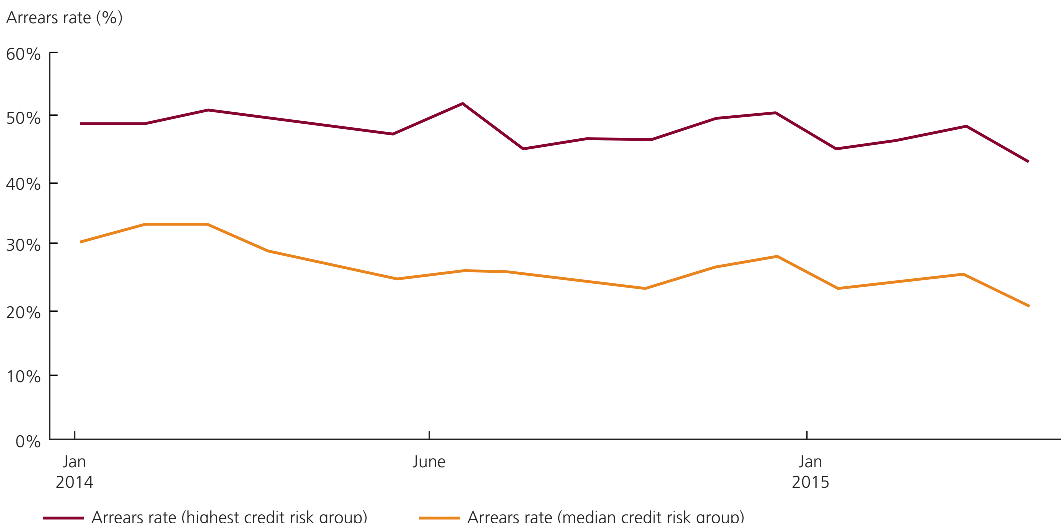
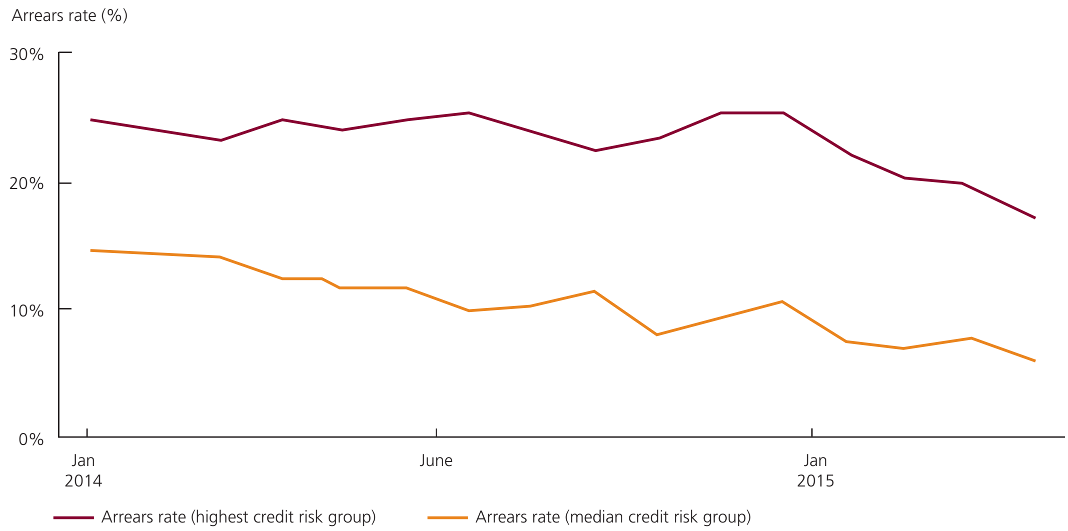


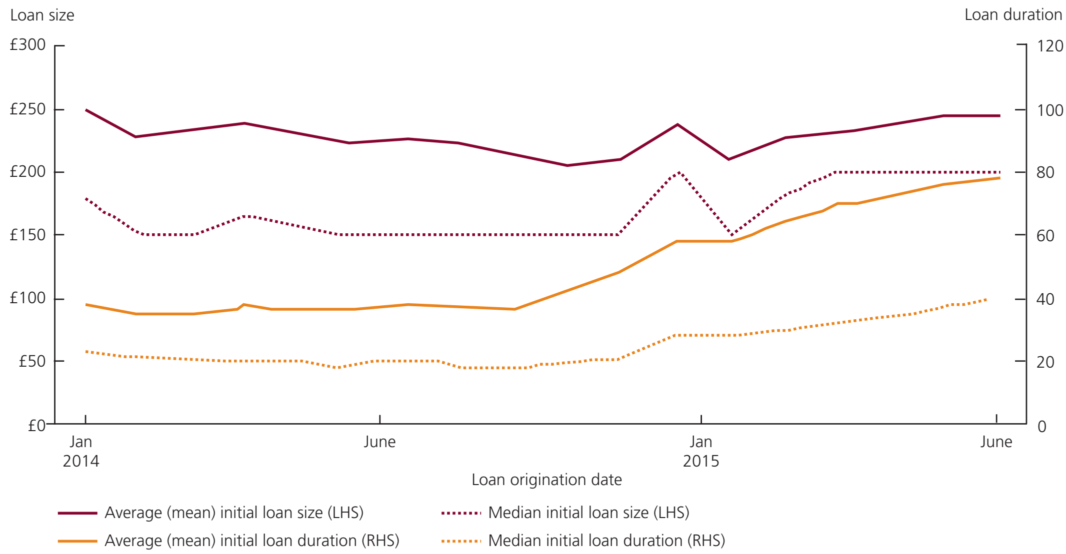
Figure 7: Arrears rates of repeat applicants by credit risk group



Changes in HCSTC loan characteristics

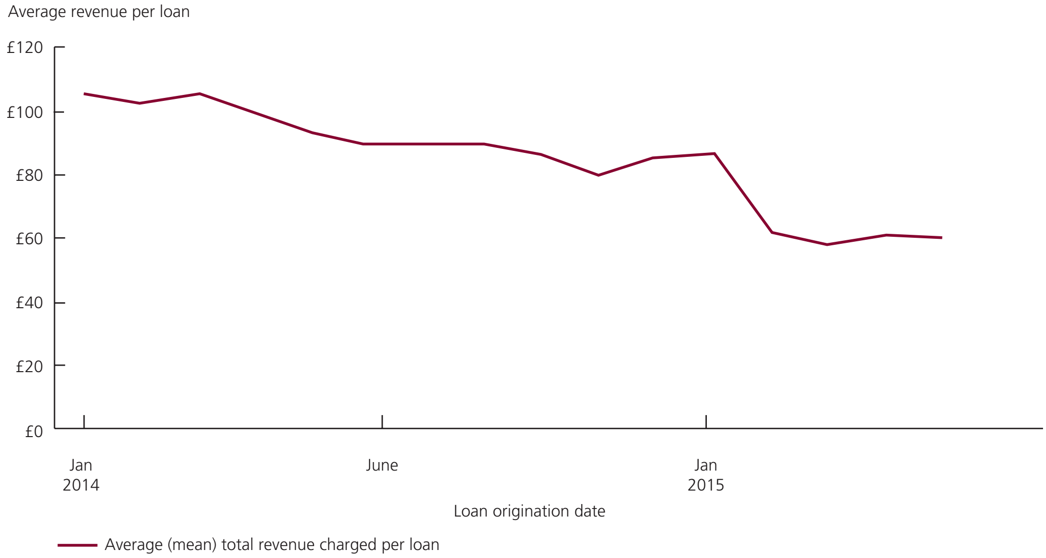
15. Typical loan sizes have remained steady, but loan durations have increased. The mean and median loan size changed relatively little between January 2014 and June 2015, with the mean loan size remaining near to £250 in June 2015. There was a more notable shift in mean and median initial loan duration over this period. At the start of 2014 the average initial loan duration was near 40 days whereas by June 2015 this had increased to near 80 days.

