



# Payday Denied:

Exploring the lived experience of  
declined payday loan applicants

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Toynbee Hall, founded in 1884, is a community organisation that pioneers ways to reduce poverty and inequality. Based in the East End of London, we provide free advice and support services which are all geared towards tackling social injustice and improving financial health. Our research looks at communities and groups suffering from financial exclusion, helping us to pilot new ways to deliver financial inclusion services and share our learning with partners and policy makers.

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# Foreword



**Martyn Evans**



**Sara Llewellyn**

This research has been commissioned by the Carnegie UK and the Barrow Cadbury Trusts. The Carnegie UK Trust vision for affordable credit is outlined in its '*Gateway to Affordable Credit*' report. It sets out an ambition that everyone, wherever they live, should have access to more affordable forms of credit, which reduce the cost of borrowing for those outside of the mainstream, support financial inclusion and promote equality and fairness.

In recent years, the Barrow Cadbury Trust has worked with partners including the Centre for Responsible Credit, the Money and Mental Health Policy Institute and most recently the New Economics Foundation (NEF) as convener for the 'End the Debt Trap' campaign, to raise understanding of the damaging impact of unsecured debt and high cost credit on individuals,

families and communities. Debt is a part of everyday life and access to affordable credit an essential part of smoothing budgets and responding to financial shocks.

The high-cost short-term credit (HCSTC) market has seen very significant and welcome changes since the FCA took over the regulatory powers in 2014 and a total cap on credit was introduced in 2015. The shift in borrower numbers (downwards) and borrower incomes (upwards) has resulted in better outcomes for consumers, and withdrawal, and more recently, the demise of many firms operating in the market.

Nevertheless, the demand for unsecured consumer credit in the UK remains at a historical high at £215 billion (September 2018, Bank of England). If the supply of harmful credit is constrained then that brings clear, positive benefits, but it also raises a fundamental question – what happens next? It is unrealistic to think that the demand for credit which fuelled the rise of payday loans has dissipated overnight – particularly when the underlying conditions which drove much of that demand remain the same – stagnating wages, heightened job insecurity, significant pressures on the cost of living and the exclusion of millions of people in the UK from mainstream financial services.



We wanted to understand the real-life choices – or lack of choices – that people who had previously borrowed from payday lenders but who are now unable do so are making about their finances. Are they borrowing money from other sources? What are the pros and cons of these alternatives? Are they ‘going without’ rather than borrowing? Is this a sustainable proposition? What are the characteristics they want to see from any source of credit they might require in the future?

Carnegie UK Trust and the Barrow Cadbury Trust commissioned this research to explore these questions and others, to inform policy and practice, and ultimately to help create better financial options and opportunities for everyone who needs them.

The research reveals that most people who can no longer access a payday loan seek to source that credit elsewhere. Most commonly they are turning to family and friends. While this might be seen as a positive outcome, the study found evidence that this experience is by no means always beneficial, brings significant additional burdens and pressures, and is highly questionable as a long-term solution to support the financial needs of low income

households. It should be a matter of concern and priority to policymakers that almost all of the research participants were wholly unaware of ethical, fair, more affordable alternatives, often located in their own communities.

As commercial high cost credit providers withdraw or fold, there is an unprecedented opportunity to fill this space through the provision of more affordable alternatives, which meet people’s needs, broaden choice and can act as a gateway to financial inclusion.

There are lessons in this report on why there is a need for credit, and the importance of social capital and self-esteem as factors within individual’s borrowing decisions. Credit remains an emotive issue. The personal accounts in this report indicate that for the majority of people it remains an important, necessary part of their lives.

*Martyn Evans*      *Sara Llewellyn*

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# Executive Summary

When the government announced a cap on high-cost short term credit (HCSTC) in 2015, in the face of public outcry about the conduct of some lenders, many campaigners were delighted. But for the millions of people with limited access to credit, what was the impact of this tighter regulation? Did it limit their choice and ability to make ends meet?

We listened in depth to 80 of these people, who needed money, and yet were rejected or ineligible for 'payday loans' because of the new criteria.

This report presents our findings and makes recommendations and suggestions for further work.

Almost everyone needs help to manage the ebbs and flows of income and expenditure at some point in their lives, and credit is the main tool which has been provided to households to assist with this. For those on low incomes or facing periods when they simply don't have enough money for essentials, accessing credit is often critical.

As Courtney told us, her borrowing was

*"never just for fun... it was always like, stuff for the kids, clothes, uniform."*

So, while the consequences of taking out high interest payday loans are well documented, we wanted to know what happened when Courtney and others like her were turned down from even the costliest of lenders. The findings were incredibly revealing:

**Most people turned to friends and family:** while this could be considered a good thing, in that it keeps people away from the risk of the formality of debt recovery or legal sanction, the human cost to families, relationships, dignity and respect is significant. While the FCA originally predicted that 60 percent of borrowers with no access to high-cost credit would no longer borrow at all, we found a significant proportion of the people we spoke to were still looking for borrowing options, making the issue far more complex than originally anticipated.

As another of our interviewees told us:

*"My mum actually took out a bank loan for me to pay off payday loans....  
The whole family I think were affected by it."*

**Some go without.** Again, if the borrowing was for luxuries, then this might also be considered a good thing. But it wasn't. As one of the people we talked to put it:

*"I'm not really throwing money about anyway, I don't have that much money to throw about."*

**For some there are benefits:** Being refused can be a wake-up call – a signal that a problem needs addressing and borrowing may not be the best answer. There is a huge responsibility on financial services industry – but also on others, such as housing providers, debt advice agencies and health and social care providers – to identify the challenges and be open to offering support.

There are many more detailed findings which this report uncovers. The process of listening to people with real, lived experience of needing credit but being turned down was an extremely revealing and important one. The people we spoke to were articulate, sensible, and reflective and understood very well their own difficulties. They were often frustrated at the difficulties in accessing, what for them was essential finance to live their lives.

It is important that their voices are heard: by government; by the financial services industry; by others who might unwittingly cause people to fall into debt; and by advice services and other agencies.

We wanted to hear direct from those with lived experience. Now we've heard from them, it is vital we take action.

## Recommendations

In this context, our recommendations include:

### 1. People need access to more and better credit products:

The alternatives – of borrowing from family and friends, going without essentials or seeking illegal lending – are often worse for some of the people we spoke to. There needs to be greater investment in developing low and mid-cost, affordable products, and in marketing the social, ethical alternatives.

### 2. Increased regulatory activity to tackle a two-tier payday loans industry:

Our research shows evidence of an industry split, with some lenders heeding to new stricter rules by the FCA on assessing affordability, whilst others appear not to do so. This suggests that some lenders are interpreting rules on affordability differently and haven't yet achieved harmonisation in their approach to affordability. Some appear not to have taken sufficient steps to improve their affordability checks and are providing loans to people who may not meet the criteria set by the FCA. We call on the FCA to tighten monitoring of regulated firms with regards to their affordability assessment process. We suggest increasing the use of mystery shopper exercises, including in how online lenders check creditworthiness using automation tools.

### 3. Organisational innovation for people to avoid unaffordable credit:

We call for a wide range of organisations, including housing associations, local authorities, social and private landlords, employers, other creditors like utilities companies, to recognise the different roles they can play in preventing individuals with short term cash flow issues from falling into hardship and seeking credit, when this is not appropriate. We ask these organisations to impact assess their internal processes to ensure they are not causing financial harm to their customers, clients, or other beneficiaries of their services. We believe having some duty of care towards individuals' financial health and potential exposure to the poverty premium should exist beyond credit providers.

### 4. Government, regulators, and third sector organisations to scope the feasibility of a UK No Interest Loans Scheme (NILS):\*

This research showed that some declined payday applicants of payday loans do not need a traditional credit product for their immediate financial issues and that any form of interest-bearing credit is too expensive. This is particularly the case for those potential borrowers not in work and for whom a formal credit product would not be appropriate, or who have longer term issues arising from benefit delay or income reduction during the transition from legacy benefit to Universal Credit (we saw evidence of this during the course of this project).

Not all declined payday applicants had access to, or wanted to, borrow from friends and family. For this group of people, we believe there is a need for more innovation around how to extend finance in a productive way. We recommend different organisations including the FCA, the Treasury, and client-facing organisations such as debt advice charities, coalesce to carry out a feasibility study on the provision of NILS similar to those running in other jurisdictions, to identify its potential to support those most in need (Australia, for example, has a NILS that is run by Good Shepherd Microfinance and supported by the Australian Government the National Bank of Australia). Such a scheme would sit alongside the scale-up of affordable credit alternatives.

We recommend that additional government departments, including the Department for Work and Pensions, work closely together to determine who would be eligible for a no interest loan and who would qualify for a non-credit, welfare-based solution such as a grant.

We recognise that this approach would need to be targeted on a relatively small group of people who are most in need and would require substantial public funding.

\* Since the report was drafted and edited the UK Government made an announcement in the Budget statement of 29th October 2018 on NILS stating "No-interest loans scheme pilot – For some people, even borrowing from social and community lenders can be unaffordable. Therefore, the government, working with leading debt charities and the banking industry, will launch a feasibility study to help to design a pilot for a no-interest loans scheme early next year"

**5. The development of guidance on informal lending:**

Another major theme of this research is that there is an unseen price to pay for informal borrowing from friends and family, which to the best of our knowledge has not been explored in previous research looking at the impact of payday loan reform. We endorse the creation of a set of guiding principles on what informal lending 'good practice' looks like, as these tools will help some people to manage their money when lending informally to family and friends.

**6. Payday lenders contributing to the financial capability of their customers:**

One finding from our research is that an individual can simultaneously be a declined applicant of a payday loan and an existing or prospective payday loan borrower. The ways in which payday lenders can improve the financial health of borrowers is therefore also relevant to declined borrowers. Payday lenders themselves have an opportunity to help borrowers rebuild their credit scores and provide roadmaps to improve financial standing for the future by helping them move into less expensive credit where appropriate. The payday loans industry

should be starting to demonstrate how it is innovating internally to help customers enhance their financial health and keep pace with other financial service providers looking to do the same.

**7. Guidelines for debt advice charities on specific courses of action for declined payday applicants:**

The Money Advice Service should, in consultation with advice providers, design a specific set of guidelines on how advice professionals advise declined payday applicants, premised by findings from this research showing their additional needs. This would set out, for all advice professionals in the regulated advice sector, a framework describing potential additional needs and signposts to address these such as other forms of credit, benefit advance information, or guidance for borrowing from friends and family. Because declined payday applicants are likely to be in a more vulnerable financial situation debt advice charities should establish a clear set of guidelines on how to deal effectively with this group.





# 1. Introduction

This research was carried out between January 2017 and April 2018. It was originally supported by Barrow Cadbury Trust to undertake research in England, and then extended through additional support from Carnegie UK Trust to include Scotland.

The aim of this research is to explore from a consumer perspective the impact of the 2015 cap on the cost of High-Cost, Short-Term Credit (HCSTC), as well as other rules governing the high cost credit industry put in place at a similar time. Our focus is on the group of consumers who previously had access to a payday loan and are now either not eligible or have experienced a decline in their payday loan application. From here on, we call this group of people declined payday applicants (See Glossary in Appendix 1).

We undertook 80 in-depth interviews with declined payday applicants to draw out the financial actions people took subsequently and to understand the lived experience of the regulation, to examine the behaviour and strategies of borrowers as a result of not having access to their previous credit provider. Due to the number of participants in our research the findings are indicative rather than exhaustive. The sample size was not large enough to support testing for statistical significance. Instead our

research provides deeper and more specific insights to complement existing quantitative data on the experiences of declined payday loan applicants.

Specifically, our research asks the following three questions:

- What impact has the new set of regulations on HCSTC had since January 2015 on the behaviour of borrowers (and to an extent, lenders)?
- Have those regulations positively reshaped the credit options for borrowers?
- What is the lived experience of those who are now declined payday applicants and how, if at all, are they accessing credit, or managing financially under changed circumstances?

We begin by setting out the **context** in the first section, outlining the payday lending market and its borrowers pre- and post-regulation. Second, we analyse our **findings** to look at the specific consumer journeys taken by those that are declined access to a payday loan and identify key themes that have emerged from the research. Third, we address the implications of our research and findings in the **discussion and conclusion** section. Finally, we set out a series of **recommendations**.



## 2. The payday lending market and consumer debt post-crash

### 2.1 Context

Economists and policymakers are again sounding the alarm on UK household debt growth<sup>1</sup>. Similarly, the Financial Conduct Authority (FCA) has noted the warning signs about the financial health of UK consumers, with levels of consumer borrowing back to 2008, pre-financial crash levels.

