Payday loans: The next generation

Changes to the high-cost short-term credit market since the introduction of the price cap

Executive Summary

The payday loan market grew rapidly in the years following the financial crisis. Millions of families faced stretched incomes and tighter restrictions on mainstream credit leaving many to turn to high cost credit like payday loans. However, poor lending practices, product features and the high cost of these loans resulted in many people getting into severe financial difficulties. Unprecedented numbers of people came to debt advice organisations with payday loan debts. At StepChange Debt Charity we saw year on year increases culminating in 82% more people coming to us with payday loan debts in 2013 than in 2012.

Widespread concerns about these products and the practices of the lenders led to much needed action. In 2015 the FCA brought in stricter rules on payday lending including limits on rolling over loans, stronger affordability guidance and financial health warnings, and a price cap on high cost short-term credit (HCSTC).

This report looks at changes in the market since these changes were brought in.

Definition of payday loans

Payday loans are relatively small sums lent over a short period of time at a high interest rate. They were previously lent for around 30 days but can now be medium term instalment loans of two months to a year. This research covers both these loan types using the FCA definition of 'high-cost short-term credit': any regulated credit agreement that has an APR equal to or exceeding 100% and is provided for a maximum of 12 months and is not a doorstep loan, bill of sale loan or overdraft. This report looks at products included in this FCA definition and refers to them as high-cost short-term credit (HCSTC) and HCSTC lenders. For ease of understanding for our respondents we used payday loans in the questions in our survey of clients.

Evidence suggests that the 2015 FCA regulation has made a difference. StepChange Debt Charity has seen significantly fewer clients coming to us with HCSTC debts 16% of our clients had HCSTC debts in the first half of 2016 compared to nearly a quarter (23%) in 2013. This suggests fewer people are getting these loans and less of those who take out HCSTC are struggling to repay.

However, the HCSTC market has changed and adapted to the post price cap landscape. The market has broadened to encompass different forms of loans that, unlike the 'traditional' 30 day payday loan, are repaid over two months to a year. Giving customers a longer period to repay and breaking up repayments into smaller chunks can be beneficial, but it can also mean interest builds up over a longer period making borrowing more expensive overall.

The report finds some welcome signs of improvement on some of the worst conduct issues seen at the peak of the market in 2013. This included widespread irresponsible lending and aggressive debt collection practices. We have seen less of lenders making excessive use of continuous payment authorities (CPAs) leaving borrowers with nothing in their account and sending threatening and misleading letters to customers.

However, there are still issues with lending practices. Over a third of our clients with HCSTC debts have three or more such debts and three quarters of clients in our survey tell us that they got a HCSTC loan when they already had outstanding HCSTC. There is also evidence of issues with affordability assessments as a quarter of our clients said that they did not know or only had a rough idea of how much they would have to repay. Furthermore, just over a quarter said they did not think the lender took reasonable steps to assess their ability to repay a HCSTC loan.

There were also issues with how HCSTC lenders treat customers in financial difficulties. Our survey found that after telling the lender they were struggling to repay, less than half of our clients were told about free debt advice and only just over a quarter had an affordable repayment plan agreed. Moreover, just under a quarter of clients found the lender continued to demand payment even when told about the client's financial difficulties, one in five found their lender continued to add interest and charges and just over one in ten were threatened with court or other enforcement action.

The FCA's review of the impact of the price cap to be completed in 2017 should look further into continuing problems with poor lending practices and poor treatment of customers in financial difficulties and take action where necessary.

In bringing in the price cap the FCA estimated that around 160,000 people a year would no longer have access to HCTSC loans.[1] This raised the question of where people turn when they are no longer able to access a HCSTC loan. Our research looked at clients who applied for HCSTC, had previously been accepted but since the price cap had been rejected. We looked at where these people turned after they could not get a HCSTC loan. Some borrowed from other lenders, including other HCSTC providers, their credit card, overdraft or home credit loans. Many missed an essential bill or another loan payment or borrowed from friends and family. These households are facing seriously constrained choices between taking out high cost credit, missing a household bill payment or not having enough money to pay for essentials like feeding their family. This confirms that as our research has previously shown, certain households are struggling to get by without borrowing or getting into arrears, and there is still a significant gap in the market for accessible, affordable credit.[2]

This report highlights issues in the HCSTC market two years on from the price cap and the package of tougher rules. It puts forward recommendations for the FCA to look at as part of their review of the price cap. It also recommends that the government look to improve access to affordable alternatives to high cost credit for the most financially vulnerable households.

Key recommendations:

1. The FCA should explore as part of their review of the price cap, what the implications of the shift to instalment loans are for the appropriate level of the price cap.

2. The FCA should strengthen their rules on responsible lending including turning their existing guidance on responsible lending into rules. For example, creditworthiness assessments should be required to take account of whether the customer is experiencing difficulties with their existing financial commitments.

3. The FCA price cap review should have a broad scope to include the continuing issues with the treatment of customers in arrears and how to tackle them.

4. HCSTC lenders should ensure that their debt collection practices are based on supporting affordable and sustainable repayments and providing appropriate support to help customers in financial difficulties.

5. The FCA should ensure consistency of regulation across different forms of high cost and mainstream credit to deal with the problems financially vulnerable consumers' experience. This would include for example, setting a cap on unarranged overdraft charges.

6. The government needs to look at new ways to provide greater access to more affordable credit safety nets for the most financially vulnerable, including looking at international examples of no and low interest loan schemes.

Introduction

Payday lending is still a relatively new sector with most lenders only entering the market in the UK over the past decade.[3] However, the payday loan market grew rapidly, particularly following the financial crisis of 2008, and peaked around 2013.[4] The Financial Conduct Authority (FCA) found that in 2013, 10 million loans were taken about by 1.6 million consumers, with a total value of £2.5 billion.[5] Payday loans had become a household name and a dominant player in the high cost credit market in the UK.

The difficulties many consumers faced with payday loans during that period of rapid growth are well documented with the Office of Fair Trading (OFT) finding that widespread irresponsible lending led to too many people being granted loans that they could not afford to repay.[6] High interest and charges, rollovers and repeat borrowing meant that many struggling borrowers found their payday loan debts spiralled out of control. The consequence of this was that debt advice agencies saw a flood of people coming to them with problems with payday loans. At StepChange Debt Charity, we saw a series of year-on-year increases culminating in 82% more people coming to us with payday loan debts in 2013 than in 2012 (36,413 people in 2012 to 66,557 people in 2013).[7]

The FCA took over regulation of consumer credit in April 2014 and identified HCSTC as a high risk market. Providers came under scrutiny when they applied for full authorisation, and a number of rules were brought in to address particular practices. The new rules included strengthened affordability checks, signposting to debt advice, financial health warnings and limiting the number of times loans can be 'rolled over'. In late 2013 the Government directed the FCA to cap the price of payday loans, and the cap came in on 1 January 2015. The price cap includes three caps. Interest on the loan must not exceed 0.8% per day of the amount borrowed; there is a cap on default charges of £15; and the total price cap means a borrower should never have to repay more than 100% of the amount borrowed.