Figure 8: Loan size and duration



16. The average revenue customers were charged on HCSTC loans noticeably decreased (in spite of this average increase in borrowing duration). Loans originated at the start of 2014 typically resulted in consumers being charged around £100 in interest and fees. Once the price cap was introduced there is a clear reduction in revenues charged to customers to around £60 per HCSTC loan in the first four months of 2015.[30]

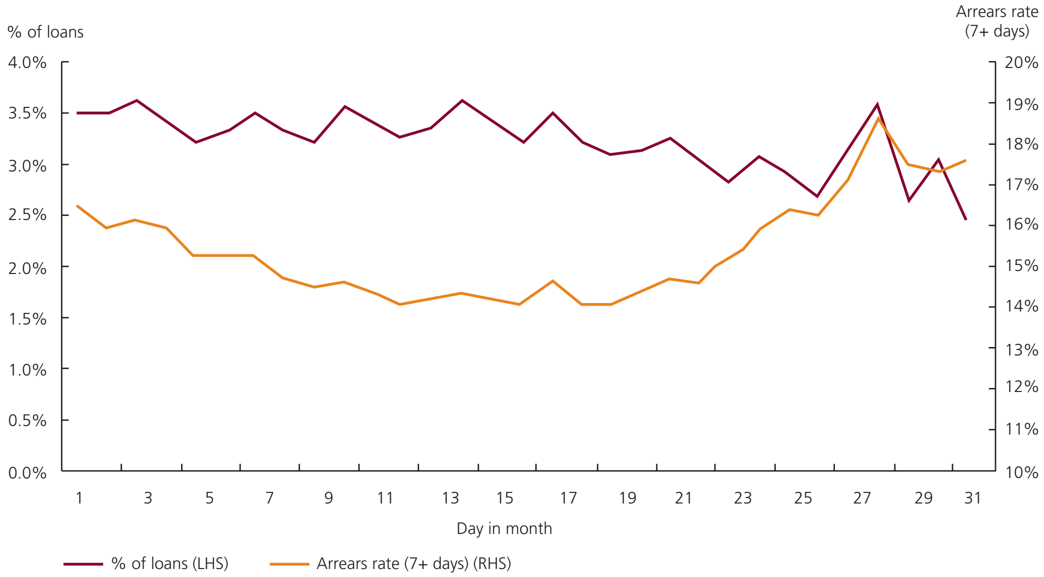
Figure 9: Average revenues charged to consumer per loan



Borrowing patterns

17. Examining the profile of borrowing over time displays interesting fluctuations within the month, day of week and time of day. A higher proportion of consumers who used HCSTC towards the end of a month entered arrears than at other times during the month.

Figure 10: Number of loans and arrears rates by day of month



30 Data for May and June 2015 not used as insufficient time passed to assess charges consumer is facing.

18. Examining the profile of lending displays that lending peaked on Friday afternoons, although default rates were fairly constant across days in the week.

Figure 11: Number of loans by time of day and day of week of loan origination

		Day of week of loan application							
		Sun	Mon	Tue	Wed	Thur	Fri	Sat	Sub total
Hour of loan application	0	0.2%	0.3%	0.3%	0.3%	0.3%	0.6%	0.2%	**2.1%**
	1	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	**0.7%**
	2	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	**0.5%**
	3	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	**0.4%**
	4	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%	**0.4%**
	5	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%	0.1%	**0.7%**
	6	0.1%	0.2%	0.3%	0.3%	0.3%	0.4%	0.2%	**1.7%**
	7	0.2%	0.4%	0.5%	0.5%	0.5%	0.7%	0.3%	**3.1%**
	8	0.3%	0.6%	0.6%	0.6%	0.6%	0.9%	0.6%	**4.3%**
	9	0.5%	0.8%	0.8%	0.7%	0.8%	1.0%	0.9%	**5.5%**
	10	0.7%	1.1%	1.0%	1.0%	1.0%	1.4%	1.4%	**7.7%**
	11	0.8%	1.1%	1.1%	1.0%	1.0%	1.4%	1.5%	**7.9%**
	12	0.8%	1.2%	1.1%	1.1%	1.1%	1.4%	1.5%	**8.1%**
	13	0.8%	1.1%	1.1%	1.0%	1.0%	1.4%	1.3%	**7.7%**
	14	0.7%	1.0%	1.0%	0.9%	1.0%	1.3%	1.2%	**7.1%**
	15	0.6%	1.0%	0.9%	0.9%	0.9%	1.3%	1.1%	**6.8%**
	16	0.6%	1.0%	1.0%	1.0%	1.0%	1.4%	1.0%	**7.0%**
	17	0.6%	0.9%	0.9%	0.9%	1.0%	1.2%	0.9%	**6.5%**
	18	0.6%	0.8%	0.9%	0.8%	0.9%	1.1%	0.7%	**5.7%**
	19	0.5%	0.7%	0.7%	0.7%	0.7%	0.8%	0.6%	**4.9%**
	20	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%	0.5%	**4.0%**
	21	0.4%	0.5%	0.5%	0.5%	0.5%	0.5%	0.4%	**3.2%**
	22	0.3%	0.4%	0.4%	0.3%	0.4%	0.4%	0.3%	**2.5%**
	23	0.2%	0.2%	0.2%	0.2%	0.3%	0.3%	0.2%	**1.7%**
	Sub total	**9.7%**	**14.3%**	**14.1%**	**13.7%**	**14.2%**	**18.8%**	**15.1%**	

Figure 12: Arrears rates by time of day and day of week of loan origination

		Day of week of loan application							
		Sun	Mon	Tue	Wed	Thur	Fri	Sat	
Hour of loan application	0	14.3%	20.5%	22.8%	21.2%	21.5%	28.8%	15.9%	**22.6%**
	1	13.9%	14.8%	16.6%	16.0%	16.2%	18.1%	14.7%	**15.8%**
	2	14.1%	15.8%	17.5%	18.7%	17.5%	18.5%	16.8%	**17.1%**
	3	15.0%	15.9%	17.6%	18.2%	15.8%	20.0%	17.0%	**17.3%**
	4	15.3%	13.8%	14.9%	14.7%	14.7%	16.1%	16.4%	**15.2%**
	5	14.7%	11.9%	11.7%	12.5%	13.4%	15.3%	13.1%	**13.3%**
	6	12.4%	10.7%	11.6%	11.3%	11.6%	14.6%	12.6%	**12.3%**
	7	11.2%	11.0%	11.5%	11.6%	11.9%	14.0%	12.0%	**12.1%**
	8	11.3%	12.4%	12.6%	11.8%	12.7%	14.4%	12.1%	**12.7%**
	9	11.1%	13.7%	14.0%	13.9%	14.4%	15.4%	12.5%	**13.7%**
	10	11.6%	16.0%	16.2%	16.1%	16.1%	17.0%	13.8%	**15.4%**
	11	12.1%	16.6%	16.8%	16.4%	16.7%	17.2%	14.2%	**15.8%**
	12	12.4%	16.8%	16.6%	16.6%	16.8%	17.0%	14.4%	**15.9%**
	13	12.7%	17.0%	17.3%	16.9%	17.0%	17.1%	14.9%	**16.2%**
	14	13.3%	17.6%	17.6%	17.3%	17.5%	17.6%	15.0%	**16.7%**
	15	13.5%	17.3%	17.1%	17.1%	17.1%	16.8%	15.1%	**16.4%**
	16	13.7%	16.6%	16.6%	16.3%	16.2%	16.3%	14.5%	**15.9%**
	17	13.6%	15.1%	14.9%	14.7%	14.8%	14.9%	13.3%	**14.5%**
	18	13.3%	13.9%	13.5%	13.5%	13.5%	13.4%	12.7%	**13.4%**
	19	13.1%	13.7%	13.3%	13.1%	13.9%	13.6%	12.9%	**13.4%**
	20	12.8%	13.6%	13.3%	13.2%	13.6%	13.6%	12.8%	**13.3%**
	21	12.9%	13.0%	13.5%	13.6%	13.5%	14.0%	12.8%	**13.4%**
	22	13.0%	13.9%	14.1%	13.9%	14.2%	14.0%	13.2%	**13.8%**
	23	14.0%	14.7%	14.5%	14.8%	15.4%	14.6%	14.4%	**14.7%**
	Sub total	**13.2%**	**15.7%**	**15.7%**	**15.5%**	**15.7%**	**16.6%**	**14.3%**	

Declined applicant analysis

19. There are notable differences in accepted and declined customers. A greater proportion of declined applicants do not have enough information in their credit file in order for CRAs to create a credit risk scores, or estimate income for producing debt to income ratios than accepted applicants.[31]

Figure 13: Distribution of overall credit score for HCSTC applications

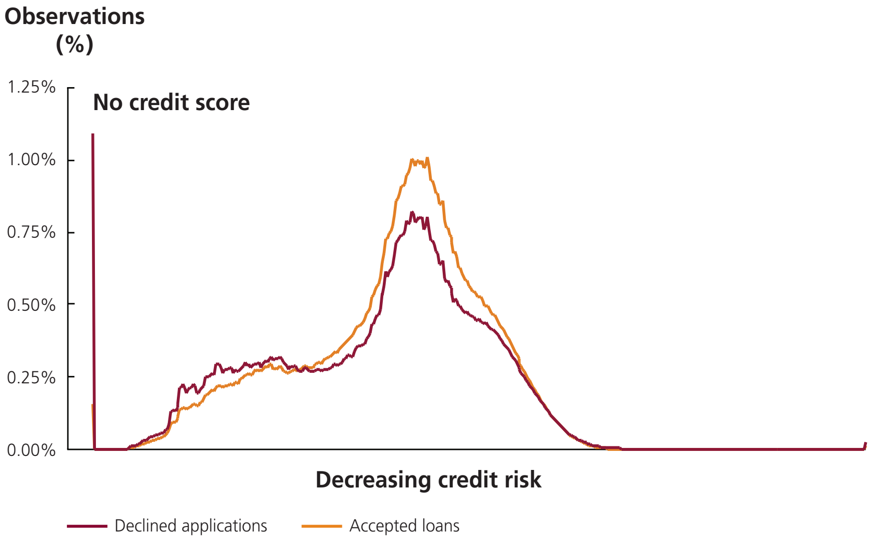
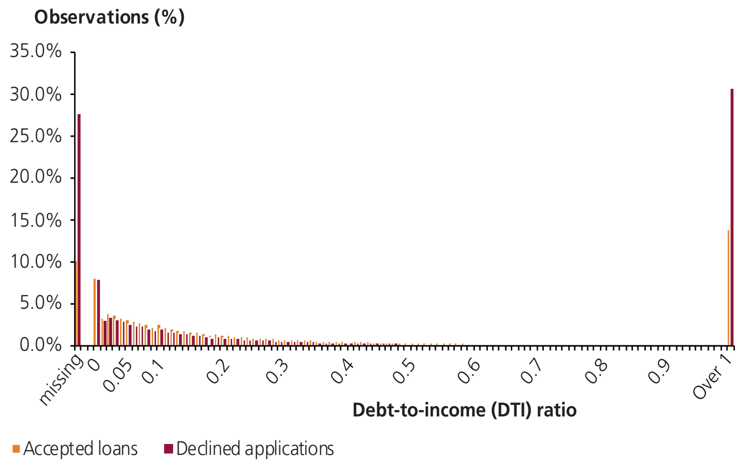