The increased use of consumer credit comes at the same time as real wages (after outgoings) had fallen to the point where they were lower in 2017 than in 2007<sup>2</sup>. The Personal Finance Research Centre at the University of Bristol have described this post-crash period for consumers making cutbacks on their essential expenditure as the “*practical recession*”<sup>3</sup> which to some extent makes it akin to a personal financial crisis.

According to one analysis the current rise in UK consumer debt is primarily being fuelled by use of credit by safer prime borrowers, contrary to some economists’ fears of a surge in borrowing by sub-prime borrowers<sup>4</sup>. However, there are increasing numbers of sub-prime customers that:

“ **may struggle, or believe that they may struggle, to meet the credit criteria of mainstream financial institutions and are often included in the definition of nonstandard [credit]**<sup>5</sup>. ”

Financial exclusion from mainstream sources of credit is an increasing problem for many people. Mainstream financial services have often focused on super-included, financially stable households with high, secure incomes on the one hand while bypassing lower income households whose exclusion has in turn led to many seeking alternative high-cost lenders such as home collected credit (aka doorstep lenders), rent to own, pawn shops, and payday lenders<sup>6</sup>.

Between 2006 and 2014<sup>7</sup> a number of conditions created the perfect storm for the growth of the payday loans industry including:

- The increase in the numbers of working poor whose incomes could not compete with the rising cost of essential goods;
- A contraction in mainstream credit after the economic recession, as well as a loss of more than 1,800 bank branches in the period between 2003-2012 changing the look of many high streets across the country, particularly in less affluent areas<sup>8</sup>; and,
- A significant interest from US providers of alternative high-cost credit in establishing a presence in the UK market.

In the next section, we explore the development of the payday market in the UK up to the point when new regulations were introduced and highlight the type of households which were using this form of credit.

### 2.2 Pre-regulation of HCSTC

While the formal payday lending sector in the UK, where shops would offer services including exchanging cash for post-dated cheques, has existed for many years, it grew in prominence at around the same time as the 2008 recession. DFC Global Corp, a large US company whose most profitable companies are outside the USA, include the Money Shop in the UK, a subsidiary of Dollar Financial UK Limited, which has provided cheque cashing services since 1992. In 2009, The Money Shop recorded 273 stores and 64 franchises across the UK, as well as the 2011 acquisition of PayDay UK, one of the UK’s biggest online payday lending outlets<sup>9</sup>.

The payday lending industry is reported to have grown from an estimated £100 million worth of loans made in 2004<sup>10</sup> to over £2.5 billion in 2013<sup>11</sup>. The number of loans taken out more than doubled from 2009 to 2013 to reach 10 million in total, taken out by 1.6 million of customers, across 400

companies<sup>12</sup>. This growth has been combined with exceptionally high profits for many payday lenders.

In the UK since at least 2010, payday loans have been the subject of considerable attention by politicians, the media, and regulators. Before regulatory changes were made in 2015, the average value of a payday loan taken out by a consumer was £270 for 30 days<sup>13</sup> and the cost of a payday loan could be between £15-£35 per £100 borrowed for 30 days, equating to between 448 percent and 3,752 percent annual percentage rate (APR)<sup>14</sup>.

In November 2013, Rt Hon George Osborne MP, then the Chancellor of the Exchequer, announced that there would be a legal cap on the cost of a payday loan or HCSTC, which the newly created consumer credit regulator, the FCA, would enforce. The cap, which came into effect in January 2015 was structured in three ways:

1. An initial cost cap of 0.8 percent per day – interest and fees charged must not exceed 0.8 percent per day of the amount borrowed;
2. A £15 cap on default fees – if borrowers default, fees must not exceed £15. Firms can continue to charge interest after default but not above the initial rate; and,
3. A total cost cap of 100 percent – borrowers must never pay more in fees and interest than 100 percent of what they borrowed.

For credit firms, the price cap covers agreements with an annual percentage rate which is equal to or exceeds 100 percent and must be substantially repaid within a maximum period of 12 months. For contrast, the FCA points out that its definition of HCSTC does not cover:

- Credit agreements secured by a mortgage, a charge or pledge;
- Credit agreement where the lender is a community finance organisation;
- A home credit loan agreement, bill of sale loan agreement or overdrafts.

Other rules set for the industry, as of July 1<sup>st</sup> 2014, included restrictions on rollovers (where borrowers can extend their loan), use of the continuous payment authority (CPA), and risk warnings to be included on financial promotions.

Furthermore, all lenders have been urged to voluntarily sign up to real-time data sharing services to better help identify credit risks. The Competition and Markets Authority (CMA) in 2015 recommended improving real-time data sharing between lenders and credit reference agencies<sup>15</sup>. Callcredit and Equifax developed services for short term lenders to use<sup>16</sup>.

The FCA estimates before the cap was set or introduced, the regulator predicted that 70,000 people every year from after the cap would be denied access to a payday loan due to the cap's impact. That was based on 7 percent of the number of payday loan borrowers in 2014<sup>17</sup>. Coupled with wider reforms to the industry, a total of 160,000 people – or 11 percent of those who had previously sought to take out a payday loan – would lose access to this form of credit<sup>18</sup>.

Before the price cap came into force, the FCA estimated that:

**“ if consumers no longer had access to HCSTC, approximately 60 percent would not borrow, 25-30 percent would go to family and friends (we have taken steps to differentiate between ‘friends’ and ‘illegal lenders’), and around 10 percent would borrow from formal sources of credit, and 5-10 percent would find funds in other ways (e.g. decrease savings).<sup>19</sup> ”**

The FCA added that less than 2 percent said they would borrow from illegal money lenders which are sometimes misidentified as family or friends. While it is difficult to see whether or not declining borrowing figures for payday loans has translated into borrowing from illegal lenders (notoriously difficult to calculate due to it being criminal activity), it is interesting to see whether it has translated into additional pressures elsewhere.

Again in 2014, the FCA estimated that only four of the 400 payday lenders in existence at the time would remain in the market<sup>20</sup>. The FCA and the city competition regulator, the Competition and Markets Authority (CMA), anticipated that the remaining lenders would have to change or diversify their business model and/or products in order to be sustainable operations. For example, products offering longer terms would be an example of where lenders were diversifying<sup>21</sup>.

In short, regulation was designed to curb irresponsible lending and protect borrowers in the payday loan market. This research adds depth to the FCA's research and highlights the lived experience of declined payday applicants since the introduction of the regulation. In the next section we explore the post-regulation HCSTC market and the impact on borrowers.

## 2.3 Key changes in the debate around high-cost credit: a chronological review

Payday lending has been hotly debated in the UK since 2010. A number of key policy changes, as well as other events of significant interest, have taken place in that time, including the establishment of the Financial Conduct Authority in 2013. In this section we detail the most significant of these events to illustrate the context behind some of those debates:

2010

### Attempted creation of the Consumer Credit (Regulation & Advice) Bill 2010-12

Stella Creasy MP, with a high-profile interest in the payday loans industry, raised the issue of payday lending in Parliament in a 10-minute rule bill. Creasy was aiming to introduce the Consumer Credit (Regulation and Advice) Bill 2010-12, a step that would have given lawmakers the ability to cap interest rates and fee charges. This would have introduced a Total Cost of Credit cap: a price ceiling on how much a lender can charge in absolute terms, including interest on the principle, fees and other ways of introducing extra costs to a loan contract. Creasy's Bill wasn't passed.

2012

### Credit Union Expansion Project (CUEP)

Department for Work and Pensions (DWP) announced that £38m would be spent on what it called the Credit Union Expansion Project (CUEP). One significant reason that government policymakers were interested in developing the credit union sector was in response to the growing use of high-cost credit. CUEP aimed to attract one million new members by 2019, and to modernise the credit union sector with new technology – the so-called Model Credit Union initiative.

In 2015 the project was pushed back by one year and to date three credit unions utilized the new platform. The CUEP contract was terminated in 2017 by the DWP.

2013

### Office of Fair Trading (OFT) refers payday lending sector to the Competition Commission

The Office of Fair Trading, which was the regulatory body with oversight of the consumer credit market before the Financial Conduct Authority, referred the entire payday loans sector to the Competition Commission, the body that preceded the Competition and Markets Authority (CMA), to assess what was referred to at the time as “*deep-rooted problems*”<sup>22</sup>.

2013

### Government to cap payday loan costs

The Rt. Hon. George Osborne MP, Chancellor of the Exchequer at the time, announced that the government would legislate to introduce a cap on the cost of payday loans. The announcement took many people by surprise. The cap was formally established through amendments to the Banking Reform Bill which was currently going through Parliament. This gave the FCA powers to set and enforce that cap.

2014

### New rules on CPAs, risk warnings and rollovers

The FCA introduced brand new rules for payday lenders and other firms offering high-cost short-term credit. The new rules related to use of the Continuous Payment Authority (CPA), risk warnings and rollover loans.

CPA: A Continuous Payment Authority, which may also be called a recurring payment, is where a business has permission to take a series of payments from a customer's debit or credit card. High-cost short-term lenders were now limited to two unsuccessful attempts to use a CPA to take a repayment and could not use a CPA to take a part-payment. The use of CPA was seen as advantageous to collections. With only 2 unsuccessful attempts allowed, the onus was on lending more responsibly.

Risk warnings: As of July 1<sup>st</sup> 2014, firms offering high-cost short-term credit must now include a prominent risk warning in electronic communications on all financial promotions (unless the medium used makes this impracticable). The risk warning is now also required on print, TV and radio promotions.

Rollovers: Where a borrower cannot afford to pay back a loan many lenders offer the opportunity to ‘rollover’ or extend the loan. Where a high-cost short-term loan has been rolled over twice, including before 1 July 2014, lenders will not be able to rollover the loan again.

Since 1<sup>st</sup> July 2014 the FCA has required lenders to provide prospective and existing borrowers with an information sheet on the risks of extending a loan.

### 2015 **The introduction of the cap on the cost of a payday loan**

The Financial Conduct Authority (FCA) introduced a cap on the initial cost of credit at 0.8 percent per day; default fees were limited to a maximum of £15 and a 100 percent repayment cap assured that borrowers would never have to repay more than double the amount they borrowed.

### 2015 **FCA on credit broking and CMA on Price Comparison Websites (PCWs)**

The FCA introduced new rules on credit broking and fees, which affect payday lenders. The rules included:

- Banning credit brokers from charging fees to customers, and from requesting customers’ payment details unless they meet FCA requirements.
- Credit brokers must make sure customers are given clear information about who they are dealing with, what fee will be payable, and when and how the fee will be payable.
- Fee-charging brokers will need to notify the FCA, quarterly, of the websites they operate.
- All brokers will need to include their legal name (as it appears in the FCA Register) in all advertising and all correspondence with customers.
- Advertising must clearly state that the firm is a credit broker and not a lender; if the firm is both a credit broker and a lender, the advertising will need to make clear that they are advertising their broking services, not their lending.
- There are additional rules on cancellation rights for distance contracts (for example, online credit broking), including rights to a refund.

The CMA published findings from their investigation into the payday loans market, where they recommended that lenders must make their product available on at least one price comparison website,

in order to “*encourage greater competition*”<sup>23</sup>. The CMA also found that most borrowers were not shopping around before borrowing from a payday lender and that 53 percent of payday loans were used for everyday expenses.

### 2016 **Applying for re-authorisation**

After the introduction of new regulations on the payday loans market all firms were invited to re-apply for authorisation. They were allowed to continue to operate with interim authorisations. Later in the year the FCA granted authorisations to firms to continue their operations in a changed regulatory environment.

### 2016 **FCA opens consultation reviewing the cap on the cost of credit**

The FCA opened a call for input on high-cost credit (including rent-to-own, home collected credit, catalogue credit) and overdrafts, including a review of the payday loan price cap.

The consultation calls for input on the following items:

**High-cost products** – The FCA will look across all high-cost products to build a full picture of how these are used, whether they cause detriment and, if so, to which consumers. This will enable the FCA to consider whether further policy interventions are needed.

**Overdrafts** – The CMA identified a number of competition issues with overdrafts, which include poor price transparency and the nature and level of charges, especially for unarranged overdrafts. The FCA will look in more detail at overdrafts from a consumer protection perspective, as well as a competition perspective using its full range of powers.

**The high-cost short-term credit (payday loan) price cap** – The price cap came into force on 2<sup>nd</sup> January 2015.

**Repeat and multiple high-cost short-term credit (HCSTC) borrowing** – The FCA will continue to monitor the impact that repeat and multiple borrowing has on the market and consumers.