There is good reason to believe that the actions of the FCA have gone some way to tackling the worst excesses of the HCSTC market. This is welcome progress. But problems remain and the FCA has committed to reviewing the impact of the price cap in the first half of 2017.[8] This briefing aims to feed into this review by exploring how better regulation and the price cap have had an impact on the HCSTC market by looking at the experiences of StepChange Debt Charity clients with HCSTC. It also explores what more could be done to ensure this type of lending could work better for borrowers and what alternative forms of more affordable credit are needed for those that are more financially vulnerable.

Methodology

To explore how the HCSTC market has changed since the introduction of more effective regulation, we reviewed the existing literature on this and conducted a number of research projects with our clients:

- **Data analysis on StepChange Debt Charity clients with HCSTC:** We compared clients with HCSTC debts who came to us in the first half of 2013 (January to June 2013) with clients with HCSTC debts who came to us in the first half of 2016 (January to June 2016). We looked at their demographic profile, household type, income, employment and housing status etc. We also compared the clients with HCSTC in H1 2013 with all our clients in H1 2016 to explore how those with HCSTC are different to the general profile of people in problem debt.

- **Data analysis on HCSTC debts:** We compared HCSTC debts recorded with StepChange Debt Charity in March 2013 with the HCSTC debts recorded with us in January 2016, in order to explore how the HCSTC market has changed from its peak in 2013.

- **Review of today's HCSTC products:** We undertook some analysis of the ten HCSTC lenders that StepChange Debt Charity clients had the most debts with in H1 2016.

- **Survey of clients:** We conducted a survey of StepChange Debt Charity clients to find out their experiences of using HCSTC and where they went if they were not able to access HCSTC. The sample was StepChange Debt Charity clients who came to the charity for advice between 2015-2016 and had all applied for HCSTC after January 2015. We had 530 respondents between 1 August and 14 August 2016.

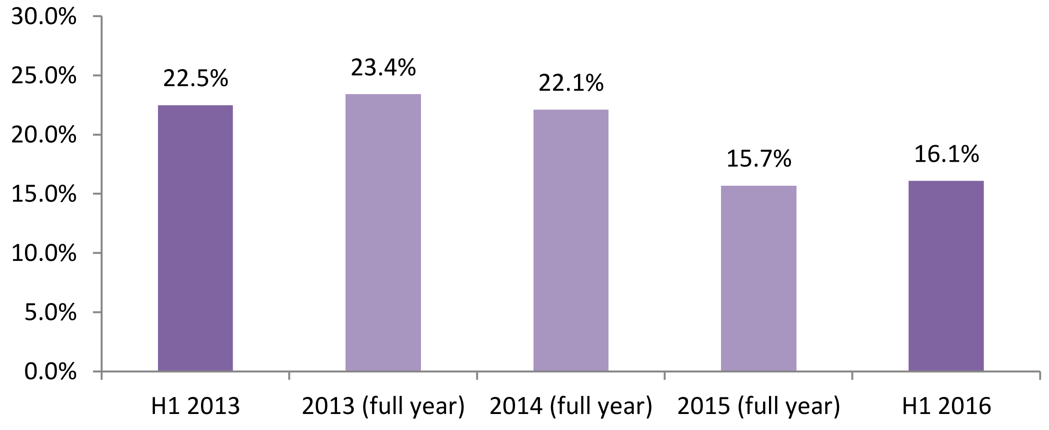
Changes in HCSTC

HCSTC debt make-up of StepChange Debt Charity clients has changed

Since the FCA took over consumer credit regulation, some HCSTC lenders have chosen to leave the market and others have gone into liquidation. Citizens Advice has estimated that 38% of the firms operating in 2013 have exited the market.[9] Other reports state that more than 1,400 payday lending companies have left the industry since summer 2014 and significantly fewer loans are being made by the companies left in the market with 6.3 million loans granted in the first half of 2013 and 1.8 million in the first half of 2015.[10] The Consumer Finance Association (CFA), a short-term lending trade association, also reported lending in March 2015 was down 68% from March 2013 levels.[11]

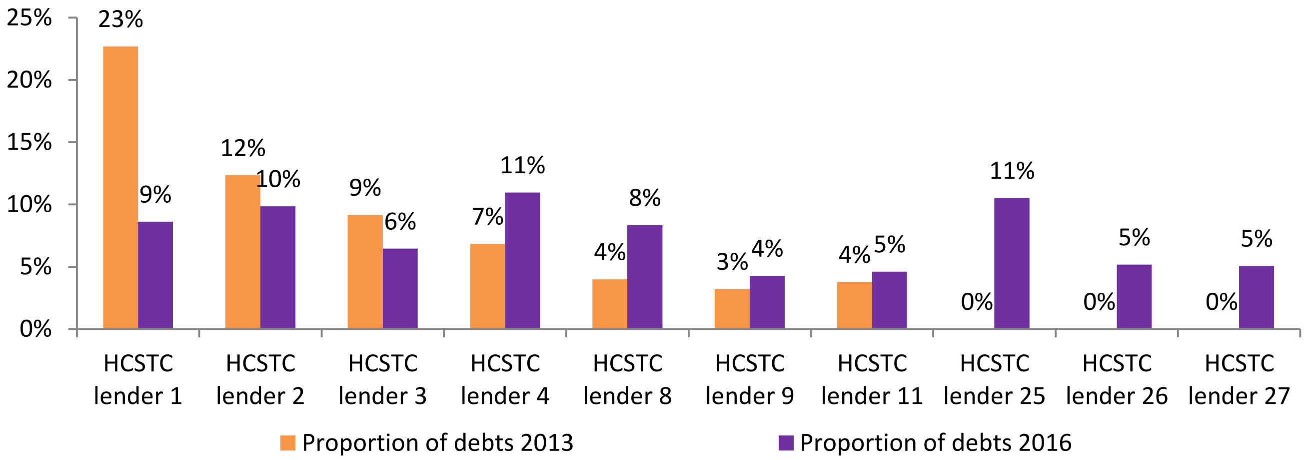
Evidence from StepChange Debt Charity clients reflects the broader trends of a contraction of the HCSTC market. We have seen a significant fall in the number of people coming to us with HCSTC debts. 23% of our clients advised in the first half of 2013 had HCSTC and this had fallen to 16% of clients advised in the first half of 2016. The average total amount owed on HCSTC by clients has also fallen from £1,647 in 2013 to £1,308 in 2016.[12] This all indicates that the FCA price cap and new rules on HCSTC lending have made a difference as it suggests fewer people are being granted HCSTC that they cannot afford to repay. Therefore substantially lower numbers of borrowers are getting into difficulties and having to turn to debt advice agencies like StepChange Debt Charity.

Proportion of StepChange Debt Charity clients with HCSTC debts



Comparing the ten lenders StepChange Debt Charity saw the most HCSTC debts with in 2016 with the number of debts we saw with those lenders in 2013 shows changes in loan product types in the debts we see. The chart below illustrates that many of the more dominant players in the HCSTC market in 2013 who at that time solely provided the ‘traditional’ 30 day payday loan product had the highest debt levels in our 2013 data. These have seen significant reductions for example, HCSTC lender 1 constituted nearly a quarter (23%) of all the HCSTC debts we saw whereas in 2016 it made up just 9%.