Figure 14: Distribution of debt-to-income (DTI) ratio for HCSTC applications

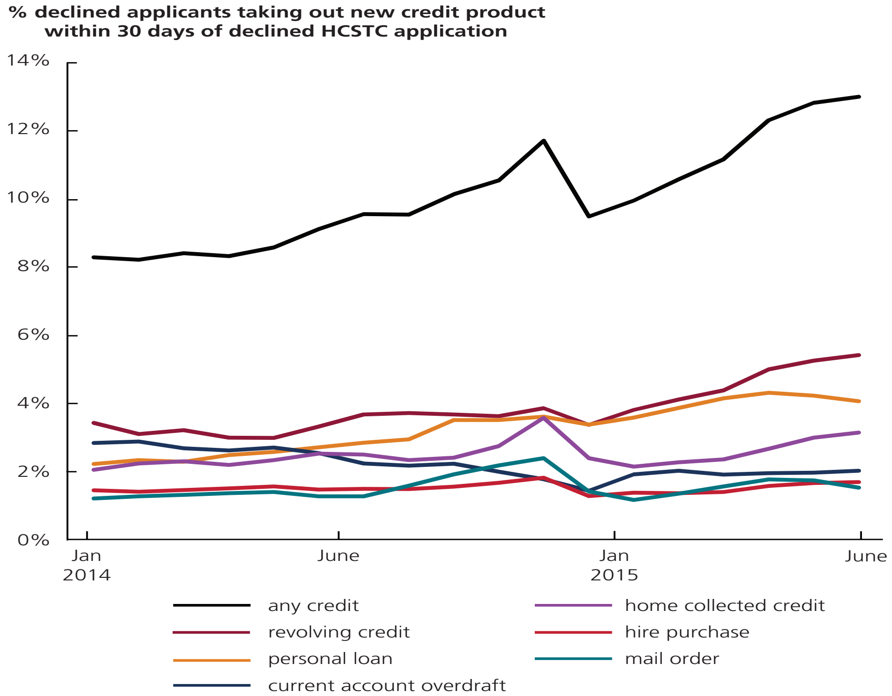


20. We examined what happened to consumers declined for HCSTC loans between January 2014 and June 2015 who did not subsequently take out another HCSTC loan over this period. We examined cohorts of consumers declined each month (hence each consumer only appears once in each cohort month based on the earliest date of loan application in that month; however, they may appear in multiple cohorts). We observe between 175,000 and 280,000 individuals in each cohort month.

31 Observations with a debt to income (DTI) ratio over 2 are top-coded at 2

21. Within 30 days of the date of individuals being declined for a HCSTC, between 8 and 13% took out a new non-HCSTC credit product. Of this, 3- 5% of individuals took out new revolving facilities (credit or store cards) and 2- 4% took out new personal products. There appears to be a trend of declined applicants increasingly taking out alternative credit products over the course of 2014 and after falling in December 2014 and January 2015 this steadily rises again over the course of 2015.

Figure 15: New credit products taken out by declined HCSTC applicants



22. There therefore appears to be limited substitution to other sources of formal credit for consumers declined HCSTC. This finding is consistent with previous analysis of consumers whose applications were declined during 2012 and 2013.[32] Previous analysis of declined applicants found 10% of consumers reported to have borrowed elsewhere.[33] It is likely that some declined applicants borrow from informal sources such as family or friends; however, this is not observable in CRA data.

23. At the time of HCSTC denial, 26% of these individual's non-mortgage debts were in revolving credit (credit cards or store cards), 26% in personal loans, 17% in hire purchase agreements and 10% in overdrafts. There is little change in the distribution of debt balances six or twelve months later.

32 Results summarised in CP14/10 Technical Annex 3, pages 161-162
https://www.fca.org.uk/publication/consultation/cp-14-10-technical-annexes.pdf

33 See pages 257-263
https://www.fca.org.uk/publication/consultation/cp-14-10-technical-annexes.pdf

Figure 16: Distribution of non-mortgage debt balances of declined HCSTC applicants at the month of HCSTC denial

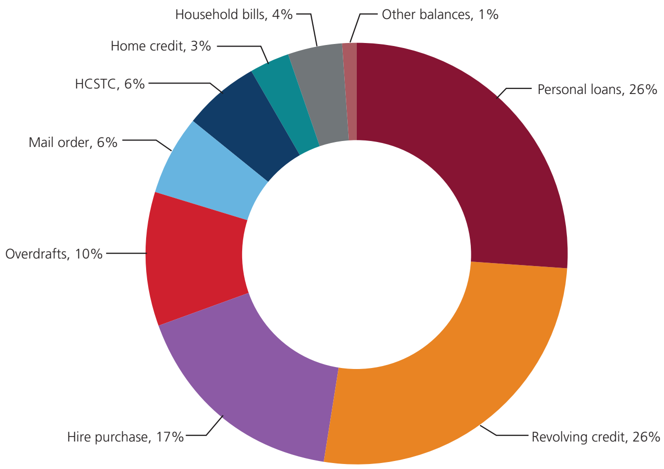
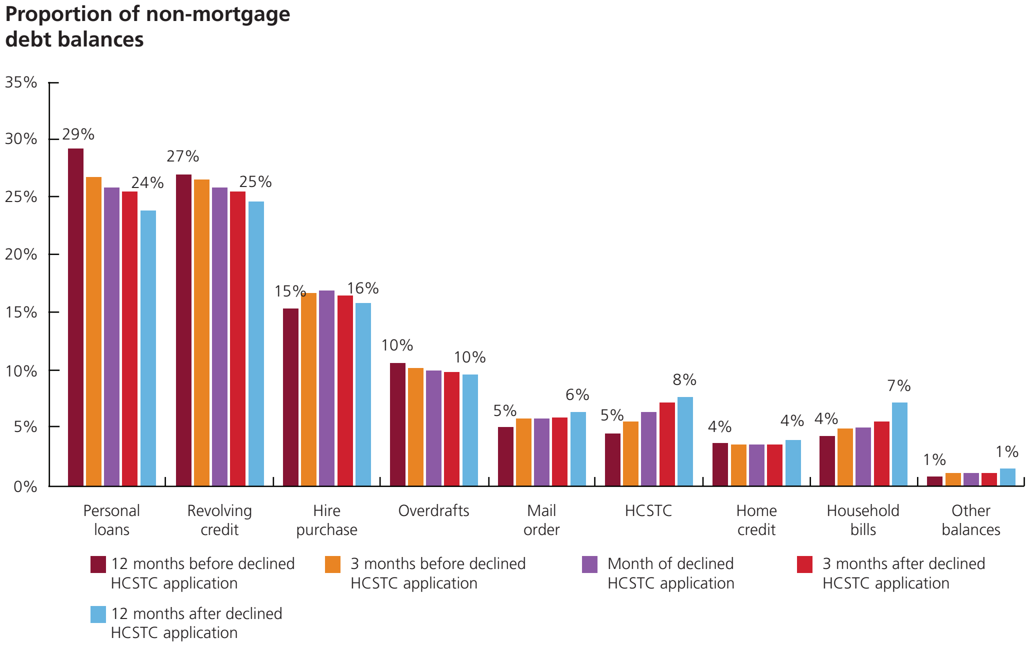


Figure 17: Distribution of non-mortgage debt balances of declined HCSTC applicants over time relative to month of HCSTC denial