### 2017 FCA high-cost credit review and CRA data analysis of UK personal debt

The FCA carried out an analysis of personal debt held by UK consumers using credit reference agency (CRA) data, including non-mortgage debt such as credit cards, personal loans, motor finance agreements and utility bill debt.

They sought to answer the following questions:

- Market size: How large are the different high-cost credit product markets?
- Credit performance: What are the outcomes for consumers using different high-cost credit products?
- Consumer circumstances: What are the socio-economic circumstances of consumers using different high-cost credit products?

A summary of the findings show:

- Over half of UK adults hold outstanding personal debt. Over 30% of outstanding personal debt is held by 1.3 million people – 2.6% of UK adults.
- There is large variation in the sizes of less mainstream credit markets. Of these, catalogue credit is a lot larger than others by number of consumers.
- There are large differences in the arrears, default rates and repeated consumer use of different less mainstream credit markets.
- There are similarities in the distribution of credit scores of borrowers using less mainstream credit products. The exception to this is catalogue credit borrowers who, despite having noticeably better credit scores, have relatively high arrears and default rates on these products.
- A greater diversity in the socio-economic profile of people borrowing across less mainstream credit products is observed via measures other than credit scores. Rent-to-own borrowers have much lower incomes, higher debt-to-income (DTI) ratios and hold debt on more products than those using other less mainstream products. HCSTC borrowers are much younger than home credit borrowers.

- Across users of less mainstream products we observe a consistent pattern of their financial situation worsening over time. However, that it not to say it is the credit product itself which causes this deterioration. It is possible for consumers to recover from these positions – we observe that former borrowers who are no longer using these products often have improved financial outcomes.
- The composition of debts varies considerably across people borrowing on different less mainstream credit products. Credit card and unsecured personal loans commonly account for a high proportion of personal debt. Home credit, guarantor loan and rent-to-own borrowers typically have the largest proportion of their outstanding debt on each of those products respectively. We observed that it is common for these individuals to have outstanding debt on household bills – though this accounts for a small proportion of their overall personal debt<sup>24</sup>.

### 2018 FCA high-cost credit review and Consultation

The FCA published a review and consultation call on HCSTC and overdrafts.

Their main finding on the price cap on HCSTC regulatory changes which had been introduced was that outcomes had improved for consumers. This finding informed the decision to maintain the cap at its current level for a further three years.

In the document the FCA identifies other credit products for review: overdrafts (arranged and unarranged), for which there is a separate consultation<sup>25</sup>, rent to own (RTO), home collected credit and catalogue credit.

The FCA details plans for further work assessing potential rules around introducing a price cap on RTO goods, and the level and structure of a possible cap<sup>26</sup>.

The other significant element of FCA reports recently has been their willingness to extort the virtue of “mid-cost” credit delivered by ethical, social lenders. This is a significant departure for the regulator recognising that credit demand will likely continue, even if supply is constrained, and that alternatives need to be supported.

## 2.4 Post-regulation of HCSTC

Post-regulation of HCSTC, payday lenders have changed their operations and created new products to remain competitive alongside the regulation. Stepchange reported that:

**“...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.”<sup>27</sup>**

Citizens Advice, for example, has not reported a surge among its clients towards other forms of high-cost credit<sup>28</sup>. However, among StepChange clients in 2017, two in five were in arrears on at least one of their priority household expenditures, such as an energy bills, council tax, or their monthly mortgage or rent payments<sup>29</sup>. StepChange also reported an increase in the percentage of clients eligible to pay Council Tax who are in arrears rising from 22 percent (in 2012) to 30 percent (in 2017). The figure in Scotland rose from 18 percent (in 2010) to 41 percent (in 2017). This does not show a direct correlation but we need to ask whether non-priority debts have risen as people that previously had access to a payday loan are no longer able.

Citizens Advice’s analysis of the market post-cap found the following:

- 42 percent of the 126 firms, who were operating in the market in 2013, have received full authorisation to carry out payday loan or instalment loan activity.
- 20 percent remain active in the market awaiting the outcome of their authorisation application.

Today, HCSTC regulation has had a positive impact for borrowers. The FCA report that of those that “took out an HCSTC loan in 2015, over 30 percent no longer did so in 2016”<sup>30</sup>. This suggests that the market is markedly smaller and there is a high turnover of payday loan customers.

The FCA shows that since the regulation was introduced, borrowers tend to have more outstanding debts (particularly HCSTC, credit cards and overdrafts) and have lower credit scores, making them higher risk borrowers. However, they go on to say that:

**“We found no evidence that consumers who have not been able to get HCSTC products since the cap have generally had negative consequences as a result. The majority (63 percent) of consumers turned down for HCSTC products since the cap was introduced believe that they are better off as a result. We have not seen a significant ‘waterbed effect’ with consumers increasing their use of other high-cost credit products after failing to get a HCSTC loan. We also found no evidence that consumers who have been turned down for HCSTC are more likely to have subsequently used illegal money lenders.”<sup>31</sup>**

Of those that applied for a payday loan and were declined, the FCA reported that:

**“ 15 percent of declined consumers take out an alternative credit product ... while around 25 percent turn to informal forms of credit such as friends or family<sup>32</sup> ”**



In our research we found that informal use of credit from friends or family is more complex. People do not feel this option is a long-term solution for them, often finding that they can do this type of borrowing only once. For this reason many of the people we spoke to would prefer to take an alternative credit product, or even continue to look for a payday loan, than ask friends or family. While consumers might feel better off today, this has the possibility of changing significantly in the near future.

**Figure 1: Number of HCSTC originations (January 2012- December 2016)<sup>33</sup>**



**Table 1: Size of HCSTC market (2013-2016)<sup>34</sup>**

	Number of consumers taking out product (millions)	Average (mean) value of originations	Number of originations (millions)	Value of originations (billions)	Value of outstanding debt (billions)
2013	1.7	£240	10.3	£2.5	£2.5
2014	1.2	£240	5.3	£1.3	£1.3
2015	0.7	£260	3.3	£0.8	£0.8
2016	0.8	£290	3.6	£1.1	£1.1



The FCA also report the number of new loans to consumers between 2012 and 2016 to show the extent of the market and regulatory changes:

- 10.3m to 3.6m loans
- 1.7m to 0.8m customers
- £2.5bn to £1.1bn outstanding

The FCA was also able to show a reduction in default loans in the time that the cap on the cost of credit was live in the HCSTC market:

**“ The ‘default rate’ is defined as the proportion of loans originated which enter default as recorded on a borrower’s credit file. [We show] these to have significantly decreased with fewer than 6 percent of loans originated during the first half of 2016 entering default compared to over 8 percent of loans at times in 2015 (and double digits in 2014 as shown in prior data analysis).<sup>35</sup> ”**

Using industry data, the Social Market Foundation found that:

**“ ...the number of loans sold in the period January to April 2016 were 42 percent lower than in the period January to April 2013. This data is drawn from firms that operated through to 2016 and may underestimate the drop in loans – for instance, a large number of firms exited the market in this period, such as many cheque centres. Consumers buying loans in 2015 are on average coming from higher-income brackets than in 2013.<sup>36</sup> ”**

After the cap on the cost of a payday loan was introduced StepChange found that just 16 percent of its clients had HCSTC debts in the first half of 2016 compared to nearly a quarter (23 percent) in 2013<sup>37</sup>. In 2016, Citizens Advice found a significant reduction in the numbers of clients with payday loan problems since the introduction of the price cap in January 2015. This included the following:

- A 45 percent reduction in clients accessing advice about payday loan issues, which is in contrast to the trend with all debt advice which has remained stable and all advice given which has increased slightly.
- An 86 percent reduction in clients contacting its consumer service about payday loans between 2013 and 2016.
- A 61 percent post-cap reduction in unique users accessing payday loan content on the external website.
- The expert advice team had 29 complex cases on payday loans referred to them leading up to the cap and have had no cases since the cap<sup>38</sup>.

Before the cap payday loans were commonly associated with sub-prime borrowers (borrowers with tarnished or limited credit histories), particularly in media discussions about the industry. Since the cap, some lenders still in the market have restructured their business models to focus more attention on a new category of borrower: the near-prime borrower (which also describes a borrower with a tarnished or limited credit history but who is nearer the stage of repairing their credit histories). One report estimates that the near-prime borrower group in the UK is between 10 and 14 million people<sup>39</sup>.

At the same time, in discussing not just the regulation of the payday loans sector but the provision of alternative affordable credit, the FCA refer to the ‘mid-cost’ credit market, which it describes as being “above prime borrowing rates, but below the HCSTC cap level.” The FCA in an update on its review of high-cost credit said the following:

**“ We recognise the value of high-cost credit for consumers who lack other options, where firms have made appropriate assessment of their creditworthiness. However, we are also exploring why relatively lower cost, mid-price, lower risk credit options are not more widely available. We have been looking at barriers to the provision of alternatives and have been considering what might be done to address these.<sup>40</sup> ”**

## 2.5 Declined payday applicants

The main remit of this research was to find out about the lived experience of a borrower who previously had access to payday loan credit, but after the cap on the cost of payday loans and increased regulation over that industry, is unable or ineligible to access that form of credit.

In 2017, the FCA reported that the borrower profile tends to be male, employed, with an average net income of £23,600, and an average age of 35<sup>41</sup>. This shift in income and borrower profile is significant particularly in an era of frozen, stagnant or reducing wages and benefits. A shift in demographic toward less risky customers is also reported by Rent to Own retailer, BrightHouse, and is also evident in the customer profiles of the largest home credit provider, Provident Financial Group.

This research supplements insight from the FCA on its initial findings on outcomes for a borrower now declined a payday loan. In July 2017 the FCA published a feedback statement on why they made the decision to maintain the price cap of a payday loan. In this statement they presented their findings on declined payday applicants:

- 15 percent of declined consumers take out an alternative credit product and 25 percent turn to informal forms of credit such as friends or family.
- No evidence that decline leads directly to illegal money lenders.
- 63 percent thought it was ‘for the best’.
- 60 percent do not go on to borrow from other sources.
- 37 percent took no further action (including ‘going without’).
- 7 percent cut expenditure as a result.<sup>42</sup>

In addition, the FCA stated the following:

- *“We do not consider the price cap is currently too tight ... consumers declined for HCSTC do not generally appear to be harmed as a result”*
- *“We found no evidence that declined payday applicants were generally taking out other high-cost products. We also found no robust evidence of declined payday applicants increasingly turning to illegal money lenders”*

In the following section, we present our own findings about declined payday applicants which provides qualitative detail to the existing snapshot of this group of people.



## 3. Analysis

Our analysis is based on 80 interviews with declined payday applicants to examine the lived experience of the HCSTC regulation. In this section, we:

- Detail the key demographics of the 80 participants.
- We outline the journeys of declined payday applicants.
- We then examine the lived experience and different impacts of being declined.

Drawing on our evidence, we highlight the complexity within each declined applicant journey which adds nuance to the existing research on declined payday applicants (and users) of payday loans. Finally, we summarise the key findings identified through the research.

### 3.1 Research participants

We undertook 80 in-depth interviews with declined payday applicants' of HCSTC<sup>43</sup> who were generally:

- Female,
- Aged between 25-44,

- Employed full-time,
- Single or living alone in rented (private or social) housing,
- Parents with dependent children and
- Educated to HND level or equivalent.
- Almost 50 percent of participants were living on a low income, in a household earning less than £20,000 per annum (39 out of 80 participants)<sup>44</sup>
- Most people we interviewed did not consider themselves to have a disability (See Figures 2 to 9 below).

Our participants are similar to those participating in previous studies focusing on the consumers of HCSTC prior to the regulation<sup>45</sup>. First, borrowers reflect a socio-economic profile which generally positions them as socially marginalised, in low paid and insecure work at risk of financial exclusion and living in poverty<sup>46</sup>. The majority of the participants were in full-time employment highlighting the financial precarity of those experiencing in-work poverty. Our interview locations centred on payday loan 'hotspots' of Glasgow<sup>47</sup>, Birmingham<sup>48</sup> and London<sup>49</sup>. Further details of our methodology can be found in Appendix 2.