In contrast, newer entrants to the HCSTC market offering medium term loans (2 months to a year) repaid in instalments, are making up more of the HCSTC debts we see. The chart below shows that two lenders offering only instalment loans have seen a significant increase in the number of HCSTC debts recorded by StepChange Debt Charity. These lenders (HCSTC lender 25 and 26) were only established after 2012 so made up zero or less than 1% of the debts we saw in 2013 but are now some of the lenders that StepChange Debt Charity sees the most HCSTC lending debts with. This suggests that although product types in the HCSTC sector have changed, this does not mean problem debts are no longer caused by the new ‘improved’ medium-term loan product. The section below discusses the impact of new instalment loans in more detail.



How the HCSTC product has changed

To explore how the HCSTC market has changed, we looked at the ten HCSTC lenders who our clients had the most debts with. This made up 74% of all our clients’ HCSTC debts in the first half of 2016.

Alignment to the price cap

All HCSTC lenders now have to price within the regulatory cap. Our review of the ten HCSTC lenders our clients had the most debts with found that they had all charged at the price cap. They had similar representative APR of between about 1200-1600% and of those that stated it on their website all had a daily rate of 0.8%. The exception was one lender who offered only medium term loans (of between 6-12 months) so had a lower representative APR. All of the lenders that charge for missed payments (three out of the ten did not charge late payment fees) have the capped level of default charges at £15. This suggests there is limited evidence of prices falling below the price cap levels.

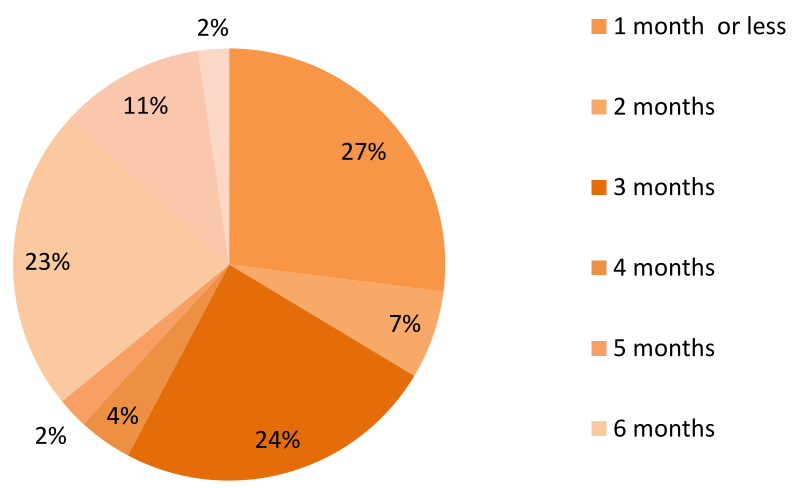
A move to instalment loans

A major change since the introduction of the price cap has been a move from products requiring a single repayment within 30 days to loans able to be repaid in instalments over 2 to 12 months. The FCA HCSTC research in 2013 found that the market at that time was dominated by short term, small sum loans with the average loan at around £260 and lent over an initial duration of 30 days.[13] The CFA has stated the sector has adapted to regulatory changes by offering slightly larger loans over a period of months rather than days.[14] It is argued that it is no longer commercially viable to offer only a very short term loan and there have been suggestions that the '30 day loan product' is now used as a loss leader to attract new customers to other products.[15]

Looking at the product offerings of the ten most common HCSTC lenders among our clients' debts we found that nearly all of them offered loans between £50-£1,000 (for first time borrowers). The majority (six out of the ten) now offer instalment loans alongside the traditional one month loan product with four lenders only offering the medium term instalment loan option. Some of the HCSTC lenders offering instalment loans are providing slightly different product features, such as offering no missed payment fees, not doing rollovers and offering weekly repayments instead of monthly.

The findings from our survey also could be reflecting the move to instalment loans with more medium term repayment periods and loans for slightly larger amounts. In our survey the average amount borrowed was £411 with 34% borrowing £200 or less, 29% borrowing between £200-£400 and 18% borrowing between £400-£600. In total over half (53%) of clients had a repayment term of 3 to 6 months, with 27% of clients having to repay within a month, 24% were borrowing for 3 months, and 23% for 6 months.

How long was the repayment term on your loan?



There are benefits to this shift to longer-term instalment loans as having the repayment spread out and not requiring repayment in a single lump sum should help prevent HCSTC creating acute payment difficulties for households. One of the problems with the one month payday loan was that people were finding that 28-30 days was not long enough to find the funds to cover the repayments and also meet their essential costs for that month. If they were unable to repay in that time, they could be forced to borrow again and the build-up of interest and charges could lead to debts spiralling out of control. If payment was missed they faced default charges, if they rolled over their loan they were also hit by charges and further interest, and if another loan was taken out to cover other expenses they faced further interest. Therefore having a longer period to repay the loan could help borrowers avoid these debt traps.

However, there are issues with instalment loans and they are still expensive credit products. Borrowers may end up paying more for an instalment loan than they would with a payday loan after making the payments in full as high interest rates are applied to the amount borrowed over a longer period. For example, if you were to borrow £200 from one HCSTC lender with a repayment period of 30 days it would cost around £250 to repay whereas if you were to borrow the same amount with monthly repayments over three months it would cost nearly £300 and if you were to borrow over six months it would cost nearly £350. The FCA review should look at whether the current level of the price cap is suitable if applied to medium-term loans.

The suggested benefit of instalment loans is that they are easier to repay and do not lead to the same extreme debt spiral. These more manageable instalment repayments are expected to lead to fewer missed payments so fewer default charges, fewer rollovers and less repeat borrowing. The question is whether these new products have led to less detriment in reality. The greater use of more manageable instalment loans could play a role in the significant reductions in people coming to debt advice charities with payday loan problems. Nonetheless, we have seen clients who still struggle with the repayments and high interest with instalment loans. In our survey, clients told us about struggling to repay instalment loans and about their issues with repaying loans even with the price cap:

"Trying never to get one [a HCSTC loan] again as I pay £237 per month for 6 months and I only borrowed £800 so paying back nearly double what I borrowed."
StepChange Debt Charity client with HCSTC debts

"I can't have this kind of stress again no more. I am paying them double payment from how much I took off them so it's actually no worth it taking from them."
StepChange Debt Charity client with HCSTC debts

The FCA should explore as part of their review of the price cap, what the implications of the shift to instalment loans are for the appropriate level of the price cap.

Who are our clients with HCSTC debts in 2016?