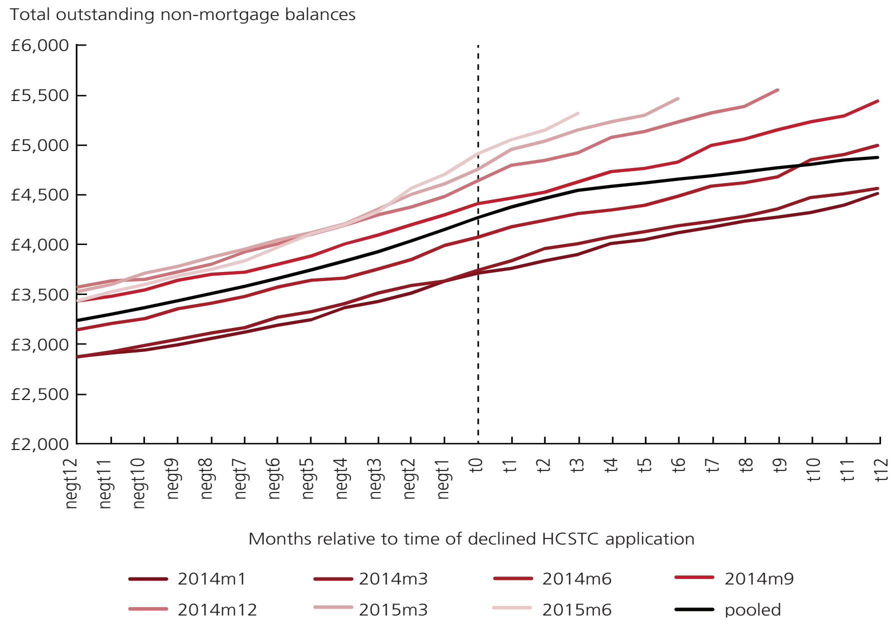


24. Debt balances of declined applicants typically continue to increase after being declined a HCSTC loan. On average, they hold £4,300 in debt at the time of applying for HCSTC – debts which have increased from £3,200 12 months earlier and continue to increase to over £4,900 twelve months later. These debts equate to an estimated median and mean debt-to-income ratio of approximately 13% and 25% respectively at the time of application.[34] One of the contributing factors to this increase in debts over time is an increase in defaulted debts.

34 Based on individuals for who have sufficient CRA data to estimate income for in order to construct a DTI ratio.

25. Examining later cohorts of declined applicants displays that, on average, these consumers have higher outstanding debts than earlier cohorts at the time of being denied HCSTC – earlier cohorts had debts under £4,000 whereas later cohorts have debts of just under £5,000. There has been strong growth in consumer credit more broadly over this time and therefore these changes in starting debt balances of different cohorts may not be HCSTC-specific.[35]

Figure 18: Debt balances of declined HCSTC applicants relative to time of first HCSTC loan observed in data, split by date of cohort



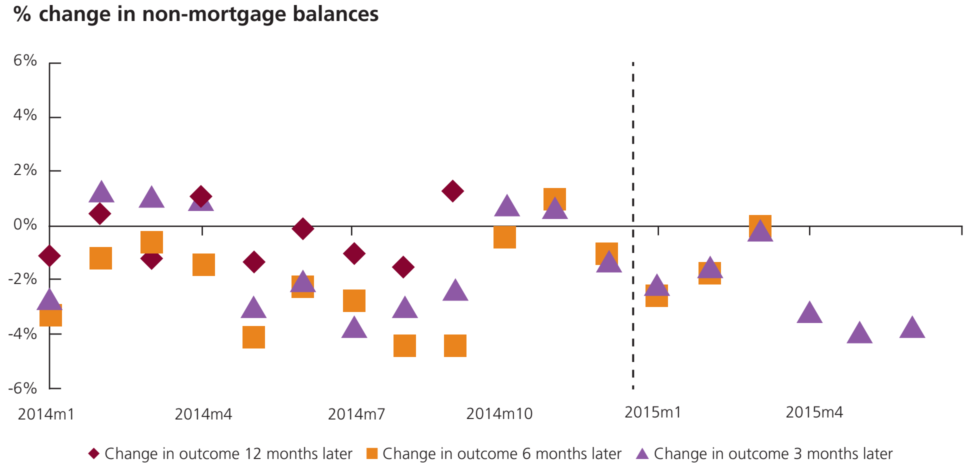
26. It is difficult from the above to examine how consumer outcomes of cohorts of declined applicants are changing around the time of HCSTC denial and over time given the different starting debt levels and debt trajectories before being declined HCTSC. We therefore use a triple difference methodology to account for the existing trend in consumer financial outcomes and examine whether these changed after taking out a HCTSC loan to make cohorts more easily comparable.[36]

27. Doing so displays that although the total non-mortgage debts of declined applicants continue to increase after HCSTC loan denial, they are typically not spiralling up in value but, if anything, the pace of their growth is slightly slowing down. For example, taking the first cohort of applicants whose HCSTC application was declined in January 2014 we observe these consumers non-mortgage debt balances are 3%, 3% and 1% lower three, six and twelve months respectively after being denied HCSTC than they would have been if they followed the path they had been on the three, six and twelve months before the time of being denied HCSTC. Comparing across different cohorts shows little clear pattern except that there appears to be consistency in that consumer debts are not increasing after being denied HCSTC more than would have been expected.

35 Bank of England Credit Conditions Review, Q2 2016, Chart 2.6
http://www.bankofengland.co.uk/publications/Documents/creditconditionsreview/2016/ccrq216.pdf

36 This is a triple difference (Difference –in Difference – in – Difference) approach. We are taking differences to account for both different starting levels and different trends before first applying for a loan. This can be written in terms of whether outcome, Y, at time period, X has changed relative to previous trend.
$[Y_{tX} – Y_{t0}]/[Y_{t0} – Y_{negtX}]$

Figure 19: Change in debt balances of declined HCSTC applicants relative to time of first HCSTC loan observed in data, split by date of cohort



28. It is very common for declined HCSTC applicants to have experienced bad credit events before applying for HCSTC and the frequency of such events increases over time leading up to HCSTC application. On average, 48% of these applicants have missed at least one payment 12 months prior to taking out a HCSTC product and this increases to 61% in the month of applying for a HCTSC, and increases to 75% 12 months after taking out a HCTSC product.

29. Related metrics display a similar pattern, for example the percent of outstanding debts that are classified as being in default increases from 24% to 30% to 45% over the same period of time. There is an increasing likelihood of these customers exceeding their overdraft limit – rising from 19% in the 12 months before a HCSTC loan was taken out to 26% at the time of making an application and peaks at 32% in 12 months afterwards. We observe a common pattern across cohorts of consumers experiencing increasing financial distress over time.

30. Taking the same triple difference approach as used for balances to correct for the different pre-application trends and starting values of different cohorts we observe a fairly consistent pattern in consumer outcomes across cohorts of declined applicants. We do not observe clear evidence that these consumers were increasingly suffering much worse adverse credit events after HCSTC denial than they would have been expected to, given how their financial situation was already deteriorating. Focusing on the cohorts of applicants declined around the price cap shows no clear relationship between this and changes in outcomes of declined applicants.

Figure 20: Change in debt balances of declined HCSTC applicants, split by date of cohort

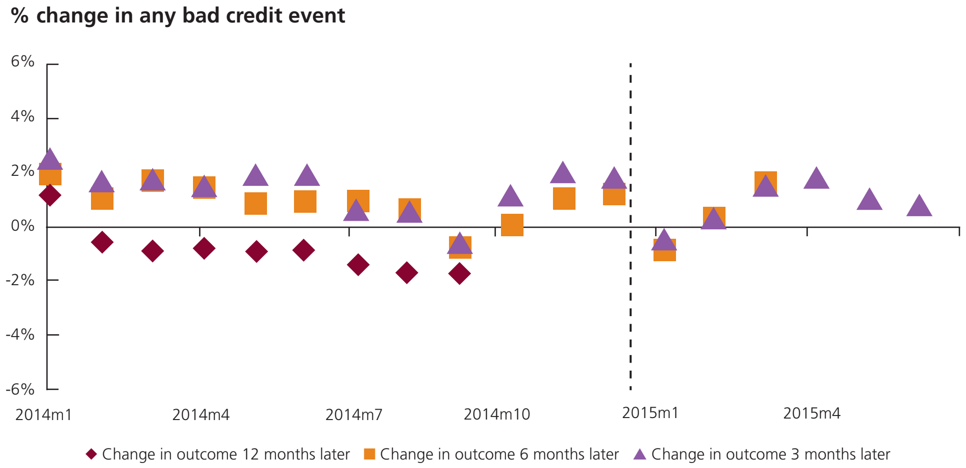


Figure 21: Change in ratio of non-HCSTC balances in default of declined HCSTC applicants, split by date of cohort