Figure 2: Participants gender

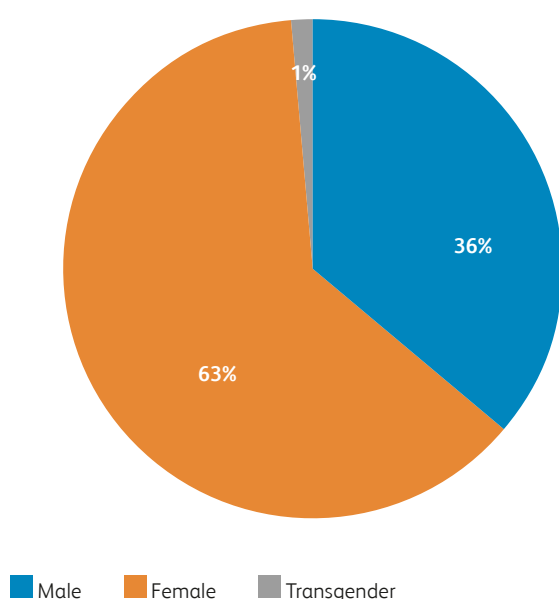


Figure 3: Participants' age

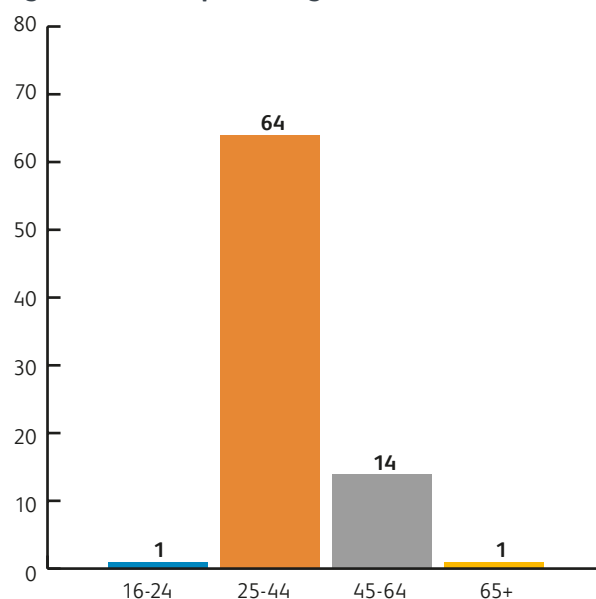


Figure 4: Participants' employment status

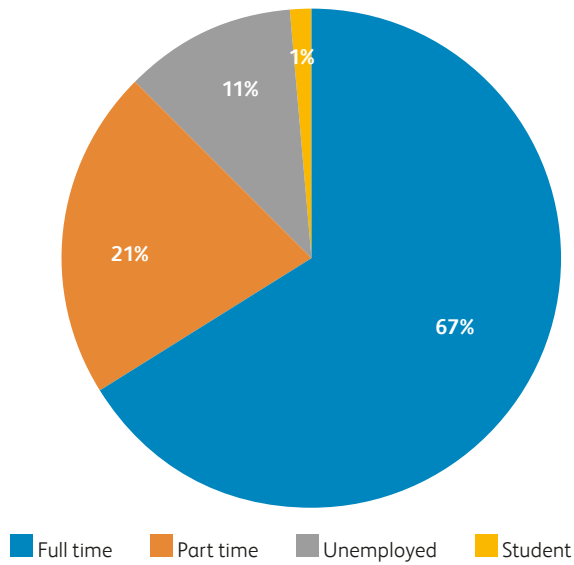


Figure 5: Participants' marital status

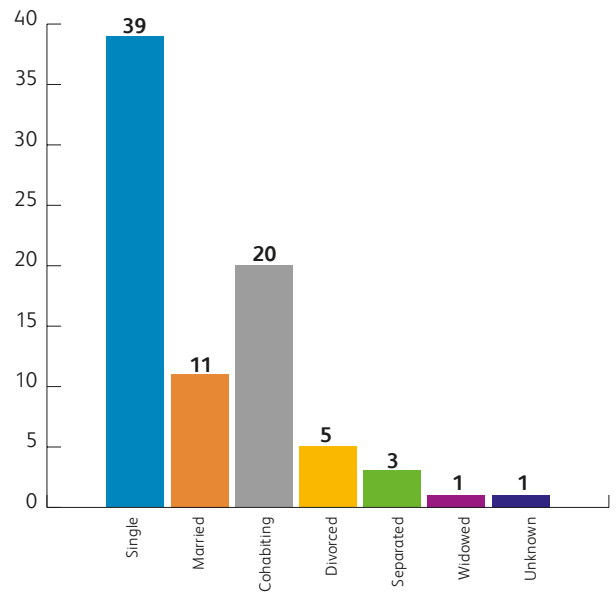


Figure 6: Participants' household income

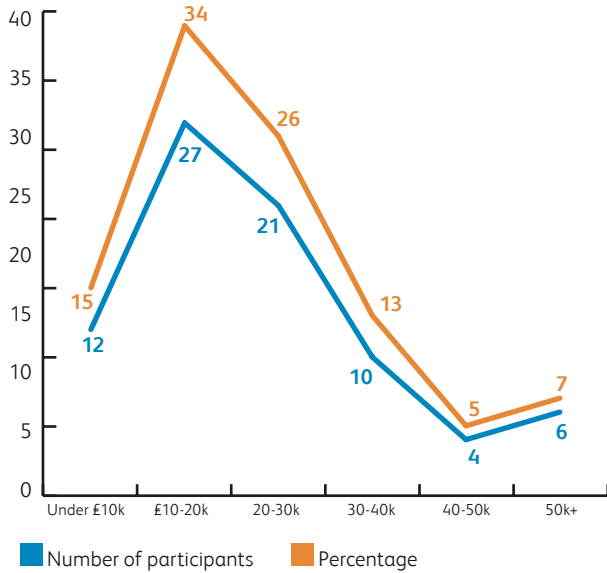


Figure 7: Participants' housing

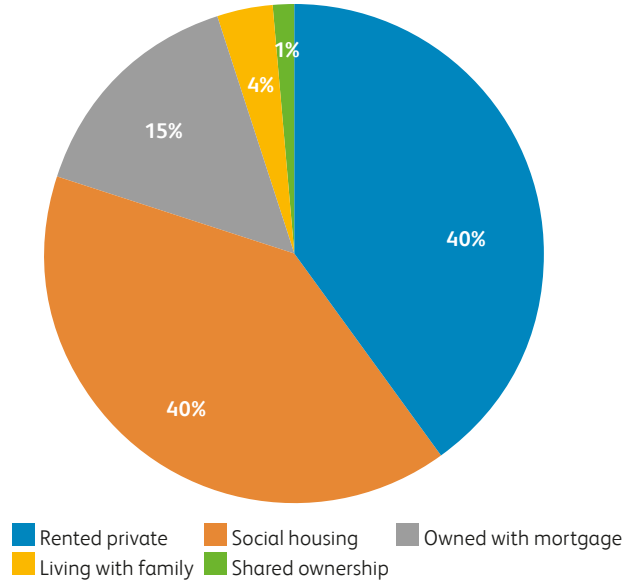


Figure 8: Participants' highest level of education and qualifications

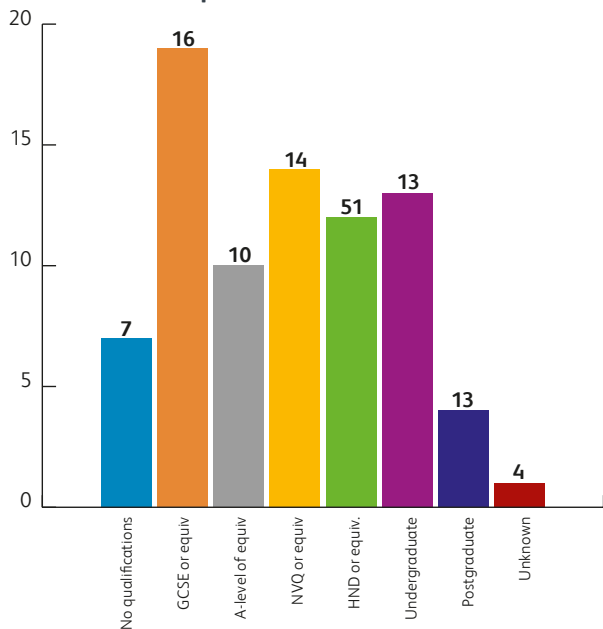
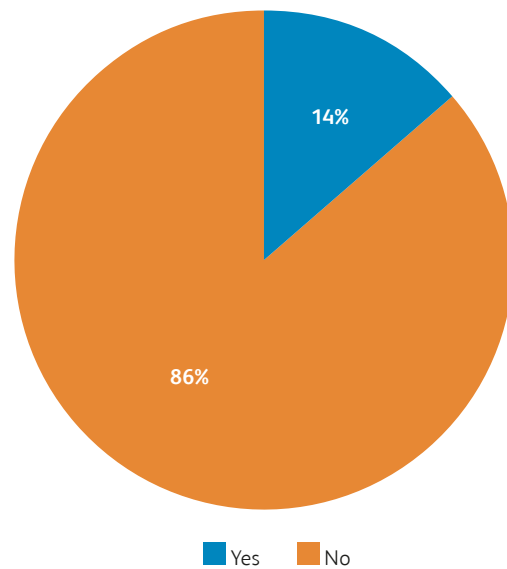


Figure 9: Participants' disability



### 3.2 Declined applicant actions

We interviewed 80 people, 64 had been formally declined from a payday loan since the regulation was introduced. The remaining 16 participants that had not been formally declined were self-excluded from this type of credit as they would no longer be eligible for a payday loan for a number of reasons (See Table 2 for typical examples). For example, they had been declined from other sources of credit such as a bank overdraft or credit card, which due to over-indebtedness or lack of affordability, positioned them in a constrained environment, and therefore put them in a similar category to those that were formally declined.

**From this point onwards, our findings focus on the 64 participants that were formally declined for a payday loan since 2015.** From these 64 qualitative research participants, we have created a typology of 16 actions that a declined applicant carried out after being declined a payday loan (see Table 3 and Figure 10). We found that participants took a series of different actions after being declined that can be categorised in two ways:

1. access to credit, or;
2. no access to credit.

Due to the number of participants in our research the findings are indicative rather than exhaustive. In the findings that follow we use percentages but the sample size is not large enough to support testing for statistical significance. Instead the findings provide deeper and more specific insights to complement existing quantitative data on the experiences of declined payday loan applicants

Our research found that when declined or unable to access a payday loan, participants were more likely to seek credit from another source (either an alternative formal lending route or friends and family) than “go without” credit by cutting back spending.

Of the 64 people that were declined a payday loan, we found that 58 percent (37 out of 64 participants) took action to seek access to other credit after being declined (e.g. applied to another lender, friends and family) (Table 3). Between these participants, a total of 46 different possible actions were identified to seek access to credit. For example, participants employed multiple strategies to manage their financial situation:

**“So, really, just manage my money better. Stop buying things that I can’t afford, really.... I’ve got an overdraft and that’s it.”**  
(Susie, Birmingham)

The remaining 42 percent of participants (27 out of 64 participants) took action towards other strategies that did not involve seeking credit (e.g. increased working hours) (Table 3). Between these participants, a total of 48 different possible actions were identified to deal with the consequences of being declined a payday loan, which did not include seeking access to credit.