Compared to our clients in general, those with HCSTC debts are more likely to be under 25, employed full-time, in a household without children, and living in rented accommodation. They are also more likely to have essential bill arrears than our clients in general:

- **Younger:** nearly a quarter (24%) of clients with HCSTC debts are under 25 whereas only 14% of clients in general are in this age group.
- **Employed full time:** Significantly more of those with HCSTC debts are employed full-time than our clients in general (48% to 30%). There are also fewer clients with HCSTC debts who are unemployed than clients in general (22% to 30%)
- **Renters:** Clients with HCSTC debts are significantly more likely to be renters than homeowners (90% are renters compared with 77% of all clients). They are more likely to be renting privately (43%) than in social housing (25%).
- **Family composition:** There are fewer clients with HCSTC debts that are in families made up of a couple with children than clients in general (22% to 26%). They are more likely to be single without children (46% to 38%).
- **Essential bill arrears:** Clients with HCSTC debts are more likely to have essential bill arrears: 15% of clients had HCSTC debts and rent arrears whereas 13% of all clients had rent arrears. 24% of clients had HCSTC debts and Council Tax arrears whereas 20% of all clients had Council Tax arrears. 24% of clients had HCSTC debts and utility (water, electricity and gas bill) arrears whereas 22% of all clients had utility arrears.

There is little change in the demographic and socio-economic profile of clients with HCSTC debts between 2013 and 2016. They are broadly the same in age and family composition, employment status and income band. There are small changes suggesting clients with HCSTC debts in 2016 are slightly less likely to be in the most financially vulnerable groups. For example, clients with HCSTC debts in 2016 are less likely to be on very low incomes (below £10,000 a year) than those in 2013 (25% in 2013 to 19% in 2016). They are also slightly less likely to be unemployed as 26% were unemployed in 2013 and 22% are unemployed in 2016. However, our evidence suggests that despite changes to the market, people with HCSTC debts are still very likely to display significant financial vulnerability.

Continued problems with lending practices

Our evidence suggests that there have been some improvements but there are still causes for concern about lending practices and inadequate assessments of affordability among HCSTC lenders. The survey asked clients how well they understood how much they would have to repay when they took out a HCSTC. The majority (73%) knew exactly, or had a good idea of, how much they would have to repay with some clients commenting:

"I felt information was clearer on interest rates and being told what the final amount would be if I repaid earlier."

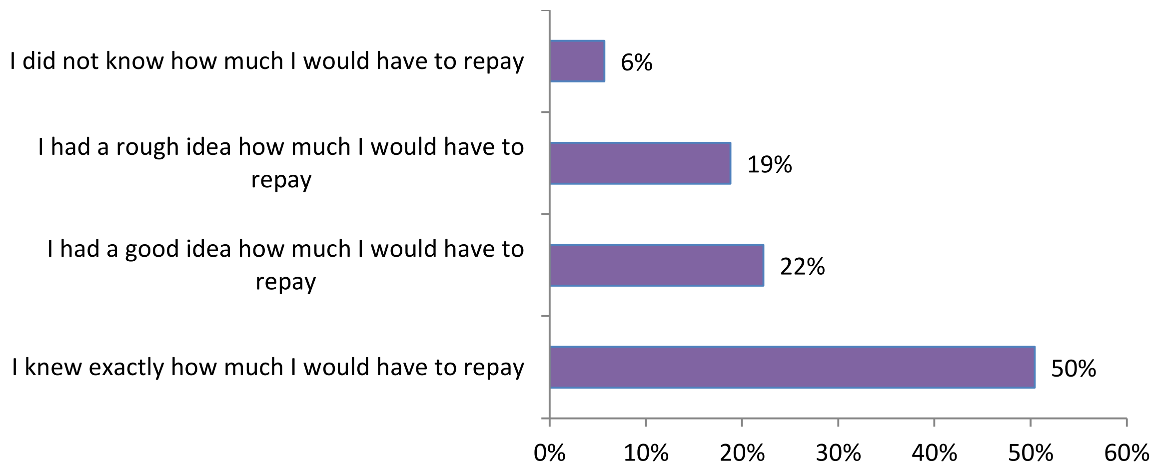
"The amounts repayable [were] clearly set out."
StepChange Debt Charity clients with HCSTC debts

However, it is still concerning that in total a quarter (25%) said that they did not know or only had a rough idea of how much they would have to repay. As one client said:

"It wasn't explained to me that I would need to pay back £650."
StepChange Debt Charity client with HCSTC debts

There could be various reasons why some clients have reported not understanding how much they would have to repay. There are requirements on lenders to provide borrowers with pre contractual information on the credit agreement including the total price that will have to be repaid (in the Consumer Credit Act 1974, section 55A).[16] Also FCA rules (CONC 4.2) require adequate pre-contract explanation to enable the borrower to understand whether they can afford to repay the credit. It may be that in some cases lenders are not complying with these requirements as the quote above suggests. It could also be that the information provided is not clear enough and is difficult for borrowers to understand.

When you took out the loan, how well did you understand how much you would have to repay in total?



When asked whether the HCSTC lender they used had taken reasonable steps to assess their ability to repay the loan (see examples in chart below), the majority (74%) thought they had. Nonetheless just over a quarter (26%) did not think the lender took reasonable steps with some commenting:

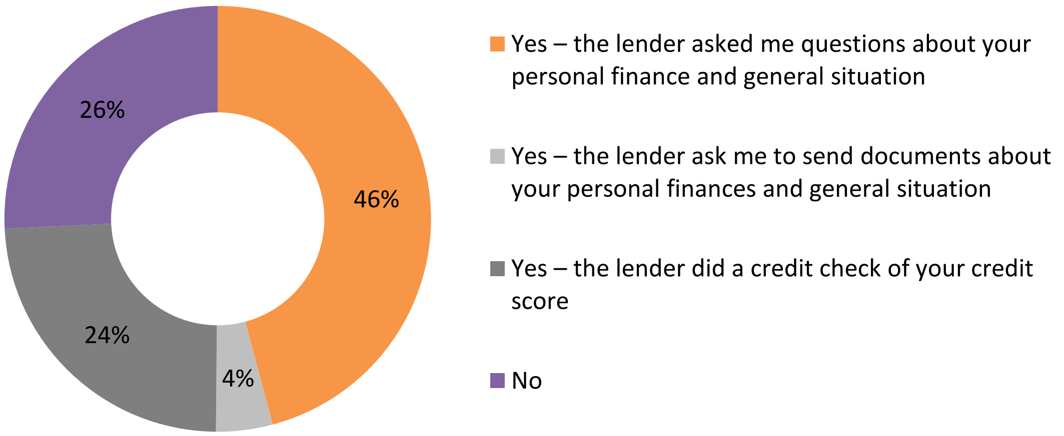
"I found that all pay day loan companies do not check correctly if you can make repayments. This made it easy to get in to a bad situation and made me feel anxious and depressed."

"The fact you can get this credit with minimal checks is shameful."

"Checks were carried out at time of first application for a loan, after that they'll just hand out loans whenever you ask for one as long as previous loan has been paid off."

StepChange Debt Charity clients with HCSTC debts

Do you think the lender took reasonable steps to assess your ability to repay the loan?



Some clients also told us they were able to get a HCSTC loan when they had considerable other debts, raising more questions about responsible lending and the adequacy of affordability checks:

"I should have not been lent the amount as I already had a huge amount of credit to repay to other creditors."

"I was in a lot of debt anyway and the payday loan tipped me over the edge."