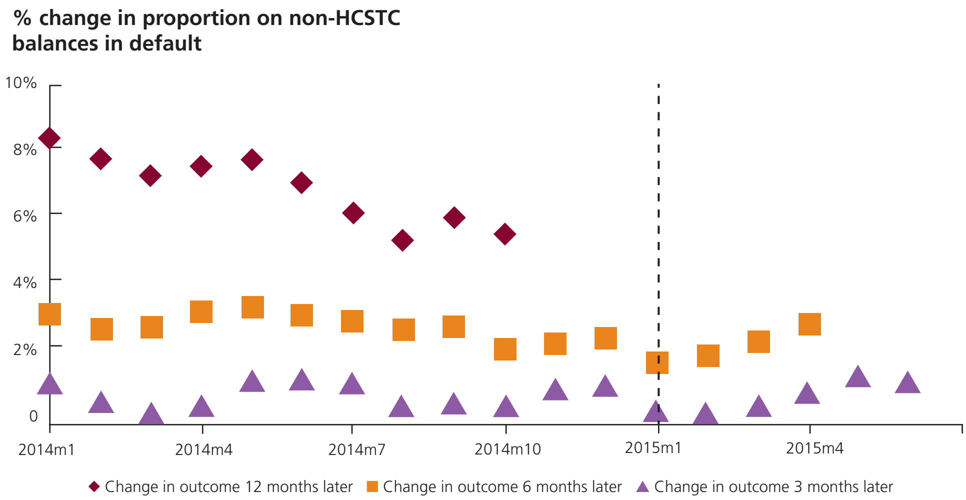
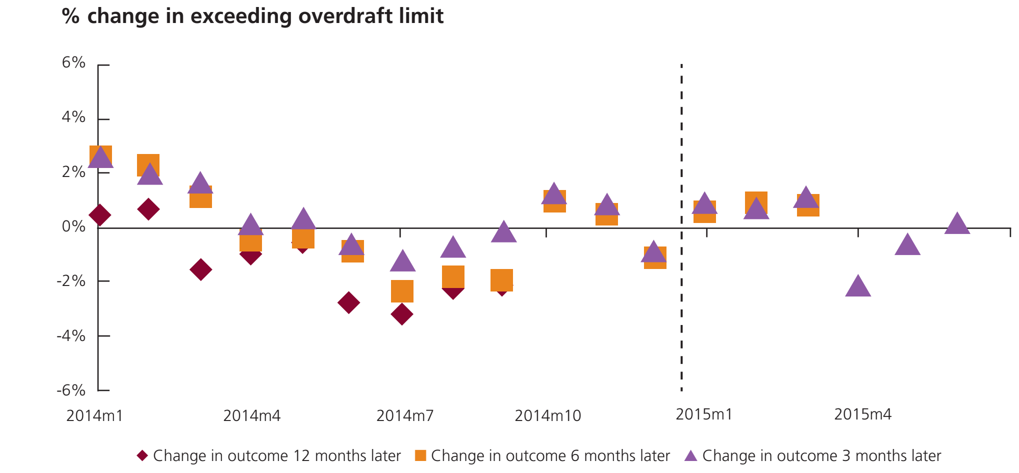


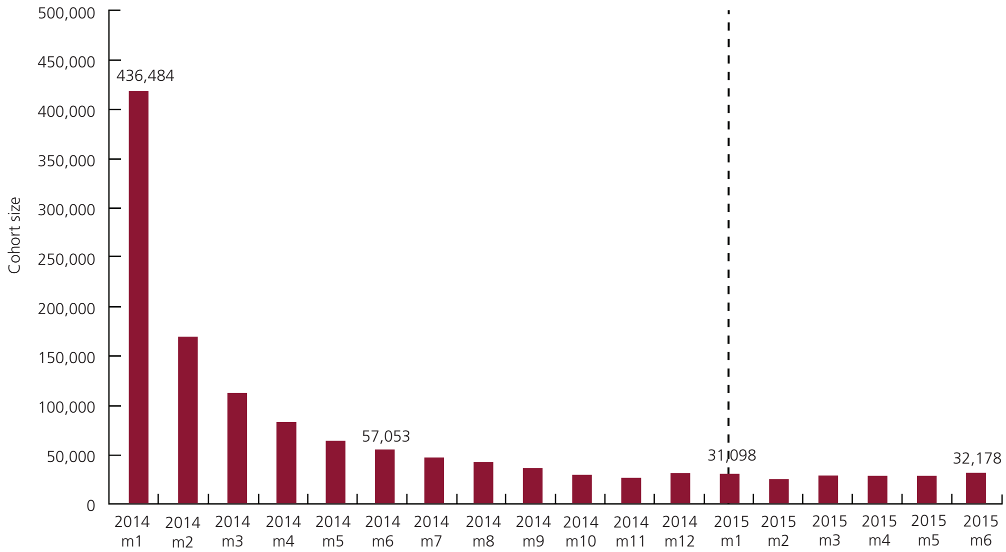
Figure 22: Change in likelihood of exceeding their overdraft limit of declined HCSTC applicants, split by date of cohort



Accepted applicant analysis

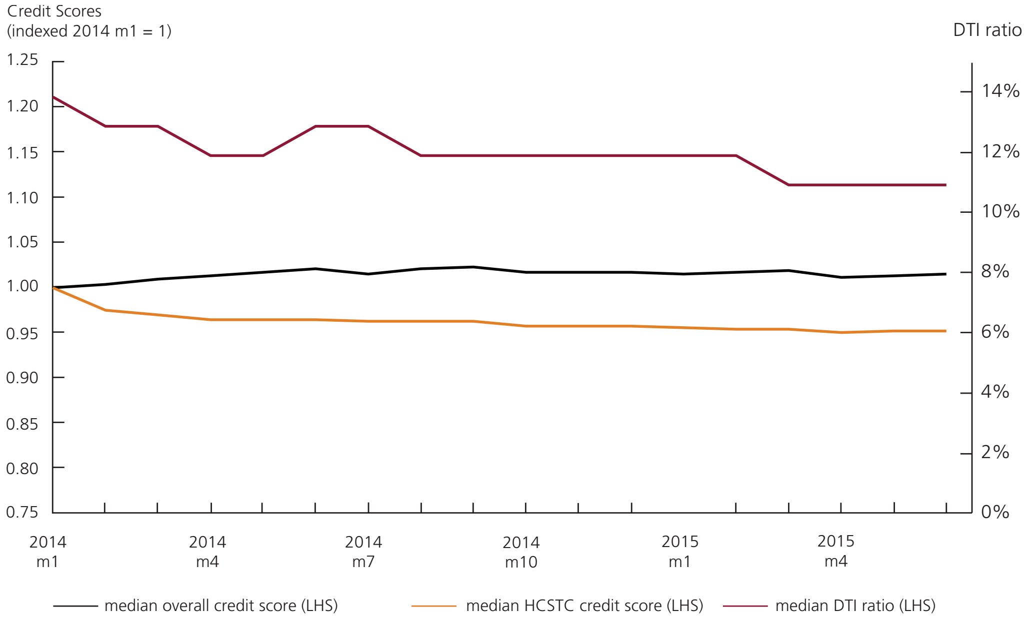
31. In order to examine how HCTSC use is related to consumer outcomes we focus on the first successful HCSTC loan application by a consumer observed in our dataset (January 2014 to June 2015). This approach is taken to more cleanly isolate how consumer outcomes vary after HCSTC use than would occur if results included consumers who were currently or recently holding HCTSC, which might confound the effects of prior loans. There are too few new individuals who have never previously applied for a HCSTC applicants to fully control for this confounding. We group these 1.3million individuals by the cohort month they first appear in the data resulting in the largest cohort being in the first month of data, January 2014.

Figure 23: Number of individuals by date of cohort



32. Examining the profile of these customers over time displays later cohorts have slightly lower median debt to income (DTI) ratios and lower median credit scores (higher credit risk). The mean DTI ratio follows a similar pattern to the median decreasing from 27% to 24% from January 2014 to June 2015.

Figure 24: Median credit scores and DTI ratio by date of cohort



33. At the time of applying for a HCSTC, 26% of these individuals' non-mortgage debts were in revolving credit (credit cards or store cards), 26% in personal loans, 15% in hire purchase agreements and 10% in overdrafts. There is little change in the distribution of debt balances six or twelve months later.

Figure 25: Distribution of non-mortgage debt balances of HCSTC customers at the month of HCSTC application