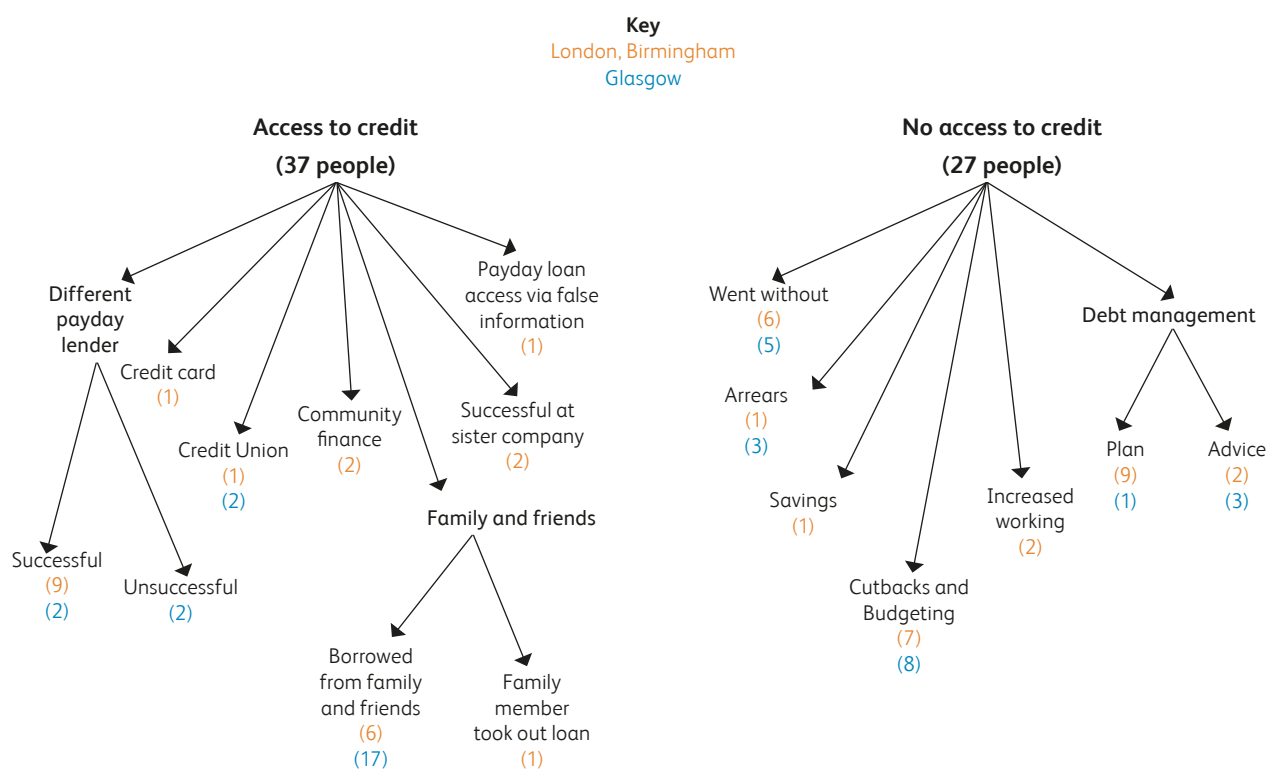
The most common step that an individual took after being declined was to access credit from friends and family (taken by 23 of the 64 declined payday applicants or 36 percent) (Table 3). Our research found the number resorting to family and friends to be similar to the 40 percent identified

**Table 2: Examples of the 16 participants that were self-excluded from payday loans**

Participant	Declined applicant of payday and other credit	Reasons why they may be declined from payday post-regulation
Steven	Overdraft	Existing loans from Street UK and Provident
Paula	Vanquis credit card Co-op bank for personal loan	Previous arrears with rent-to-own
Nikki	0 percent credit card	Yes, previously in a debt management plan with credit card debt
Molly	Home improvement loan Equity release	Too many payday loans

**Table 3: Declined applicant actions**

Declined outcome	England	Scotland	Total
<b>Access to credit</b>	<b>23</b>	<b>23</b>	<b>46</b>
Successful at a different payday lender	9	2	11
Unsuccessful at a different payday lender	0	2	2
Successful at sister company	2	0	2
Community finance	2	0	2
Credit Union	1	2	3
Credit from credit cards	1	0	1
Money from family and friends	6	17	23
Family member took out loan	1	0	1
Entered false information to payday lender	1	0	1
<b>No access to credit</b>	<b>28</b>	<b>20</b>	<b>48</b>
Went without	6	5	11
Arrears	1	3	4
Savings	1	0	1
Cutbacks and Budgeting	7	8	15
Debt management advice	2	3	5
Debt management plan	9	1	10
Increased working e.g. overtime	2	0	2

**Figure 10: Declined applicant journeys<sup>51</sup>**

by the FCA<sup>50</sup>. This was particularly significant in Scotland. However, as we outline later in the report, accessing this money is not always a positive experience with some interviewees expressing that they would rather have been able to access a form of (regulated) credit from a formal provider rather than expose their financial difficulties to other people close to them. For example:

**“ Well if no payday loans were available in the world, then I might have tried to get a credit card. Or I might have called my parents, probably worst-case scenario. ”**  
(Nikki, London)

The second most common step taken by participants after being declined a payday loan was to apply for some other kind of formal credit product. Eleven of our interviewees sought and were successful in accessing a payday loan from another company. One person accessed a payday loan by providing false information. Another accessed a bank loan via a family member. Two people were unsuccessful in their attempt to borrow from another payday lender, while another two were successful with the sister company of their original payday lender. Three borrowed from a credit union, one used credit cards, and two others used a community finance provider.

This evidence clearly signals to us that many people now declined access to a payday loan still seek access to credit. This decision to seek credit was preferable for the majority declined payday applicants rather than managing in other ways. This potentially strengthens the case for better and more affordable borrowing options for those now declined a payday loan, and better marketing of these social lenders. Overwhelmingly, participants were unaware of fair, ethical alternatives. The next section explores the trends and key themes that have emerged from the data.

### 3.3 Access to credit: From a different payday lender

After being declined, eleven (out of 64) participants reported successfully accessing a payday loan with another HCSTC lender. For those stuck in cycles, the ability to apply elsewhere after being previously declined, enabled continued access to credit.

Participants commented that a hierarchy of lenders exists. They initially seek credit from the better known companies, but if unsuccessful they may move on to try those that are less well known with apparently less stringent checks. The following examples highlight the situations within which participants accessed credit from a different payday lender after being declined.

One example of this was Graham. In his 30s he accessed payday loans because of a temporary period of not working and needing to meet credit card repayments. He was single, lived in social housing and had one pre-school child. He explained his payday loan use rationally through establishing that the interest over a short period was less than paying the full payment on his credit card. After being knocked back from one lender he tried another payday company in order to acquire the funds he needed:

**“ And I looked at the payday loans because it worked out less than the interest I would have got from not paying the full amount on my credit card because it was quite a large bill, it was like £1,600 or something. I was just about £200 short so I got knocked back from one place, but then another place gave me it and it was just like basically it was two days until I got my next money. ”**  
(Graham, Glasgow)

In this case, using a payday loan to bridge a finance gap is a logical financial decision. The payday loan provided a quick solution which was cheaper than the penalty for not paying his credit card bill or using an unauthorised overdraft<sup>52</sup>. The FCA's proposed overdraft reforms could provide greater short-term borrowing options for declined payday applicants if the costs are known and proportionate<sup>53</sup>.

A further example of this was Stan. Stan was in his late 30s, worked full time and married with two children, rented privately and accessed payday loans to pay for everyday items after running out of money. Stan was an example of a participant who was in a credit cycle, repeatedly accessing

payday loans and utilising credit cards on a monthly basis. Stan described this as a “repeated micro cycle” saying “I was really just broke, generally surviving each month”. He was asked about the impact of being declined a payday loan:

**“ what impact did that have on you... when you were turned down did you go alright, I will turn to another one? Yes, I’ve done that, sometimes that’s successful. But more likely being turned down affects your credit score and I think that’s the biggest negative impact it probably had. When we had to move house, so we rent our house, because our credit record was so bad, it caused problems with being able to move house. ”**  
(Stan, London)

In Stan’s case the more lenders he sought finance from, the greater the likelihood of being denied access to those lenders. Even if he was sometimes successful in accessing credit from some of them, he was worried about the wider impact it would have on his credit file and the longer-term implications for his financial security.

Some online payday loan companies have declined payday applicants, but then referred them to their sister lender which is a form of brokering that requires a license to do so. Bob was single and in his 30s, worked full time and lived in Birmingham. He had accessed payday loans because his monthly expenditure was often higher than his wages. Bob described how when his application was declined, lenders suggested applying to a sister company that had a higher rate of approval. Bob was declined by one lender, referred to another and was successful:

**“ When rejected, they didn’t say, they didn’t give you your credit file, credit rating or? Yeah some of them do. They say refer to your credit reference agency bureau.**

**And did they signpost to you any other organisations, like debt advice charities or anything like that? A couple of them, yeah. Other ones would them refer you to their sister company.**

**Okay, so they said we can’t lend to you but. But why don’t you try our sister company who have higher approval rate. ”**  
(Bob, Birmingham)

This is an example of the ‘temporary’ status of the declined applicant. Our research demonstrates the difference in lenders’ assessments of creditworthiness and interpretation of the HCSTC regulation. This is an area which needs to be explored further by the FCA.

In their review of the HCSTC price cap, the FCA found that the reforms to the payday loan market were generally effective and their research suggested that declined payday applicants did not generally seek other forms of high-cost credit. However, the FCA also recognised that some payday lenders’ “*creditworthiness and affordability assessments for high-cost credit products are poor or inadequate*” which may be because some lenders are not making a profit and are taking risks to remain in operation<sup>54</sup>.

Our research shows that some declined payday applicants **are** seeking credit from other payday lenders and despite the regulatory reforms, pockets of irresponsible lending appear to remain within the payday market.



### 3.4 Access to credit: Irresponsible lending and borrowing

Some borrowers who had been declined payday loans were adept at manipulating the application process. This again demonstrated that some declined payday applicants were desperate to access a payday loan at any cost. Whilst borrowers must take responsibility for providing accurate information about themselves, lenders also have responsibility to verify information from each new application to ensure that the loan is appropriate and affordable.

Chloe was a woman in her 30's who worked full time and was cohabiting, renting privately in London. She was educated to NVQ level, did not have children and accessed payday loans because of overspending and having to find funds to pay for bills over a period of six years. Over this six-year period the lender did not request updated information. She was aware of this oversight and used it to her advantage to access credit. This suggests that the use by lenders of self-reporting as a process to verify a borrower's income and outgoings is flawed:

*"Any information, I think at the first time when you apply, I think you got your pay slip and that is all, since you got your account open, I think I had sometimes with like [payday lender] for 6 years, even longer, they never, ever ask me for more details apart from the first time I applied, if I put I'm earning two and a half thousand pounds a month, they just take it." (Chloe, London)*

Furthermore, the study showed instances where borrowers modified their earnings and other requested information such as rental payments to deceive the lenders to gain access to credit and credit at a higher amount. Several participants said they were aware that the financial information requested upon application was not checked and how this could be used to their advantage. A further example of this was Zara who was in her 20's, single, working full time, living in Leicester and educated to postgraduate level. She used a number of payday loans to pay for unexpected costs for her car and the house as well as her sister's birthday:

**“ So, when you were applying for the loans, did they ask for any information from you?**

**Yes, they do an eligibility questionnaire, so they ask you what your income is, what your outgoings are. But these things aren't tracked. They don't confirm the information that you're giving. So, really, anybody could lie on those forms and you could get quite a lot of money, which you can't afford to be paying back. So, it's not very good in that sense. It doesn't help you control your finances.**

**So, you didn't have to provide proof of income or anything like that?**

**No, you don't have to provide any type of proof of income. They don't really do any checks on your credit rating, they don't check with your bank or anything like that. So, it's very easy to lie on your eligibility questions.**

**So, would you know what to put in to get the loan accepted?**

**Yes, I would. Towards the end, I was lying all the time because I was obviously in such a bad financial situation that I needed the money to be able to survive the month. So, you do what you need to do to get some money, don't you? ”**

**(Zara, Leicester)**

These practices were made possible for borrowers due to inadequate document assessment by lenders. Failure to check information was particularly prevalent among some online payday lenders and some borrowers reported being in a payday loan cycle – taking out one to pay back another. The lack of checks performed by these lenders pre-regulation and the failure to re-check the financial situation of borrowers facilitated this. Post-regulation, this should not be happening.

On being declined from one payday lender, at least one borrower also employed other practices to secure credit deceiving lenders by providing a false payday date and reporting their card as stolen to prevent lenders taking payment from their bank account. Jason was a man in his 30s who worked full time, was single living in Middlesbrough, was educated to undergraduate degree level, and accessed payday loans because of a drop in his wages after moving away from London and taking a pay cut. He stated his actions when he could not afford to repay:

**“ I can remember one time, because how they pay it they take your 16-digit card number and it’s automated, so if you give them the date when it’s paid by then you’ve given them your debit card and it will automatically take that unless you defer it...So, what I used to do, to stop them from doing it, not always but enough times I did this with [payday lender], I used to ring my bank and report my card lost...And they would send a new card and a new card would have a new 16 digit, the pay day company couldn’t take the payment because my old card had been reported lost, it was no longer valid. So, I would, me I would like, delay my payment back by doing that a few times. ”**  
(Jason, Middlesbrough)

This action illustrates the financial situation people can find themselves in and the creative financing strategies used when accessing payday loans and not being able to afford to repay.