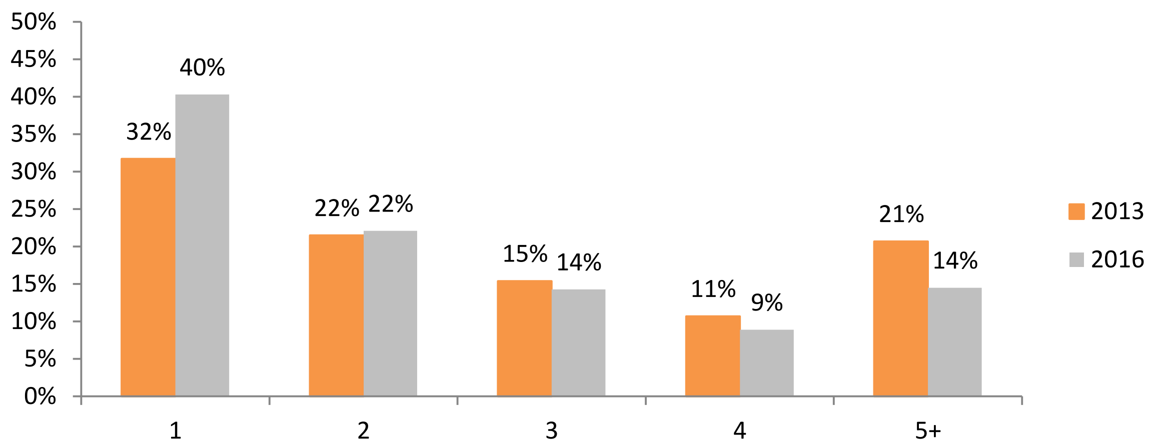
"I already had 6 loans out and rejected by 100 more but they still accepted me."

StepChange Debt Charity clients with HCSTC debts

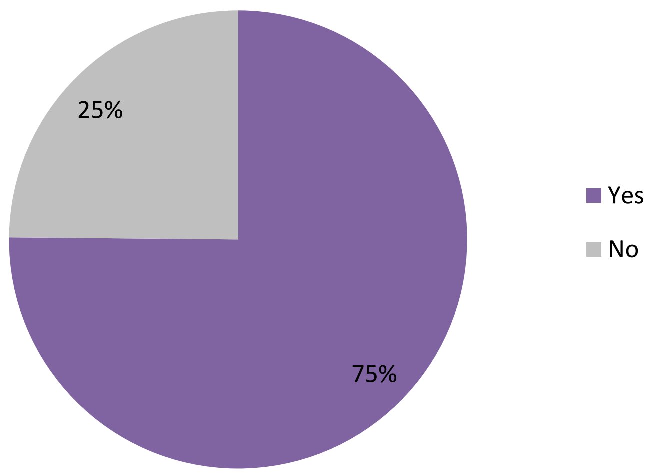
We also continue to see a high proportion of StepChange Debt Charity clients with multiple HCSTC debts. In 2016 over a third (38%) of our clients with HCSTC debt had three or more.

Additionally nearly a quarter (23%) have four or more and 14% have five or more. The chart below shows there has been some changes since 2013, as more clients now have just one HCSTC debt (+12%) and slightly fewer have 5 or more HCSTC debts (-6%). Despite these small changes, there is still a concern that so many of our clients are still coming to us in 2016 with multiple HCSTC debts.

Proportion of clients with one of more HCSTC debts



Our client survey also found that the majority of respondents had a HCSTC loan that they were paying off when they took out another HCST loan as the chart below shows:



Some of clients described how they were able to access a HCSTC loan when they already had outstanding HCSTC:

"I had multiple loans out with them and other lenders."

"Considering I already had 11 other payday loans, I am surmising little/no checks were done."
StepChange Debt Charity clients with HCSTC debts

In summary, our evidence suggests that some borrowers still do not fully understand how much they have to repay and some do not think the HCSTC lender took reasonable steps to assess their ability to repay. Moreover, some people are still able to get HCSTC when they already have considerable other debts, including other HCSTC debts. This all suggests that the FCA should look closer at responsible lending measures in this market.

The FCA strengthened their rules around affordability assessments for HCSTC in 2014 and worked to encourage lenders to share data in real-time in order to identify up-to-date data on outstanding credit commitments. However, they have acknowledged that there are still issues with this as not all lenders report data to one or more credit reference agencies in real time and there is no standard definition of what constitutes real-time data sharing.[17] The FCA have said that this is an area that they are monitoring closely. However, the significant number of clients with multiple HCSTC debts suggests that the FCA could go further and look again at the case for mandating a system of real-time data sharing. However, this may not be any more effective if lenders are still lending when they know potential borrowers have considerable other debts.

In introducing the price cap, the FCA stated that they would be keeping certain aspects of the HCSTC market under review, including the adequacy of affordability assessments.[18] There are continued issues around lending practices with borrowers with considerable existing commitments able to get HCSTC loans and multiple HCSTC debts. This suggests lenders could be doing more comprehensive creditworthiness assessments and that the FCA needs to look again at lending practices. The FCA Consumer Credit sourcebook (CONC) includes a section on responsible lending (CONC 5) with rules. However some of this is only guidance, for example, it is currently only guidance that lenders should take into account whether a customer is experiencing difficulties with their existing financial commitments.

The FCA should strengthen their rules on responsible lending including turning their existing guidance on responsible lending into rules. For example, creditworthiness assessments should be required to take account of whether the customer is experiencing difficulties with their existing financial commitments.

HCSTC: Arrears and forbearance

Treatment of customers in financial difficulties

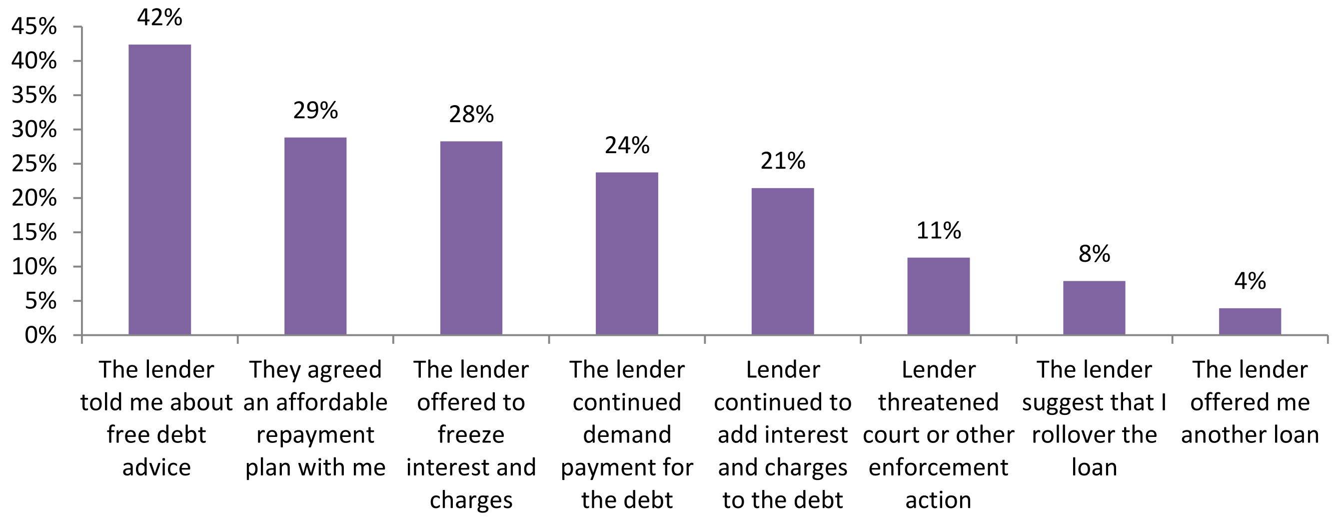
In 2015, the FCA reviewed how HCSTC lenders treat their customers who struggle to repay.[19] This found evidence of unacceptable practices including lenders not recognising customers in financial difficulties, not directing people to free debt advice and offering inflexible repayment options. The FCA also found that lenders were making some improvements to management and training practices in this area.