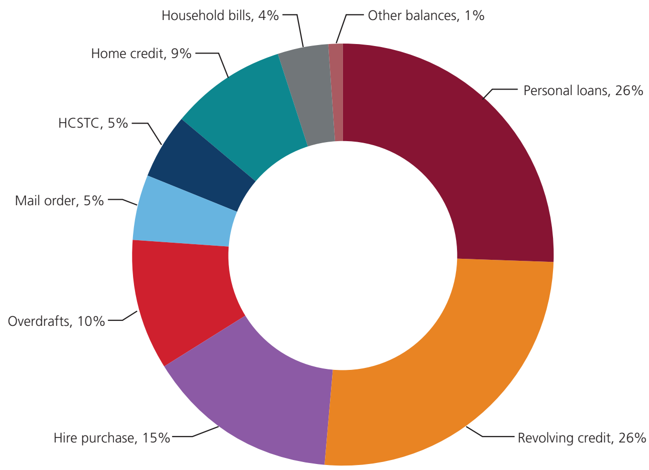
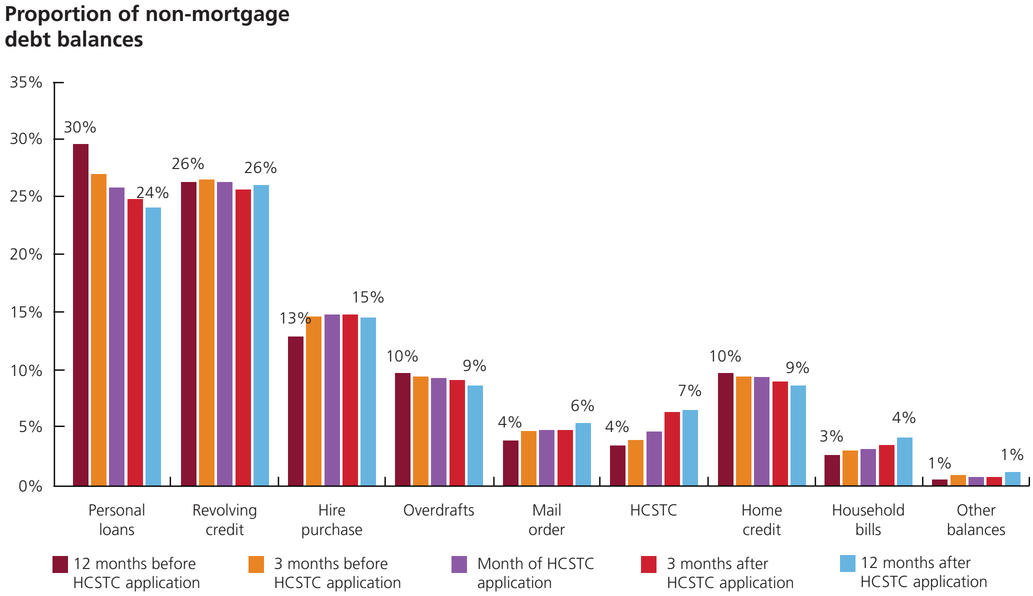
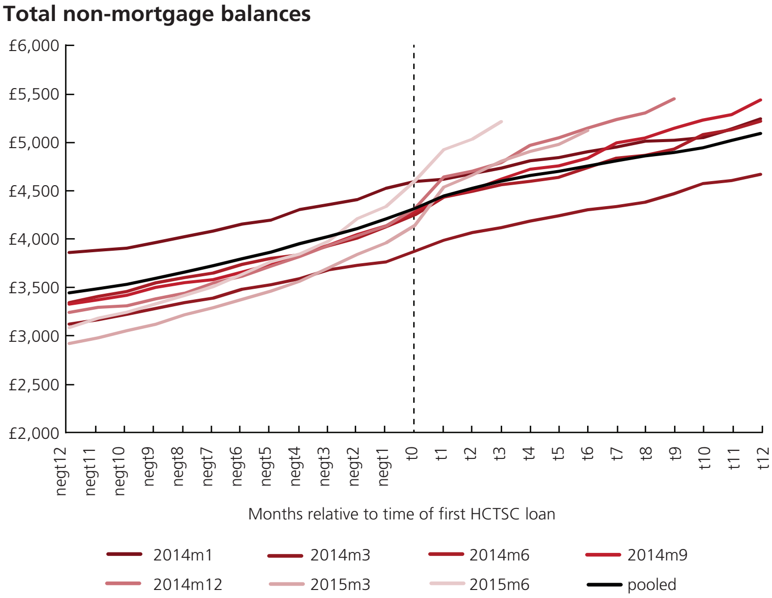


Figure 26: Distribution of non-mortgage debt balances of HCSTC customers over time relative to month of HCSTC application



34. We then examine the financial outcomes of these individuals, constructed from credit file data, relative to the timing of their loan application. This displays that in the 12 months leading up to taking out a HCSTC loan consumers' debts were steadily increasing. On average, consumers' outstanding debts (excluding mortgage debts) increased from £3,400 to £4,300 in the 12 months leading up to the time of first taking on a HCSTC loan over our sample period. After taking out a HCSTC their non-HCSTC or mortgage debts keep on rising to £5,000 12 months later.

Figure 27: Debt balances relative to time of first HCSTC loan observed in data, split by date of cohort



35. It is common for consumers applying for HCSTC to have experienced bad credit events and the frequency of such events increases over time. On average, 43% of consumers have missed at least one payment 12 months prior to taking out a HCSTC product and this increases to 53% in the month of applying for a HCTSC, and to 67% 12 months after taking out a HCTSC product.

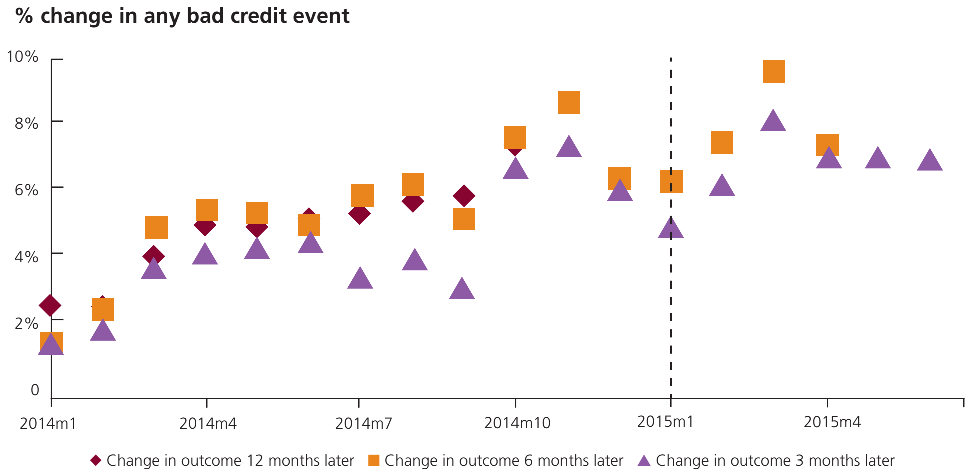
36. Other metrics display a similar pattern, for example the percent of outstanding debts that are classified as being in default increases from 20% to 25% to 34% over the same period of time. There is steadily increasing likelihood of these customers exceeding their overdraft limit – rising from 16% in the 12 months before a HCSTC loan was taken out to 19% at the time of making an application and 25% in 12 months afterwards.

37. These patterns of increasing borrowing and financial distress over time appear consistent across different cohorts of individuals. However, the cohorts of consumers who took out HCTSC loans after late 2014 appear to be suffering worse outcomes three months after taking out their loans than earlier cohorts did.

38. Examining the reasons for this difference between earlier and later cohorts in more detail displays that while these later cohorts of consumers suffered worse outcomes three months after taking out a HCSTC loan they were already suffering worse outcomes 12 months prior to this. To isolate this we use the same triple difference methodology applied to analysing declined applicants in order to account for the existing trend in consumer financial outcomes and be able to compare cohorts.[37]

39. Using this methodology shows that consumers experience worsening financial outcomes in terms of experiencing bad credit events after taking out HCTSC than would have been expected based on the trends in their finances before the time of first applying for HCSTC. These worsening financial outcomes could be due to HCSTC causing their financial situation to worsen or to other factors unrelated to HCSTC use or a combination of the two. Later cohorts appear to experience elevated worsening outcomes than earlier cohorts.

Figure 28: Change in proportion of consumers experiencing bad credit events after taking out HCSTC loan, split by date of cohort



37 This is a triple difference (Difference –in Difference – in – Difference) approach. We are taking differences to account for both different starting levels and different trends before first applying for a loan. This can be written in terms of whether outcome, Y, at time period, X has changed relative to previous trend.
$[Y_{tX} - Y_{t0}]/[Y_{t0} - Y_{negtX}]$

40. Examining other measures of financial distress such as the percent of non-HCSTC balances in default and percent of consumers exceeding their overdraft limit do not show much of a change in consumer outcomes among later cohorts of consumers compared to earlier cohorts.

Figure 29: Change in ratio of non-HCSTC balances in default after taking out HCTSC loan, split by date of cohort

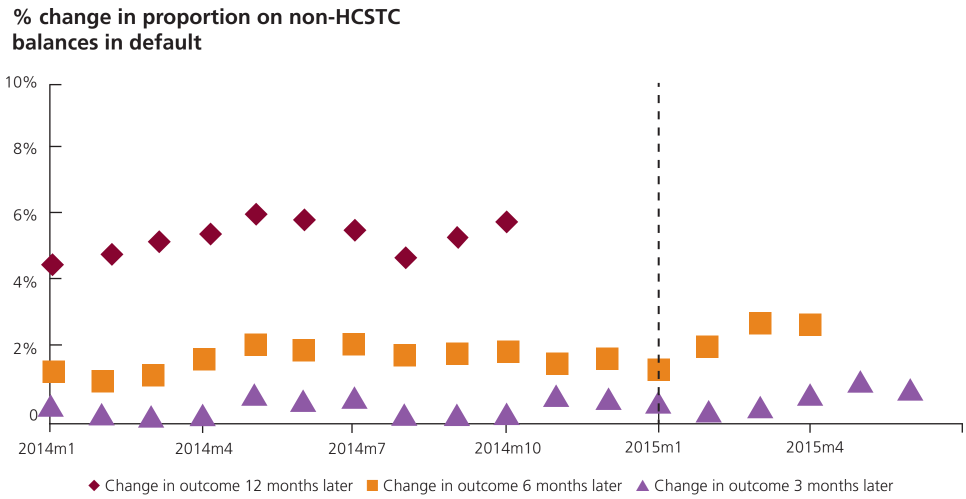
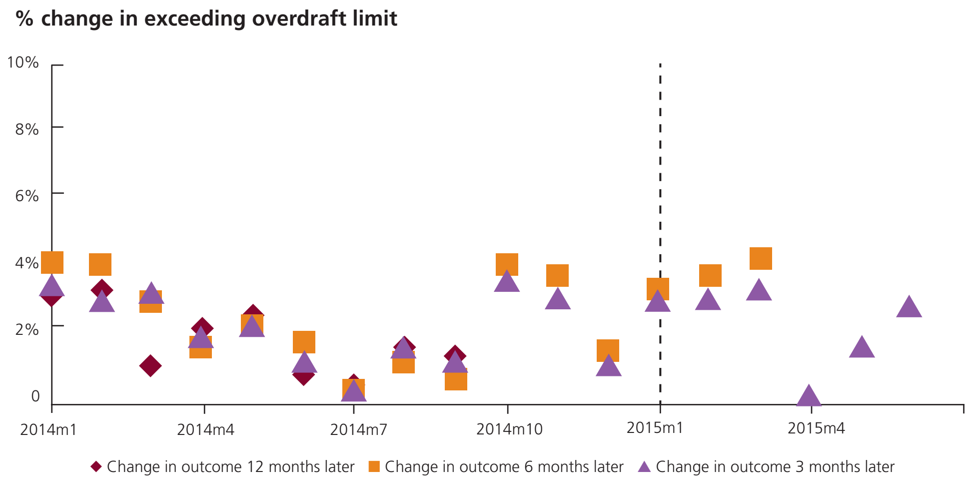