### 3.5 Access to credit: borrowing from family and friends

Family and friends played an important role as a lender of last resort to turn to when participants were declined a payday loan. To give an example, David, a man in his 30’s, who rented privately, lived with his partner and had one child, spoke about

turning to his mum after being declined a payday loan. David had previously used payday loans to pay for bills and to repair his car. Upon re-applying David was turned down because of a poor credit rating amongst a “long list of reasons”. When asked what impact this had, David said:

**“ I had to go and ask my mum and ask for it, I suppose, but it was a one-off really. A few things had happened that month and it was going to be a one-off. ”**  
(David, Glasgow)

There were further examples of where the participants turned to their family and friends in order to ‘end’ a cycle of loans, often brought about through being declined. One such example was Courtney. Courtney was married, lived in social housing, educated to undergraduate degree level, had two children and used payday loans to pay for school uniforms and other items for her children:

**“ It was always for house stuff, it was never for just for fun, it was always like, stuff for the kids, clothes, uniform. Anything really, even if it came to Christmas, it was I needed to get stuff for the children for Christmas, then I would just get a pay day loan ... get the money and not really think about it until afterwards. ”**  
(Courtney, London)

This turned into a cycle of loans and Courtney spoke about being declined for loans when her “credit had been refused” and that she was aware she had “bad credit”. This prompted her to talk about her debt issues with her family to get out of the circle of loans:

**“ Yes, well basically I ended up to get myself out of the circle, I kind of done a confession to my granddad, and then he lent me the money to pay back the last one to get me on my feet and then I paid him off over time, just to stop doing it. ”**  
(Courtney, London)

The study also presented several examples of borrowers wanting to keep their payday loan activity hidden from family and friends. Borrowers discussed how they felt embarrassed and wanted to hide the fact they had taken out a payday loan. Winston was cohabiting, in his 30s, worked full time, had an annual income of more than £50,000, was educated to Higher National Diploma level and used payday loans to pay for everyday living costs as these increased after moving to London. Winston was one of many examples of participants who avoided asking family and friends for financial help in an effort to preserve his sense of self-worth, trying to resolve his financial issues alone:

**“ What did you need the funds for? Just day-to-day living, kind of thing, because as I say I moved to London. It’s a lot more expensive but what I found was, because I’d only been here a few months, it wasn’t long enough at an address and it wasn’t long enough at an employer...I didn’t want to worry my family thinking that I’ve just moved to London, but I can’t afford it...Do you know what I mean? I didn’t want to put that burden on, like, worrying my mum, thinking, “Oh, my son’s in London on his own and he can’t afford to be there” kind of thing... So, I tried to do it on my own. ”**  
(Winston, London)

Whilst some participants in this situation wanted to preserve their self-esteem, some participants didn’t ask for help or discuss any financial problems with family members due to feelings of shame and guilt. Rowlingson et al.<sup>55</sup> found that prior to the cap, payday borrowers wanted to manage their situation independently without being a burden on their families. A number of participants noted that their financial situation caused them anxiety and stress. In addition, the distress of not being able to access a loan was often significant as Chloe explains:

**“ I think, the psychological impact, like you feel, you feel like you fail yourself. You know, like, you couldn’t control your finances...Because it does impact everything in your life. ”**  
(Chloe, London)

This could lead to people withdrawing from family and friends, thereby reducing their social capital and ability to seek help. In our research, people showed a preference to manage their situation themselves. In many cases, drawing in family as a support mechanism could be counter-productive and have a negative psychological impact on their wellbeing.

Our research highlighted many cases where the participants used credit to take responsibility for their situation. For example, Elizabeth was a young, single woman, working part time, renting privately in Glasgow, who tried to access a payday loan to pay for unexpected costs. On this occasion, Elizabeth needed funds to repair her boiler even though she was in rented accommodation and by law this is responsibility of the landlord, she stated that the landlord would not take responsibility for this and fix it for her<sup>56</sup>. Elizabeth explained that asking to borrow funds from her family, rather than access a payday loan after being declined, was degrading and went against the idea of being a ‘grown up’ taking responsibility for her situation and being able to sort out her own finances. When asked what happened when she was declined a payday loan, she said:

**“ I ended up having to borrow off my mum. Yeah, I know... Oh honestly, I hate doing it, I absolutely hate doing it, but yeah, I ended up having to go to her. Just because it makes you feel as if, like it’s my problem, do you know what I mean, it’s not hers, it’s mine, so I’m an adult now I should be able to deal with these kind of things myself. I just don’t like it. Like she doesn’t grudge it or nothing like that, she does get me it if I needed, but I’d rather not, it’s just pride really. ”**  
(Elizabeth, Glasgow)

There was an overwhelming lack of knowledge about affordable alternatives such as community finance and credit unions. Greater awareness of such mid-cost credit options is essential to offer declined payday applicants an alternative option to relying on family and friends who may be unwilling or unable to provide this support.

In addition, we see an increasing likelihood of people unable to access any form of credit with interest and therefore believe that a UK-wide No-Interest Loan Scheme (NILS) as in operation in Australia should be considered (subject to a feasibility study) to meet the needs of poorest households<sup>57</sup>. This will involve public subsidy as well as significant funding from banks.

### 3.6 Access to credit: Use of family and friends to access formal credit

The research presented a number of cases where borrowers did not borrow directly from friends or family, but used these people in order to access to credit after being declined for a payday loan. These approaches reflect the need that the borrowers had for credit but often had potentially negative implications for the borrower and/or their family.

For example, some participants said they used family members' better credit score and ability to access lower interest financial products, such as a bank loan. This had an impact on the financial situation of families as well as the relationships within the families, as the following example from Louise highlights:

**“ Did you ever borrow money from a family or friend? Yes, on many occasions. My mum actually took out a bank loan for me to pay off payday loans.**

**Did that affect anything financially, not just you but someone else? Absolutely, yes. The whole family I think were affected by it. ”**  
(Louise, Lanarkshire)

The research found other examples of access to credit across family and friend groups almost being treated as something to be negotiated collectively, with potentially concerning consequences. For example, Jack was a man in his 20's currently receiving benefits, living in social housing and educated to NVQ level in Birmingham. He had a payday loan to move home and to pay for appliances. Here he discusses how he accessed a payday loan at a high-street lender and pressurised his partner into also taking out a loan:

**“ My partner didn't want to get one ... I feel like I've pressurised my partner to get one ... Because she was there and she looked, and I looked and she just said, look I've got, there's a thousand pound cash and they're going to give it to me in a minute and then she goes, oh would your partner like one and I was like, yeah, yeah, yeah ... She was like, no I'm alright, I was like go on, go on and then she also got one as well, so it's both into that... Know what I mean ... Just the money was there, it was just there. ”**  
(Jack, London)

We endorse the creation of a set of guiding principles on what informal lending 'good practice' looks like, as recommended by the Money and Mental Health Policy Institute (MMHPI) in a recent study. The MMHPI found that nearly half of research participants said that informal borrowing put a strain on their relationship with the lender or that the relationship broke down<sup>58</sup>. It calls for the new Single Financial Guidance Body (the as-yet unnamed entity which replaces the Money Advice Service) to develop tools and templates around informal lending to help both parties reach a clear agreement. It also asks the advice sector to ensure the social consequences of non-payment are considered in any proposed debt solution. We agree that these tools will help some people to manage their money when lending informally to family and friends.

### 3.7 No access to credit: went without

Participants spoke about having to ‘go without’ after being declined a payday loan. This might mean not being able to pay household bills, buy a present or an item needed by a child, or something that might not be essential but was desired. An example of this was Fran.

Fran was a woman in her late 30s; she worked full time and was living with her partner and child in social housing. She had been declined a payday loan several times and considered that her loans were often for luxuries and “*more frivolous things*”. She spoke about one instance where she wanted to buy a new pair of trainers for her child with the payday loan funds but was declined:

**“ If I didn’t get the money, I wouldn’t be able to buy them. But you’ve just got to kind of add it all up in other ways. I’ve never not got food in the fridge or anything like that. So, it wouldn’t have been that adverse for me. It would’ve just been nice. If I was refused, it’s not going to be the end of the world. ”**

(Fran, Glasgow).

This example demonstrates that some people consider some goods as luxuries but these may actually be essential items such as clothing, holidays, birthdays, as part of social and cultural participation, which are included within the UK Minimum Income Standard<sup>59</sup> which identifies items that should be included for an acceptable quality of life and the cost of this acceptable standard of living. Notably saving is not included in the Minimum Income Standard calculations.

### 3.8 No access to credit: cutbacks and budgeting

Further actions participants undertook after being declined a payday loan were making cutbacks, sacrifices and budgeting their income. This however is not an easy task for those on low incomes when credit was often used to meet essential needs such as rent, food or utilities. A good example of this practice was Abel, a man in his late 20’s who worked full time, was single and had an undergraduate degree. He used payday loans to pay for everyday living costs when his wages were short. When asked whether Abel had any difficulties in paying back his payday loans he discussed prioritising his repayments over other expenses:

**“ Okay, have you ever had difficulty in paying back a loan? Like I would have, I would have been afraid that, say maybe I would have probably at some stage with some of them yes. No, would I, no I always paid them off on time, every time, okay I might have had to cut back on my living because of it, but I always did pay it off on time, yes.**

#### **So, you prioritised those payments?**

**...Food and this kind of thing, if I had to stop shopping, say if I was shopping in Sainsbury’s or Tesco I might start shopping in say Lidl or Iceland for a while, build up my shopping in. And I started budgeting as well, I would have had done a budget on my laptop and that kind of thing and I would have just been able to see, if I was able to, how much I was able to pay off and how much I would have needed to live for a month and that kind of thing. ”**

(Abel, London)

As well as making cutbacks for everyday spending, participants also spoke about cutting back on bills like utilities. Rose, a woman in her 50's who worked full time, and lived with her partner in social housing, spoke about going into short-term arrears and cutting back on her telephone and internet bills after being declined:

**“ I just need to cut down. I'm not really throwing money about anyway, I don't have that much money to throw about. I've done a bit already, like Sky or my mobile phone or something like that if I've not got enough money for the direct debit I'll just phone them up and say I don't get paid until next week, I'll come to an arrangement with them. That way I don't get cut off or anything like that. They're generally quite good. ”**  
(Rose, Glasgow)

This example highlights good practice by particular companies in respect of the duty of care that providers have in helping people manage their finances in times of difficulty. However, individuals need the financial knowledge and confidence to be able to negotiate this with their providers<sup>60</sup>. Financial capability and confidence is a key theme throughout our research and we outline this in greater detail below.

### 3.9 Financial capability and confidence

A clear theme running through the data was the different levels of financial capability and confidence of participants (see our glossary for how we define these terms in Appendix 1). This is also a key finding in other research undertaken with users of HCSTC<sup>61</sup>.

Several participants in our research displayed scant knowledge of the repayment rates, terms and conditions of credit. However, other participants who used payday loans, had an apparently high level of financial capability, suggesting other factors at play. Needing to access funds as soon as possible, and ease of access to payday loans, drew in participants from different backgrounds

who were desperate and required funds as soon as possible.

Sarah a former bank manager but her situation meant she was driven to using payday loans. She was in her 40s and a single parent, employed full-time, rented her home privately in Birmingham and had an NVQ. She borrowed £250 and paid back £400 due to a cash flow problem and because she needed to buy items for her daughter at university. Loans were also taken out to pay for unexpected costs such as car repairs. Sarah had three payday loans in total and said she had a bad credit rating:

**“ because I was working, I always thought well I'll pay, I'll pay it back. I'll pay it back so it doesn't matter. So, yeah, I always tried to justify what I was doing. ”**  
(Sarah, Birmingham)

Sarah felt very guilty that she had turned towards payday loans as a solution to her situation:

**“ I didn't want to take it out in the first place but it was my only option at that time. And then you're thinking, well the interest's high, so does it matter, they're going to get the money, so does it matter, but then there's the guilt that comes back. Yeah, now looking back, you think, you know, it's extortionate and why didn't I think more clearly at the time and that but, at the time, the need, you know, is far greater than their interest. ”**  
(Sarah, Birmingham)

Such behaviour shows some borrowers seek a rapid solution when in financial crisis, not comparing loans or searching for the best deal. Such irrationality may in fact seem entirely logical on an emotional level<sup>62</sup>. These declined borrowers took out a loan with the first company that accepted them rather than taking time to find alternative options.

In another example, Paris was a woman in her 30s, working part time and living with her family in London. After being declined, she accessed a

payday loan to attend her cousin's wedding and to pay hotel costs. When asked what the reason was for choosing that particular lender she replied:

**“ I think it was one of the first few that I found online that just seemed to accept me. ”**

(Paris, London)

Frequent borrowers acted within a hierarchy of options, trying well-known brands that advertise widely or previously used lenders first and then, if declined, using other lenders. The quote below shows how one participant created a hierarchy of lenders based upon the cheapest to the more expensive.