At the peak of the market in 2013, we saw significant issues with how HCSTC lenders where treating customers in financial difficulties. This included lenders ignoring the borrower's financial difficulties, harassing them for repayments, refusing to accept reasonable repayment plans and general poor customer service. There were also cases where lenders were using continuous payment authority to take back full debt balances leaving people with no money to live on and where lenders sending letters from fake solicitors firms to try and reclaim debts.[20] Anecdotally, we have seen signs of improvements in the HCSTC industry as we are not seeing the very worst practices of 2013, or the level of complaints about lenders we were seeing previously.

However, our evidence suggests there are still some issues with how HCSTC lenders treat customers in financial difficulties. Our recent research on creditor and debt collector conduct found that 28% of our clients said they were treated unfairly by HCSTC lenders.[21] This is an improvement on previous research we undertook in 2013 that found 42% of families in a survey stated they were treated 'badly' or 'very badly' by HCSTC lenders.[22] However, it indicates some borrowers are still not being treated fairly.

In the survey of our clients with HCSTC debts, over half (58%) told their lender when they got into financial difficulties. Of these many were not treated with forbearance and due consideration. Less than half (42%) were told about free debt advice and under a third (29%) had an affordable repayment plan agreed and just 28% had the lender offer to freeze interest and charges. Moreover, 24% found that the lender continued to demand payment even when told about the client's financial difficulties. Our advisors have seen other cases like this since January 2015, for example one of our clients told us that after she missed a payment with a HCSTC lender she was bombarded with texts and emails even though she had explained her situation to them. Another client told us that the HCSTC lender she has borrowed from called her work to the collect the debt, stating who they were and making her colleagues aware of her financial situation.

Our survey also showed that 21% found their lender continued to add interest and charges and 11% were threatened with court or other enforcement action. We have also seen examples of this reported by our advisors. For example, a client informed the HCSTC lender that they were in financial difficulty after the monthly repayment on the loan was taken and the lender reacted by trying to take the full outstanding balance. Another client had his HCSTC lender ask him to make payments outside of their agreed debt management plan and the lender also contacted the client's family, friends and workplace asking for repayment.



Our survey suggests that although some people who get into financial difficulties when repaying their HCSTC are helped by the lender, many are still not getting fair treatment. The thematic review of the arrears and forbearance in high cost short-term credit was undertaken by the FCA before the introduction of the price cap and stated that the FCA authorisation and supervision process should tackle issues around arrears and forbearance.[23] In light of continuing issues with how customers in financial difficulties are treated by HCSTC lenders, we call for the FCA to look into this as part of their price cap review.

The FCA price cap review should have a broad scope to include the continuing issues with the treatment of customers in arrears and how to tackle them.

It is also essential that all HCSTC lenders are closely following FCA rules and doing enough to support customers when they get into arrears.

HCSTC lenders should ensure that their debt collection practices are based on supporting affordable and sustainable repayments and providing appropriate support to help customers in financial difficulties.

Where are people going who can no longer get HCSTC?

The FCA estimated that 11% of borrowers (around 160,000 people a year) who would have otherwise have got HCSTC would no longer get these loans after the introduction of the price cap.[24] Of the clients in our survey 60% had applied for a HCST loan since January 2015 and been rejected on at least one occasion.

When asked what they had done when they were not able to access that HCSTC, clients had a range of strategies with most missing a payment, borrowing or getting help from friends or family or borrowing from other lenders. The most common outcome (40%) was that they missed a payment for a different loan or bill and many felt they had no choice but to do this. When asked why they missed a payment or bill, clients said:

“I felt like I had no other way out and didn't know what to do.”

“Because I would of had no food in for my son. Plus I have to be wise with my money because my gas and electricity bill is due.”

“Because it was that or the children didn’t eat.”

“Had to repair car so I could work.”

StepChange Debt Charity clients with HCSTC debts

Many households in this situation are left with severely constrained choices between taking out high cost credit or paying for essentials like food or not paying their household bills as the quotes above illustrate. Falling into arrears with rent, Council Tax or fuel can have serious consequences. However, using high cost credit to for essential bills or the cost of other credit commitments can lead to debts spiralling and becoming unmanageable. As discussed in the previous section, clients with HCSTC debts are more likely to also have essential bill arrears than our clients in general. In some cases if other creditors or essential service providers have fair debt recovery policies it may be preferable to deal with them rather than using more credit to cover shortfalls.

31% of our clients felt they could not go without the money and turned to friends and family for support. Again many felt they had no choice but to turn to friends and family:

“I needed the money for living expenses.”

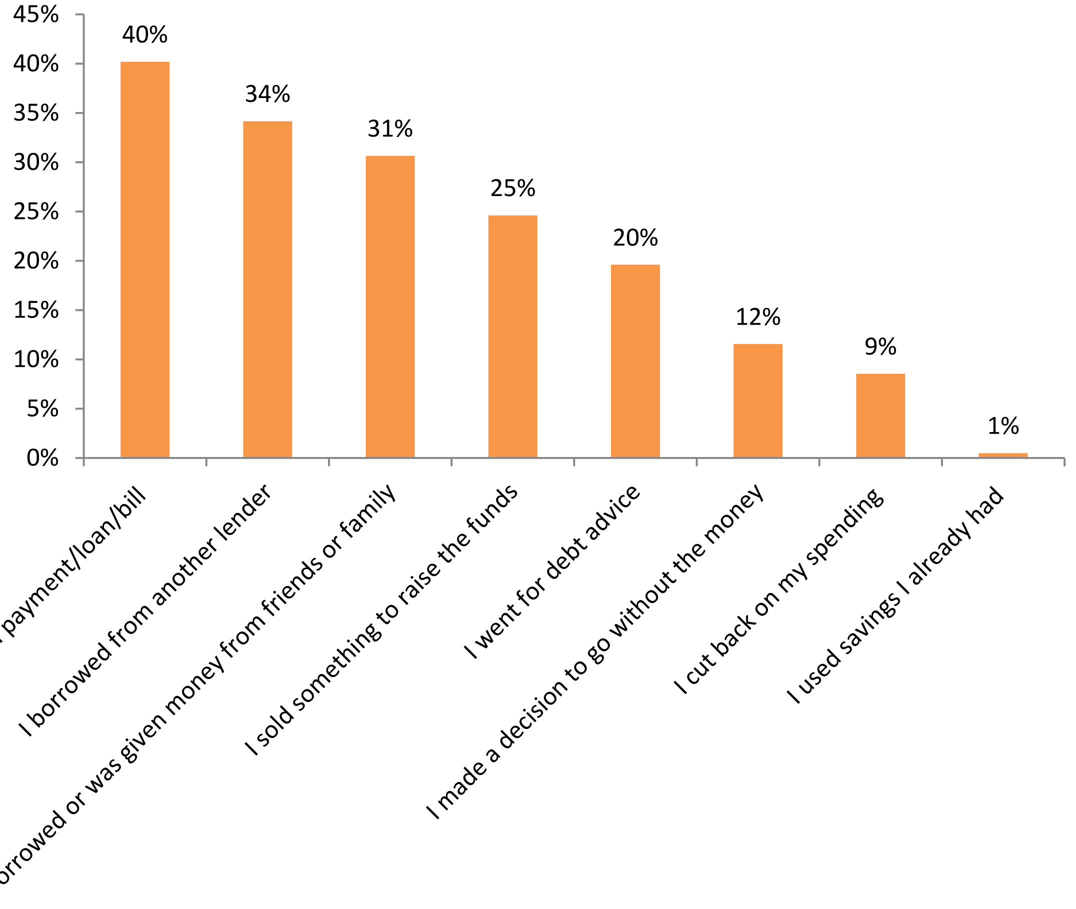
“Desperately needed to pay a bill.”