Figure 30: Change in likelihood of exceeding their overdraft limit after taking out HCSTC loan, split by date of cohort



Repeat and multiple borrowing: January 2014 to June 2015

Repeat borrowing

41. The decline in the number of HCSTC loans from 2012-13 to 2014-15 has resulted in a smaller number of individuals repeatedly taking out HCTSC loans. Whereas between January 2012 and June 2013, approximately 150,000 people took out 18 or more loans (averaging one or more a month) that declined to under 60,000 people for the period January 2014 to June 2015. Fewer than 85,000 individuals took out six more loans during the first six months of 2015 compared with approximately 275,000 individuals during the first six months of 2014.

Figure 31: Number of loans taken out by consumers over 18 month period

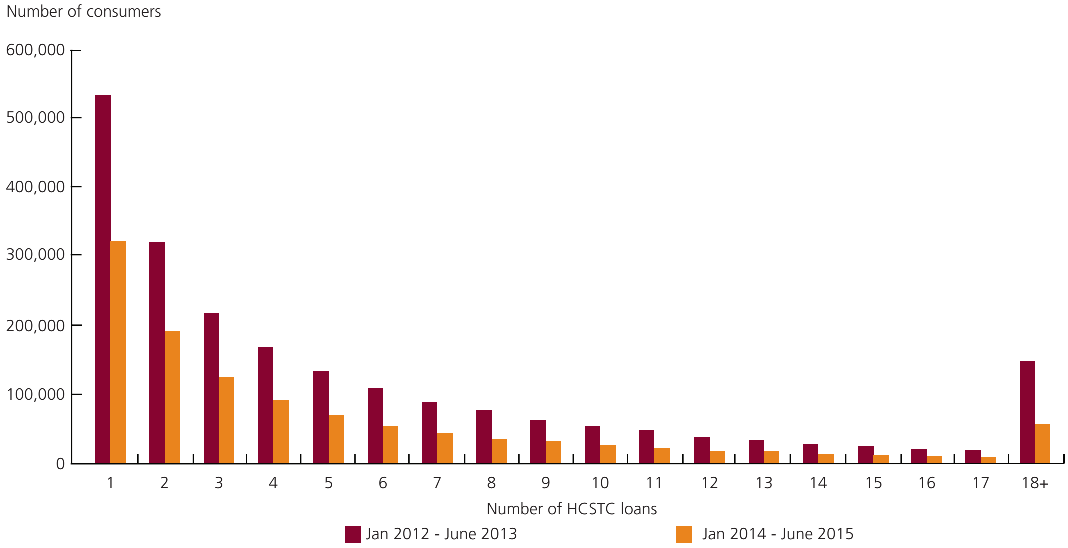
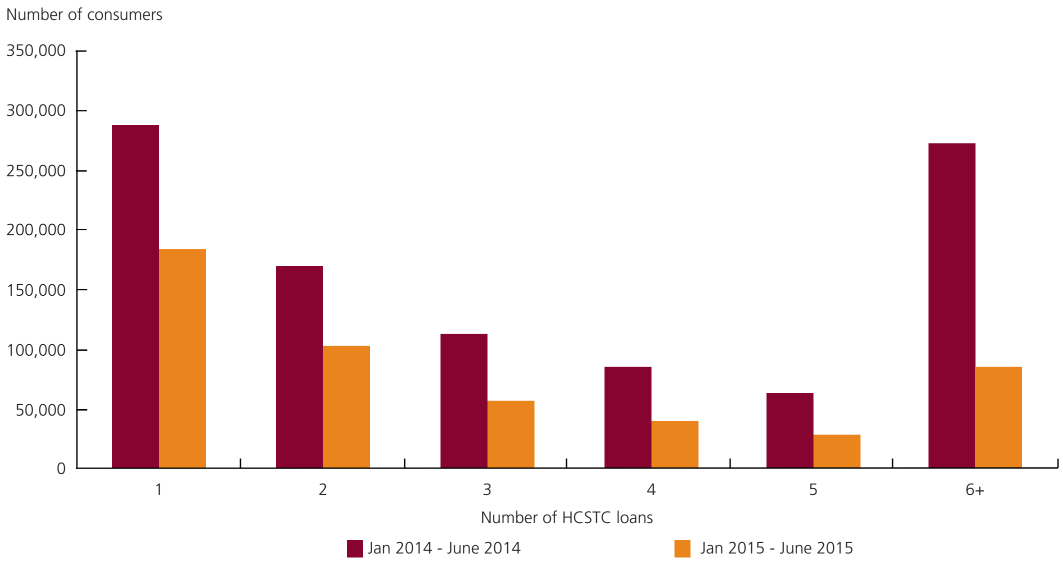
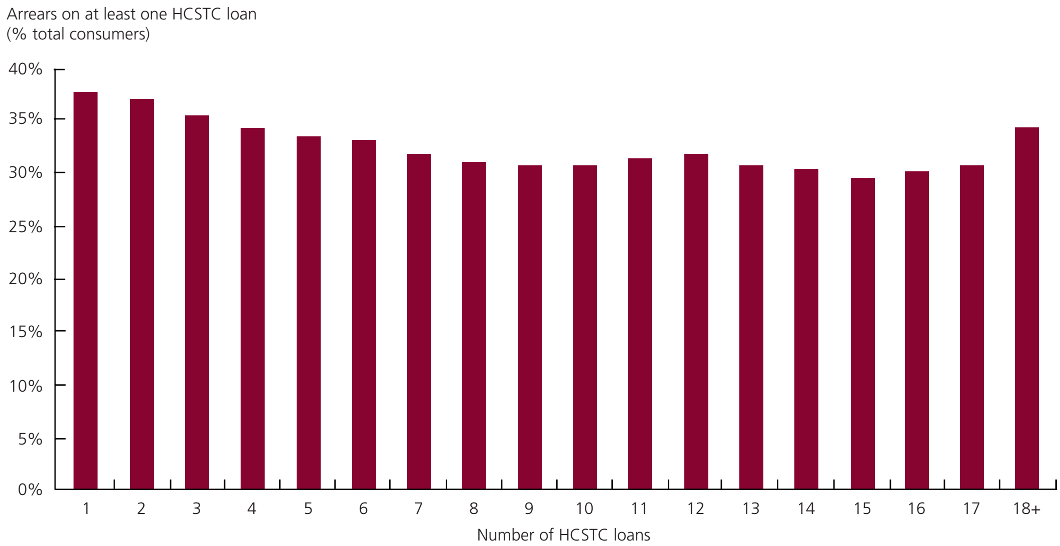


Figure 32: Number of loans taken out by consumers over 6 month period



42. There is no clear relationship between repeat borrowing and loan arrears. A higher proportion of individuals who borrow a few times over an 18 month period fall into arrears on these loans than those who borrow more frequently.

Figure 33: Consumer-level arrears rates by number of loans



43. The average (mean) HCSTC loan size is slightly lower for consumers with more loans. Average (mean) borrowing duration recorded on credit files also decreases for consumers with more loans. The average borrowing duration is longer for consumers with 1 or 2 loans due to the proportion of those who have defaulted: this frequently remains on a credit file as an open agreement for 120 days. However, it should be noted that consumers may not be incurring additional interest charges on all of these days they were borrowing.