Arthur was in his 30s, single, working full time in South Yorkshire. He was educated to undergraduate degree level and had recently had a baby. Payday loans were used for everyday living costs and funds for placing bets. Arthur explained that cost of the loan was not a consideration (as he used the funds for his gambling addiction):

**“ I'd say I had a few personal problems at the time, so I started out with the cheapest ones you could get but when you've done them, you just start going through the dearer ones until a certain point where there were no more that you could get. ”**

(Arthur, South Yorkshire)

This is a further example of the 'temporary' nature of declined status and how regulation is being enacted by some payday lenders. Some participants were aware that they had poor credit and this was justified as one of the reasons for accessing payday loans and excluding themselves from other forms of credit. However, some said they were using payday loans as a form of credit to show that they could be bankable in the future.

Gwyneth was in her 40s, married and working full time in Scotland. She was an owner occupier with a mortgage, and held a Higher National Diploma.

She had two children and used payday loans to pay for vet costs when her dog was unwell and needed treatment. She discussed here that she is conscious of how her credit rating has an impact on the APR of the loans she can access and is taking steps to improve her credit score:

**“ I've had problems in the past with my credit score, just because things had happened with family and getting ourselves into a bit of debt. But if anything I thought my situation would have improved. Because I do keep an eye on my credit score, which isn't great, but like I've got a credit card and they increased my credit limit within that time. ”**

**So I'm trying to make sure my credit scores [improves]... I'm doing all the right things to try and increase that, so that if I ever needed, maybe a bigger loan in the future, then there would be better options available, that would have a more favourable APR and interest rather than paying higher amounts.”**

(Gwyneth, Glasgow)

Whatever its particular merits, whilst Gwyneth was creative in her approach to using payday loans to actively build her credit score, others lacked an understanding of what a credit score was and how it worked and why this was important in terms of their creditworthiness and ability to access credit.

The theme of financial capability and confidence highlights the significance of emotions in the use of payday loans. Moreover, we identified that financial capability and confidence were key to declined payday applicants developing strategies to overcome their financial challenges which we explore further in the next section.

### 3.10 The role of time and constrained choice

The amount of time available to consider different payday loans available, speed of access to money and whether this type of loan was right for the borrower were important factors. Several participants made instant decisions about getting loans and later regretted their decision when finding out about other credit products available. This is illustrated by participants' accounts of whether they would use payday loans in the future. Several indicated they would not and that they would have looked at alternatives had they known about community finance<sup>63</sup>. When provided with more time to consider the options, participants demonstrated greater financial awareness about making a decision that was appropriate for them. For example, they noted that being turned down for a loan gave them the opportunity to reconsider their finances and to question whether payday loan products were right for them. For example, Ali who was in his 30s, unemployed, single, and renting privately in Birmingham described being turned down for a loan as a wake-up call to reconsider his financial situation:

**“ By stopping me getting a loan, really. It is, literally, like... because I haven't been able to get the loans, I've learnt to budget a lot easier. If I was able to get the loans, I think I'd be in a lot more trouble than what I'm in now, kind of thing, but yes, it's helped. It's helped. ”**  
(Ali, Birmingham)

Alex was a single woman, working part time, living in social housing in Birmingham, educated to GCSE level, with two children. She used payday loans to purchase items for her children, a washing machine and make holiday payments. Alex turned to an alternative, affordable community finance lender as well as using her local credit union after being declined a payday loan. She explained how it became more difficult to access payday finance

over the last few years and that after going back to previously used payday lenders and being turned down, her local credit union and community finance provider offered her an alternative.

Our evidence indicates that people were making difficult choices and that greater awareness of how to access independent advice through agencies such as Citizens Advice and the current Money Advice Service is essential. Seeking debt advice in general was found to usually be a last resort such as when people are faced with a court appearance or eviction<sup>64</sup>. As people are unlikely to seek advice, they live with the worry of the debt, the effect of which is often underestimated<sup>65</sup>. One of the reasons why online access to payday borrowing is beneficial for borrowers is because it provides anonymity, privacy, and is quick and simple<sup>66</sup>.

Prior to the regulation of HCSTC, Richard in his 30s, single, working full-time, owns his house with a mortgage in South Yorkshire and has two children, accessed loans to pay back other payday loans. When he was declined, he sought independent debt advice and entered into a debt management plan:

**“ When I started getting turned down it was sort of a bit of wake-up call that obviously things were getting bad because I was getting turned down for loans that I would have got quite easily... ”**  
(Richard, South Yorkshire)

The impact of the HCSTC regulation for many in our research was an opportunity for behaviour change such as making small budget changes, saving, seeking more ethical, affordable credit alternatives or seeking independent advice. Whilst it appears being declined a loan may have acted as a behavioural intervention in the short-term, the limitations of our research cannot provide us with evidence that this behaviour change has had a longer-term impact. Further research on credit use would be valuable.



## 4. Conclusion

Our research shows that the HCSTC regulation has helped protect payday borrowers from significant financial harm. This research has provided a greater understanding of the lived experience of being a declined applicant of payday loans and is intended to provide policymakers, financial service providers, and client-facing charities with further evidence to enable them to reflect on what more they can do to support people who find themselves in either regular or one-off instances of financial hardship.

The strongest theme developed in this research is the demand from declined payday loan applicants for a form of credit to help smooth over incomes during financially lumpy periods, or when experiencing short term financial difficulties. Our key research finding is that the most likely behaviour someone who is a declined payday loan will demonstrate is to seek another borrowing option. This most commonly involved borrowing from friends and family (putting them among 3.6million people in the UK that do this). Our research interrogated this relationship further and found that this type of borrowing can sometimes have its own hidden costs.

In contrast, we found that interviewees had very limited knowledge of alternative credit providers be they low-cost options, or the growing number of mid-cost borrowing options (such as Credit Unions and Community Development Finance Institutions (CDFIs)). Work is needed in this space, to market and promote these services to ensure they are widely available – and better known – to many more people. This aligns with previous work, which has identified the need for alternative credit provision where individuals are captive to the payday loans market<sup>67</sup>. We recommend the development of more affordable borrowing options for those for whom borrowing is manageable. Because the demand for credit is still significant for those that are declined a payday loan it would be preferable to see an increased supply of alternatives to HCSTC as well as ways to help households reduce credit usage, including for example better signposted advance payments for those in receipt of benefits, or easier access to advance payments from employers.

As we demonstrate, credit isn't always the solution to all the borrower's problems, but more affordable credit options would provide a lifeline for many people today who feel their only option is to use very expensive credit products. This research demonstrates a need for alternative credit products to meet demand.

One way to achieve growth in affordable credit would be through a coalition of organisations working in the social finance sector, the FinTech space and among mainstream commercial providers to jointly develop a roadmap for the creation of a suite of sustainable and affordable credit products in the UK. Potentially, this coalition could be coordinated by a single non-lending civil society organisation, so that the current uneven geographies of provision are overcome<sup>68</sup>, creating new products where needed or signposting to existing services.

At the same time, we see an increasing likelihood of people unable to access any form of credit with interest and therefore some exploration of the potential for a No-Interest Loan Scheme (NILS), such as in operation in Australia<sup>69</sup>, may be required to support the poorest households – while recognising that such a scheme requires significant public subsidy and access to private capital.

While demand for credit remains significant, we know that borrowing is not, and should not be, the only option available to people. Many borrowers we spoke to had reduced their spending and found alternative ways to budget. Our research found that being refused a loan from a payday lender was a catalyst for other non-borrowing strategies for some people, which included closer budgeting or going without credit altogether. However, we know this isn't the end of the problem for the individual. An individual's credit usage has to be viewed in the context of other financial pressures, such as exposure to the poverty premium<sup>70</sup>. It's clear that affordability rules are there to ensure there is a system to recognise where more debt might exacerbate a precarious financial situation. This is regulation working for the good of borrowers and responsible lenders.

The findings of this research do not present any evidence to support a relaxation of either the rules regarding affordability for payday lenders; or the payday loan price cap. From our primary research and insight into the wider data on payday loan usage in the UK it is clear that regulation has had a major impact. It has restricted supply of high-cost credit for certain households. Comparing the incidence of consumer harm triggered by payday loan use before and after the cap, we can see that positive change has been made to that market and the consumers within it. This could be a useful starting point for the regulator to scope the impact and consider raising a cap on other forms of high-cost credit such as in the Rent to Own market in order to lower prices to consumers for products.

This research found that the biggest commercial names in payday lending tended to conform closely to regulations. We say this with caution

as this research interviewed only a small sample of people with lived experience of declined applications and the lenders they borrow from. Tools are available for the FCA to test this finding further, such as mystery shopping exercises.

The FCA has previously addressed the issue of illegal moneylending. They have said that there is no evidence to suggest that the cap on the cost of a payday loan would increase levels of borrowing among informal creditors undertaking criminal activity<sup>71</sup>. This research has given us no reason to contradict this. However, the research did identify other concerns. Borrowing from friends and family is finite, and going without is also, in many cases, a temporary solution. There are alarming statistics around non-priority debt which all indicate that people still need access to small sums to make ends meet.



## 5. Recommendations

### 1 People need access to more and better credit products:

The alternatives – of borrowing from family and friends, going without essentials or seeking illegal lending – are often worse for some of the people we spoke to. There needs to be greater investment in developing sustainable mid-cost, credit products.

### 2 Increased regulatory activity to tackle a two-tier payday loans industry:

Our research shows evidence of an industry split, with some lenders heeding to new stricter rules by the FCA on assessing affordability, whilst others appear not to do so. This suggests that some lenders are interpreting rules on affordability differently and haven't yet achieved harmonisation in their approach to affordability. Some appear not to have taken sufficient steps to improve their affordability checks and are providing loans to people who may not meet the criteria set by the FCA. We call on the FCA to tighten monitoring of regulated firms with regards to their affordability assessment process. We suggest increasing the use of mystery shopper exercises, including in how online lenders check creditworthiness using automation tools.

### 3 Organisational innovation for people to avoid unaffordable credit:

We call for a wide range of organisations, including housing associations, local authorities, social and private landlords, employers, other creditors like utilities companies, to recognise the different roles they can play in preventing individuals with short term cash flow issues from falling into hardship and seeking credit, when this is not appropriate. We ask these organisations to impact assess their internal processes to ensure they are not causing financial harm to their customers, clients, or other beneficiaries of their services. We believe having some duty of care towards individuals' financial health and potential exposure to the poverty premium should exist beyond credit providers.

### 4 Government, regulators, and third sector organisations to scope the feasibility of a UK No Interest Loans Scheme (NILS):\*

This research showed that some declined payday applicants of payday loans cannot repay a traditional credit product for their immediate financial issues and that any form of interest-bearing credit is too expensive. This is particularly the case for those potential borrowers not in work and for whom a formal credit product would not be appropriate, or who have longer term issues arising from benefit delay or income reduction during the transition from legacy benefit to Universal Credit (we saw evidence of this during the course of this project).

Not all declined payday applicants had access to, or wanted to, borrow from friends and family. For this group of people, we believe there is a need for more innovation around how to extend finance in a productive way. We recommend different organisations including the FCA, the Treasury, and client-facing organisations such as debt advice charities, coalesce to carry out a feasibility study on the provision of NILS similar to those running in other jurisdictions, to identify its potential to support those most in need. Australia, for example has a NILS run by Good Shepherd Microfinance supported by Australian Government and the National Bank of Australia.

Such a scheme would sit alongside the scale-up of affordable credit alternatives. We recommend that additional government departments, including the Department for Work and Pensions, work closely together to determine who would be eligible for a no interest loan and who would qualify for a non-credit, welfare-based solution such as a grant or scheme similar to the former social fund. We recognise that this approach would need to be a targeted on a relatively small group of people who are most in need and would require substantial public funding.

\* Since the report was drafted and edited the UK Government made an announcement in the Budget statement of 29th October 2018 on NILS stating "No-interest loans scheme pilot – For some people, even borrowing from social and community lenders can be unaffordable. Therefore, the government, working with leading debt charities and the banking industry, will launch a feasibility study to help to design a pilot for a no-interest loans scheme early next year"

## 5 The development of guidance on informal lending:

Another major theme of this research is that there is an unseen price to pay for informal borrowing from friends and family, which has not been explored in previous research looking at the impact of payday loan reform. We endorse the creation of a set of guiding principles on what informal lending ‘good practice’ looks like, as these tools will help some people to manage their money when lending informally to family and friends.

## 6 Payday lenders contributing to the financial capability of their customers:

One finding from our research is that an individual can simultaneously be a declined applicant of a payday loan and an existing or prospective payday loan borrower. The ways in which payday lenders can improve the financial health of borrowers is therefore also relevant to declined borrowers. Payday lenders also have an opportunity to help borrowers rebuild their credit scores and provide roadmaps to improve financial standing for the future by helping them move into less expensive credit where appropriate. The payday loans industry should be starting to demonstrate how it is innovating internally to help customers enhance their financial health and keep pace with other financial service providers looking to do the same.