“Through recent divorce proceedings and financial difficulty I had no choice

StepChange Debt Charity clients with HCSTC debts

We have seen a growth in our clients turning to family and friends for loans with 20% of clients having these debts in 2014 and 28% having these debts (in the first half) in 2016.[25] These more informal loans can be useful to help cover an unexpected expense but can have serious consequences and adverse effects on family and friend relationships. Our previous research found debt can damage relationships, with one in three indebted people reporting negative effects caused by their financial problems and one in 20 revealing a break-up as a result.[26]

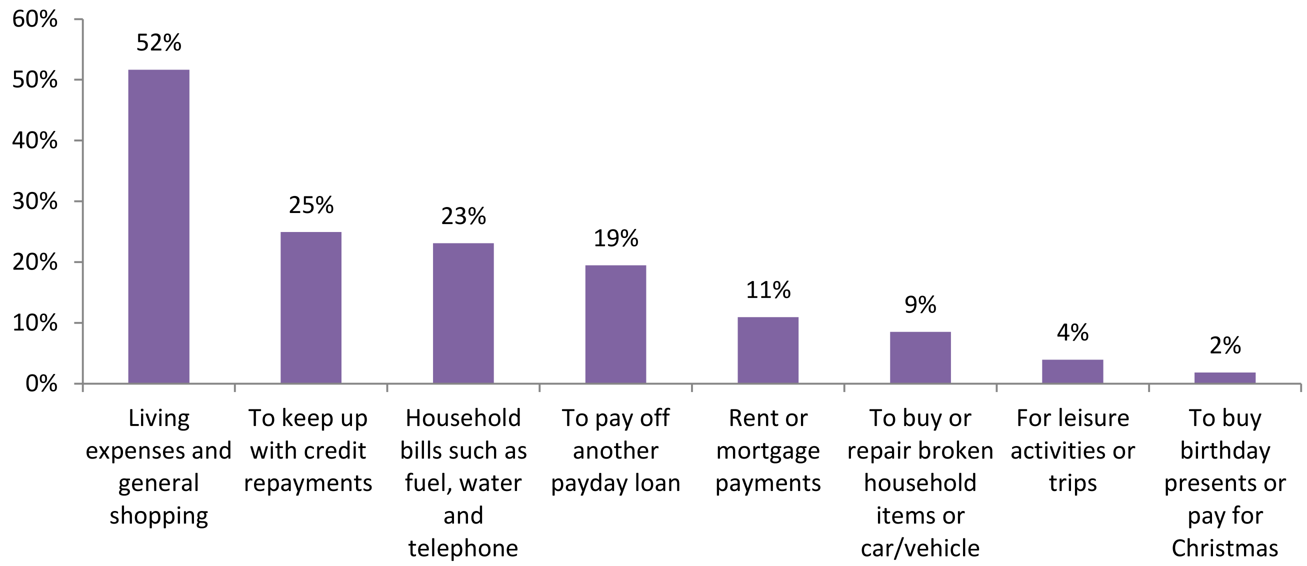
When you were not able to get a payday loan on that occasion, what did you do instead?



Most of our clients who are unable to get HCSTC therefore are either falling behind on other bills or credit payments or having to borrow from other sources to keep up. This all suggests that these households are in such difficult financial situations that they are facing seriously constrained choices between defaulting on a payment and using costly credit to keep up.

Our survey findings on what clients are using HCSTC for also suggest that many are using high cost credit to get by and keep up with other commitments. Many clients were using the loan for essentials including 52% to cover living expenses and general shopping and 23% to pay household bills. 25% were using HCSTC to keep up with other credit repayments and 19% were using them to pay off another payday loan.

What did you use your most recent payday loan for?



This all raises the question of where the more financially vulnerable and excluded can turn where commercial credit is not a viable option. Community lenders like credit unions have widely been championed as a way for more people to access more affordable credit products. However, the reach of community lenders is, despite recent expansion, still limited. We have previously highlighted how no and low interest loans could provide greater access to affordable credit to financially vulnerable households.[27] This is based on the Australian Good Shepherd no-interest loans scheme that is funded through a partnership between the Australian government and a national bank. This scheme provides no interest and low interest loans and other products to financially excluded households.

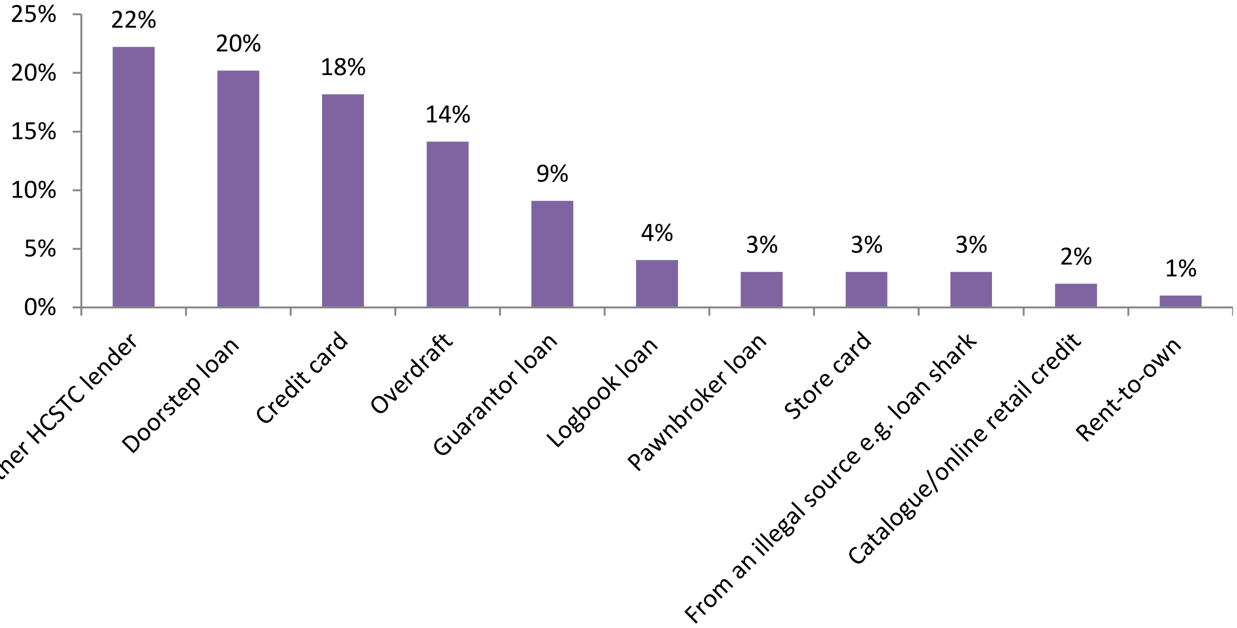
The government needs to look at new ways to provide greater access to more affordable credit safety nets for the most financially vulnerable, including looking at international examples of no and low interest loan schemes.