Figure 34: Average (mean) loan size by number of loans

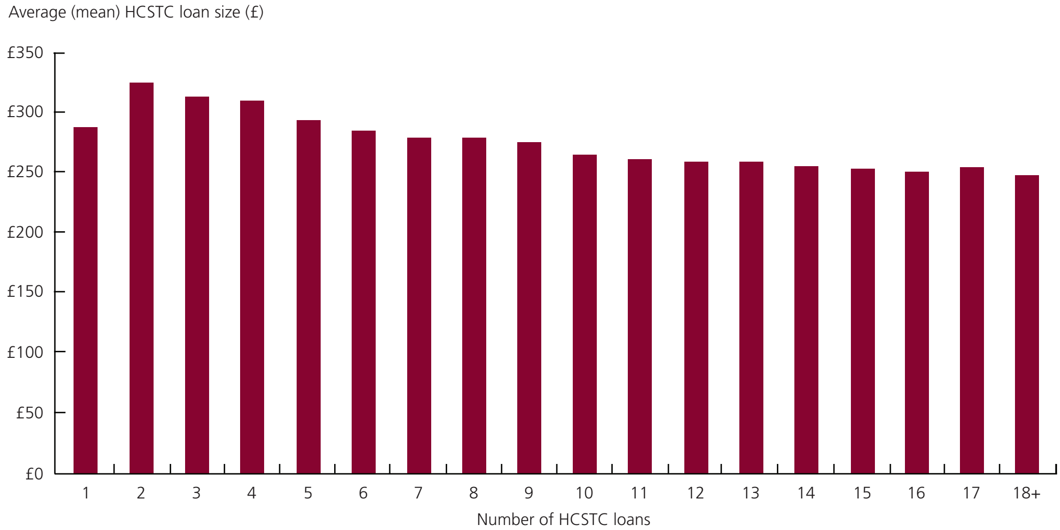
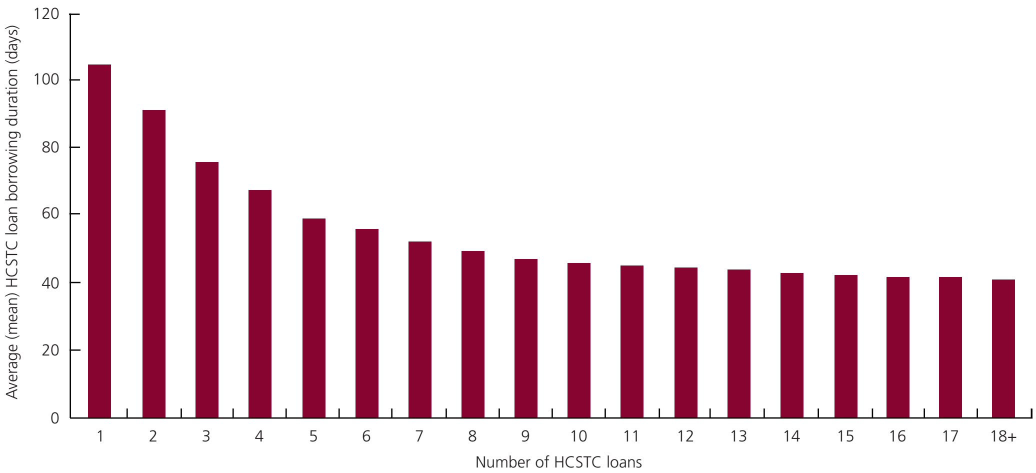
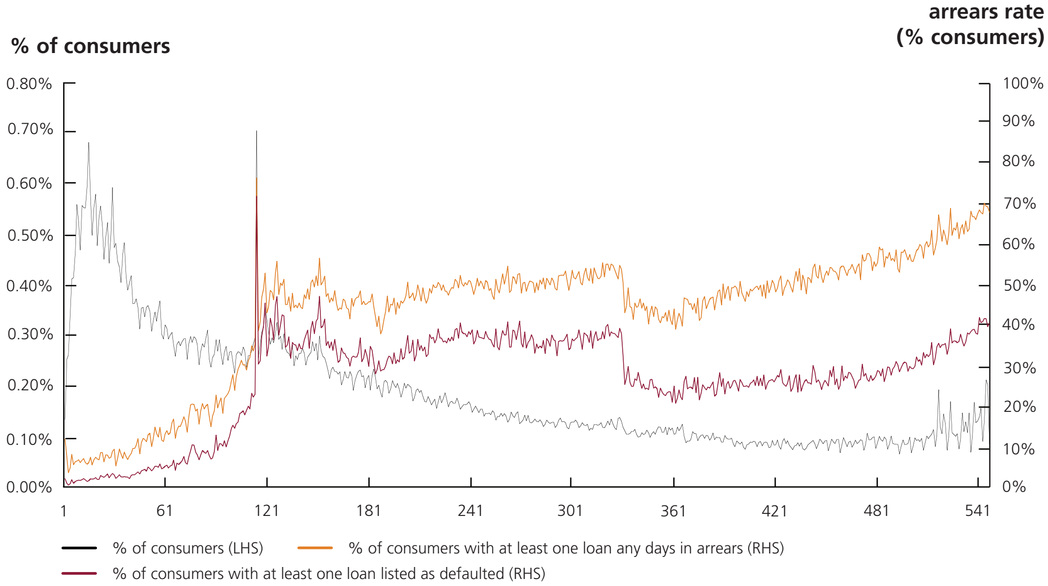


Figure 35: Average (mean) days borrowing by number of loans



44. Examining the relationship between the number of days a consumer has borrowed and arrears does not clearly show that individuals who persistently borrow are more likely to enter arrears on any of their HCSTC loans. There are spikes in the data for consumers borrowing around 30 days – a typical duration for a single loan – and 120 days – the total duration of time a defaulted loan often stays on a credit file for.

Figure 36: Number of consumers and consumer-level arrears rates by number of days borrowing



Multiple borrowing

45. The majority of users of HCSTC did not simultaneously hold multiple HCSTC loan agreements between January 2014 and June 2015. The more loans an individual held simultaneously, the more likely it is for at least one of those loans to enter arrears. However, the relationship between the number of loans held simultaneously and at least one of those loans entering default is less pronounced.

Figure 37: Percent of consumers by maximum number of loans simultaneously held

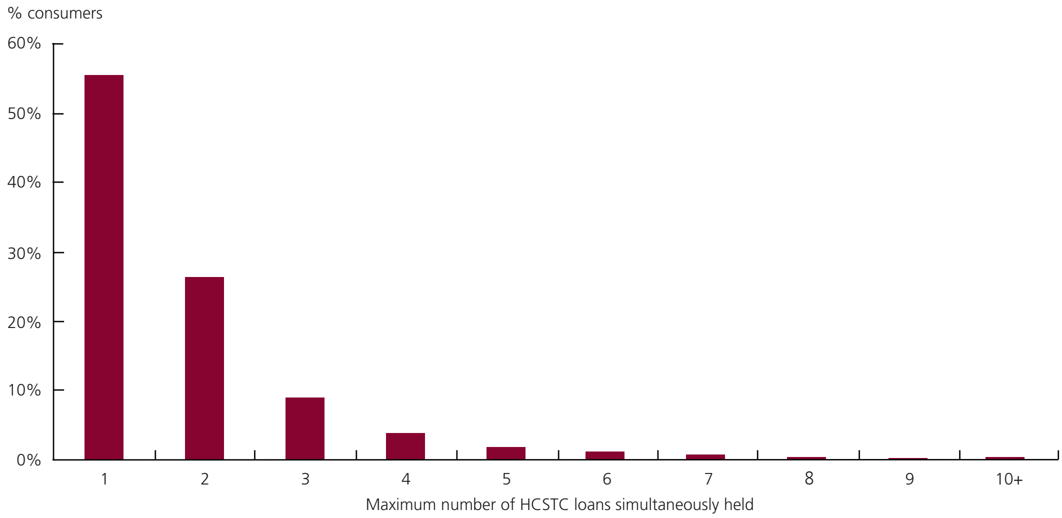
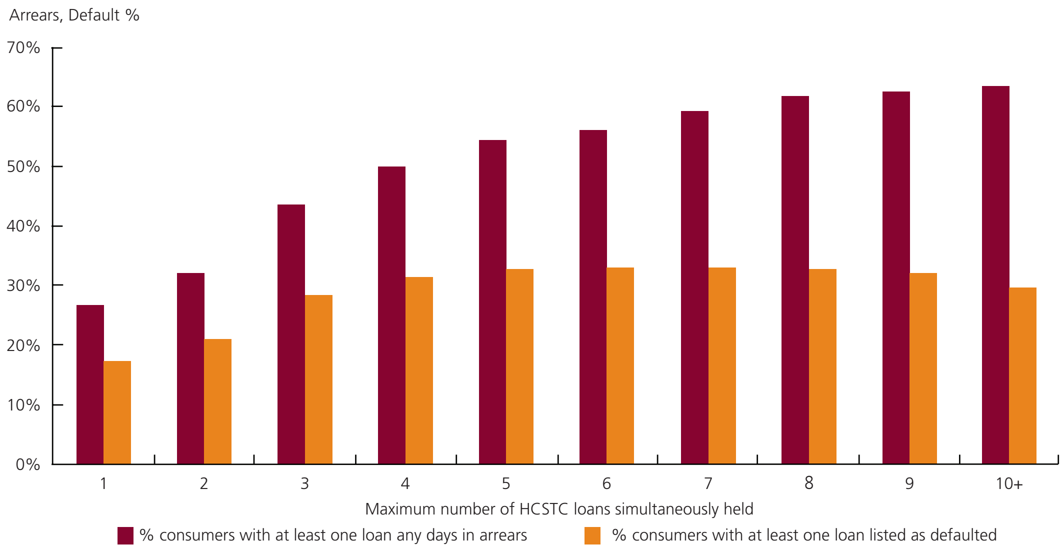


Figure 38: Consumer arrears and default rates by maximum number of loans simultaneously held



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