## 7 Guidelines for debt advice charities on specific courses of action for declined payday applicants:

The Money Advice Service should, in consultation with advice providers, design a specific set of guidelines on how advice professionals advise declined payday applicants, premised by findings from this research showing their additional needs. This would set out, for all advice professionals in the regulated advice sector, a framework describing potential additional needs and signposts to address these such as other forms of credit, benefit advance information, or guidance for borrowing from friends and family. Because declined payday applicants are likely to be in a more vulnerable financial situation debt advice charities should establish a clear set of guidelines on how to deal effectively with this group.



# Appendix 1: Glossary of terms

**CPA:** A continuous payment authority, which may also be called a 'recurring payment', is where a business has permission to take a series of payments from a customer's debit or credit card. High-cost short-term lenders are now limited to two unsuccessful attempts to use a CPA to take a repayment and cannot use a CPA to take a part-payment.

**Declined applicant:** a declined applicant in the context of this research refers to someone that had previously accessed a payday loan and has subsequently been declined credit from a payday lending business.

**Financial capability:** using the definition provided in the Money Advice Service's Financial Capability Strategy, financial capability is the measure of how well people are able to manage money well, both day to day and through significant life events, and their ability to handle periods of financial difficulty. It is also the measure of people's financial skills and knowledge, attitudes and motivation.

**Financial confidence:** financial confidence is a measure of someone's ability to use their financial capability, skills, and knowledge. Financial confidence can sometimes imply the ability to put those skills into practice, or it can describe the personal ability to withstand and navigate a complex financial system, for example someone might be described as having high financial capability (e.g. closely monitoring spending and observing a rigid budget) but for various reasons have low financial confidence (e.g. a number of disruptive financial shocks have occurred all at the same time which has a negative effect on that individual's ability to make appropriate financial decisions). While a person might have high capability the environment in which that person makes financial decisions might render capability temporarily inoperative.

**High-cost credit:** a high-cost credit product, typically a payday loan, a rent-to-own contract, home-collected credit, catalogue credit, or an overdraft. According to the FCA it refers to a regulated credit agreement where the APR is equal to or exceeds 100 percent.

**High-Cost, Short-Term Credit:** Payday loans are often referred to as high-cost, short-term credit (HCSTC) as they are high-cost and repaid over a short term (typically less than one month). See payday loan definition below.

**Mid-cost credit:** is a relatively lower price (though not always low price) credit option than high-cost credit (see above). Suppliers of this credit are often CDFIs and credit unions. The feeling by the regulator, the FCA, in their 2018 report reviewing high-cost credit regulation is that mid-cost credit will not replace high-cost credit but give borrowers with previously very few options more choice around the credit products they use.

**Payday loan:** a payday loan is a small, short-term loan not secured against an asset or protected by a guarantor. They are typically loans live for less than one month. More recently lenders in this market have created longer term loan products that fall under the regulator's cap for payday loans.

**Risk warnings:** As of July 1<sup>st</sup> 2014, firms offering high-cost short-term credit must now include a prominent risk warning on all financial promotions. These lenders had to include a risk warning on all financial promotions in electronic communications since 1 April 2014 (unless the medium used makes this impracticable). The risk warning is now also required on print, TV and radio promotions.

**Rollovers:** Where a borrower cannot afford to pay back a loan many lenders offer the opportunity to 'rollover' or extend the loan. Where a high-cost short-term loan has been rolled over twice, including before 1 July 2014, lenders will not be able to rollover the loan again.

**Sub-prime and near-prime borrowers:** Sub-prime borrowers are excluded from mainstream sources of credit due to poor or thin credit histories. These borrowers are often have a low or precarious incomes which means that their borrowing is restricted to high-cost and non-standard forms of credit. Near-prime borrowers tend to have minor entries on their credit files, for example address inconsistencies or a low number of small missed payments.

## Appendix 2: Methodology

The aim of the project was to investigate the impact of the regulation of High-Cost, Short-Term Credit (HCSTC) since January 2015 on lenders and borrowers, and how this is reshaping credit markets for borrowers. We initially carried out a review of the media, academic and policy literature in the time after the cap on the cost of credit was introduced, and a market analysis to see the degree to which there had been innovation in the high-cost credit market in response to the regulatory changes.

### Consumer interviews

Between July 2017 and February 2018, we completed 80 in-depth, semi-structured qualitative interviews of HCSTC consumers to capture an insight into the lived experience of the online and high street payday loan borrower that had been declined after the regulation. The interviews explored perceptions of financial wellbeing after taking out a payday loan, ability to gain access to a payday loan after the price cap, and what stricter guidelines for responsible lending have meant for consumers.

These interviews took place in two phases. The first phase took place in England, with 40 interviews largely spread between London and Birmingham, West Midlands. The second took place in Scotland, primarily in Glasgow. We avoided snowballing (a sampling technique where existing study participants, in this case interviewees, take on a role of recruiting other participants from among their close acquaintances, friends, and family) to be representative, and our participants were largely within the majority group that national statistical data point to (namely, low income, etc).

In the first phase, participants were recruited through our project steering group. Project information was included in email newsletters and sent via the Financial Health Exchange (a network of over 400 organisations including financial inclusion service delivery organisations and practitioners). We also shared information with Stepchange (the debt advice charity), and

Street UK (an alternative lender). Interviewees were also sought from highlighting the project through social media channels and inviting responses<sup>72</sup>. The second phase of the qualitative research was conducted in Glasgow, Scotland. As this part of the research needed to be conducted within a short-time frame, we appointed an external marketing company to recruit participants using a screening questionnaire to identify participants. The recruiters ensured that we had a mix of participants (in terms of age and gender) and also arranged for the interviews to take place in local community venues with good transport links.

The majority of interviews (63 out of 80) were undertaken face-to-face in the first phase, with the remaining interviews undertaken via telephone. We found this to work just as well as face-to-face interviews and in fact for some participant's communication via telephone may have facilitated a more open, honest and in-depth discussion due to the greater level of anonymity and confidentiality than an interview undertaken in a public place.

The procedure for all the interviews was as follows; first, each participant was provided with an information sheet detailing the project, how their data would be used, and their rights to confidentiality, anonymity and withdraw their data (within a specified timeframe); following this a consent form was provided to be signed and an incentive of £30 for the participant's time was given for taking part. The participants were verbally reminded of the project details and were asked permission to audio record the interviews. We transcribed the interviews in full and the transcripts produced 490 pages of data.

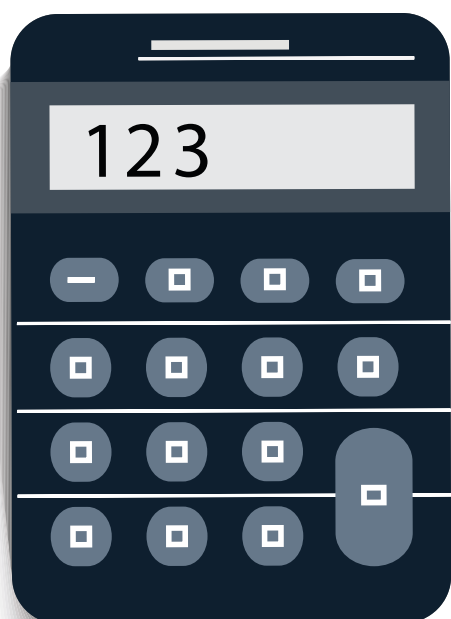
We undertook a thematic analysis of the interview material using NVivo. This primarily utilised the interview schedule as a coding frame with further themes and sub themes identified through further analysis stages and case study development. All participants were given pseudonyms to protect their identity.

## Ethical considerations

On ethical review at Coventry University the qualitative research was considered medium to high-risk on account of the potentially sensitive subject matter (in this case, financial difficulties e.g. over-indebtedness) and in addition, the possibility of interviews being undertaken outside of office hours.

Our aim was to mitigate any institutional concerns around 'doing research' and risks of the research to both participants and our experienced research team. Part of the solution was to undertake the interviews in pairs in public spaces such as cafes or community spaces during the week. This allowed second interviewers (a Postgraduate Researcher paid the living wage) to shadow more experienced researchers by taking notes and record relevant contextual information that cannot be recorded by

audio recorders, such as the interview setting and the participants facial expressions or reactions. We found the experience of having two researchers was extremely valuable. First, having mixed gender interview pairs helped to alleviate concerns participants may have had in meeting a stranger and undertaking an interview. For example, female participants may have not felt comfortable meeting with a male interviewer for various reasons, including cultural or religious grounds. Second, using a two-interviewer method can help to improve the richness and depth of the data, as it can aid the interviewers' ability to ask probing questions, with there being two experienced qualitative researchers. For example, the second interviewer can help put the participant at ease through introductory conversation whilst the interview is being set up and assist in clarifying aspects of the research or questions, helping to reduce miscommunications.



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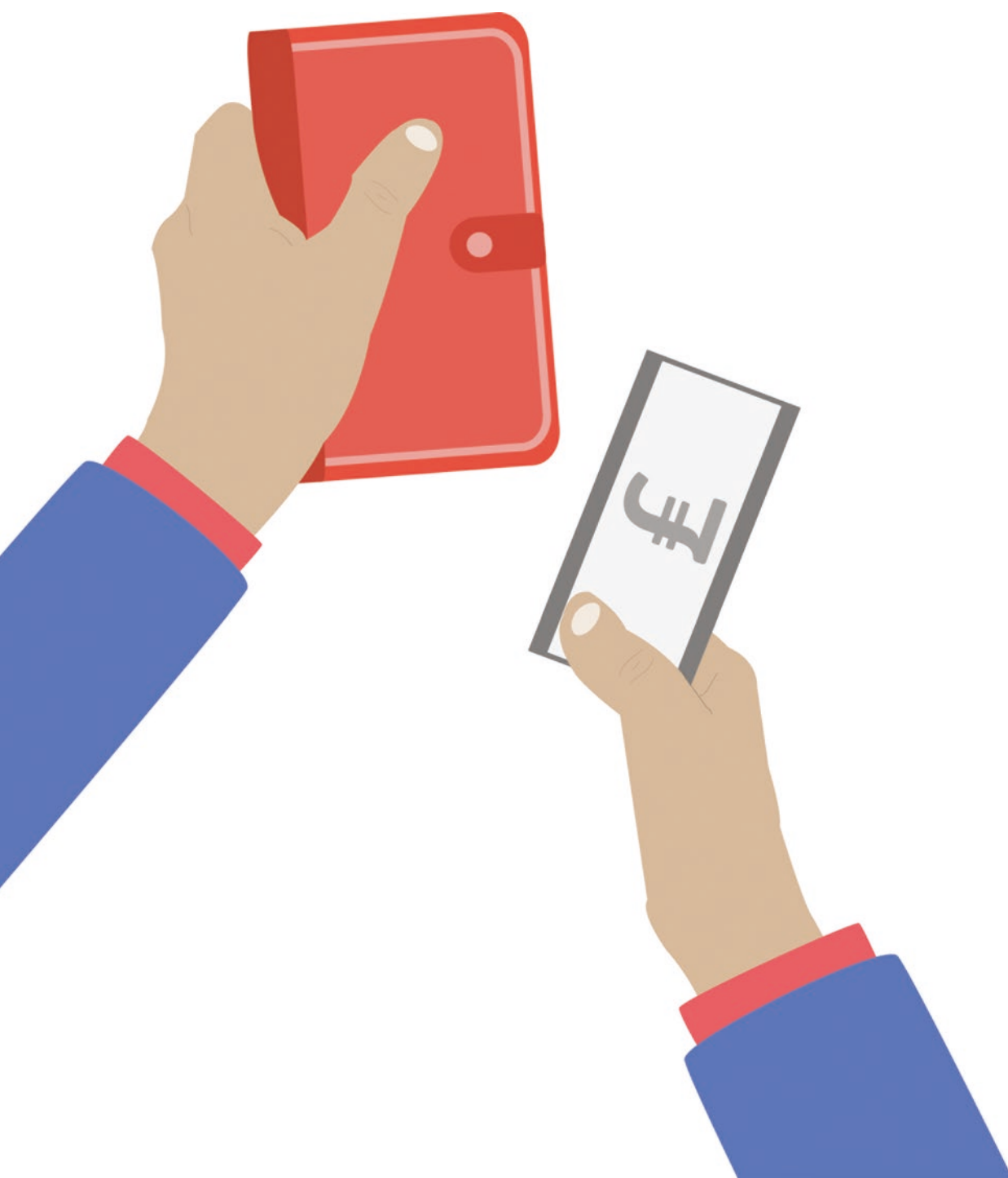
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