These questions of financial exclusion and access to affordable credit are not solely in the remit of the FCA. However, one of the FCA's statutory objectives is to secure an appropriate degree of protection for consumers by having regard to differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity. We would support the FCA undertaking further research into where people who can no longer get HCSTC are turning as part of their review of the price cap.

Which other lenders are those that cannot get HCSTC turning to?

Of clients who borrowed from another lender in our survey, the sample size was small but found that the most common option (22%) was another HCSTC lender. Others turned to different forms of high cost credit with 20% using a doorstep lender and 9% using guarantor loans. Some turned to mainstream credit with 18% using a credit card and 14% going into or further into their overdrafts. Only a small proportion went for other lenders with a tiny number saying they went to an illegal loan shark, despite concerns that illegal lending would rise after the price cap was introduced. Nonetheless, it is difficult to get a clear picture of illegal loan sharks due to the nature of the lending.

If you borrowed from another lender, which other type of lender did you use on that occasion?



There are concerns about those not able to get HCSTC turning to other lenders that can also cause difficulties. Those turning to mainstream credit such as credit cards and overdrafts might also face difficulties if they are persistently in debt with these forms of credit. Those who have to turn to their overdraft may find they go over the limit and are hit by unarranged overdraft charges that can be more expensive than HCSTC.[28] Other forms of high cost credit such as home credit and guarantor loans can cause similar difficulties as HCSTC as borrowers can struggle to keep up with the level of repayments. We have also seen similar cases of aggressive debt collection practices among guarantor lenders in particular that were previously widespread in the HCSTC lending sector.

We understand that the FCA is undertaking work to tackle issues with some of these other forms of credit including the credit card market study and the introduction of stricter rules on guarantor lending. The CMA has recently undertaken a retail banking market investigation that recommended the FCA look further into the usage of overdrafts and charges associated with them. We would call for the FCA to ensure consistency of regulation across different forms of credit to ensure that financially vulnerable consumers are protected from detriment that any of these products can cause.

The FCA should ensure consistency of regulation across different forms of high cost and mainstream credit that used by financially vulnerable consumers. This would include, for example, setting a cap on unarranged overdraft charges.

Conclusion and recommendations

The evidence in this report suggests that FCA regulation and price cap has made a difference and there have been significant changes in the HCSTC market. This is most clearly demonstrated by the reductions in the numbers of people coming to StepChange Debt Charity struggling with HCSTC debts. We also found that some of our clients have seen improvements with medium-term instalment loans giving them longer to repay the loan, greater clarity on how much they have to repay and some improvements in how those that get into financial difficulties with their HCSTC loan are treated by lenders.

The move to instalment loans has led to HCSTC customers having longer periods to repay their loans from between two to a year. This gives them longer to recover from the initial financial shock that meant they needed the HCSTC so helps them to make more manageable payments. However, it can also mean that HCSTC customers are taking out larger loans at high interest rates that accumulate over a longer period of time. This should be a key area looked at by the FCA in their review of the price cap:

The FCA should explore as part of their review of the price cap, what the implications of the shift to instalment loans are for the appropriate level of the price cap.

Despite clear signs of improvements, we still found some continuing issues in the HCSTC market around lending practices and affordability assessments. We found evidence of continuing multiple HCSTC debts and clients being able to access HCSTC when they have considerable other debts. The FCA review needs to tackle these lending practices.

The FCA should strengthen their rules on responsible lending including turning their existing guidance on responsible lending into rules. For example, creditworthiness assessments should be required to take account of whether the customer is experiencing difficulties with their existing financial commitments.

Our evidence also highlights that some HCSTC lenders are still not treating customers in financial difficulties fairly. Some clients found their lender adding interest and charges to debts, repeatedly demanding payment of the debt with some lenders going as far as calling the clients' workplace. Some clients were threatened with court or other enforcement action. In light of this we call for the FCA to include treatment of customers in arrears in their price cap review and for HCSTC lenders to improve their debt collection practices:

The FCA price cap review should have a broad scope to include the continuing issues with the treatment of customers in arrears and how to tackle them.

HCSTC lenders should ensure that their debt collection practices are based on supporting affordable and sustainable repayments and providing appropriate support to help customers in financial difficulties.

This report also shows families on tight budgets struggling to keep up with their essential costs and having to turn to high cost credit to get by. Some clients who could not get a HCSTC loan borrowed from other lenders including other high cost credit or more mainstream credit. There is a clear need to explore further where people are turning when they cannot get a HCSTC loan and to tackle issues in some of the other products customers are turning to. This is in order to prevent financially vulnerable households getting into further difficulties with other types of credit:

The FCA should ensure consistency of regulation across different forms of high cost and mainstream credit used by financially vulnerable consumers. This would include for example, setting a cap on unarranged overdraft charges.

Many of our clients who had been unable to get a HCSTC loan have to make the choice between missing an essential bill payment, relying on family and friends or borrowing from another lender. For some, they could not go without as they needed to pay for food or heat their home. Despite the more effective regulation of HCSTC, there is still a clear demand for greater access to more affordable credit. Struggling families on tight budgets need alternatives to high cost credit that prevent them paying a premium to cover essential expenditure. The expansion of community lenders like credit unions alone will only go some way to tackling this issue. There needs to be alternative affordable credit safety nets where commercial credit is not a viable option:

The government needs to look at new ways to provide greater access to more affordable credit safety nets for the most financially vulnerable, including looking at international examples of no and low interest loan schemes.

The impact of the price cap and new rules on the HCSTC market is clear evidence that tough regulation can improve broken markets and go some way to improving outcomes for financially vulnerable people. However, this research indicates that effective regulation is an on-going process and must continue to pick up on new and continuing issues in markets. There is also a limit to what regulation can do when there is continuing demand for families on tight budgets to access emergency credit that is manageable and sustainable. Government, regulators, the financial institutions and the third sector should work together to tackle the areas where markets are not meeting needs in order to provide safety nets for the most financially vulnerable.

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