

ISLE OF MAN OFFICE OF FAIR TRADING



Isle of Man Office of Fair Trading

REVIEW OF PAYDAY LENDING AS IT AFFECTS ISLE OF MAN CONSUMERS



Isle of Man
Government

Reiltys Ellan Vannin

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FOREWORD BY THE CHAIRMAN



Over recent months the subject of Payday Loans has enjoyed a high profile in the British media, with both an initial report by the United Kingdom ('UK') Office of Fair Trading and then a reference of the whole UK payday lending industry to the Competition Commission. In that context the Isle of Man Office of Fair Trading ('OFT') has undertaken a general review of the way in which payday lending affects local consumers.

As the registration authority under the Moneylenders Act 1991, the OFT registers the small number of local companies who provide payday loans in the Island. In its consumer protection role the OFT has a duty to look after the interests of Island residents who choose to access payday loans from the UK through online or call centre channels.

Amidst all the publicity there is a widely held view that payday lending is a bad thing and that authorities should protect vulnerable consumers by curtailing the industry or capping "exorbitant" interest rates. Whilst some of the growth in payday lending is down to clever marketing the reality is that any successful industry has to be providing a product for which there is real demand. It is all too easy for more advantaged members of society to decry the need for short term finance. All short term finance is expensive and payday lending, which is targeted at consumers who are denied access to other more mainstream forms of credit, is certainly no exception. The OFT does advise consumers about the benefits of better budget planning so that they do not need short term credit but we have to accept that people sometimes do need it. Our role is to ensure that those accessing this form of credit do so on the basis of fair and equitable terms which are properly explained to them upfront and to ensure that lenders lend responsibly ensuring that customers can afford repayments.

In that regard it is pleasing to report that the local lenders who are providing payday loans on the Island are generally doing so responsibly. Certainly we did not find any evidence that payday moneylenders are guilty of the sort of bad practice highlighted by the UK authorities in their payday loan industry.

Clearly Isle of Man consumers who choose to access payday loans from the UK are presently being exposed to the same bad practice as their UK counterparts; this is most unsatisfactory. The current reference to the UK Competition Commission is intended to resolve those problems and hopefully it will do so. The OFT has considered whether it would be in the best interests of IOM consumers to prevent UK payday lenders from operating into our market but we believe that provided the UK Government can resolve the current difficulties, the advantages around additional choice and real competition for business should outweigh any disadvantages. We have therefore deferred any decision on the need for enhanced legislation until we see the outcome of the UK review.

**David Quirk MHK
Chairman**

1. INTRODUCTION

Whilst the term "Payday Loan" has a number of differing connotations at a professional level the OFT defines it as:-

the provision of small sum unsecured cash loans on a short term basis, typically repayable on the consumer's next payday or at the end of the month, but specifically excluding home credit (where repayments are collected in the consumer's home).

Some payday lending providers also engage in wider activities such as pawnbroking, medium-term loans, cheque cashing, gold buying, foreign currency exchange, international money transfers or buying and selling of second-hand goods.

In March 2013 the UK Office of Fair Trading published a damning report '*Payday Lending: Consultation on a market investigation reference*¹' into the payday loan industry in the UK. It concluded that it had found fundamental problems with the way the payday market works and widespread breaches of the law and regulations, causing misery and hardship for many borrowers. The report highlighted major systemic problems which are discussed in more detail in section 4.

In the Isle of Man the OFT has a number of perspectives on the payday loan industry:-

- (a) As the registration authority under the Moneylenders Act 1991² under which any payday lender operating in the Island must be registered;
- (b) As operators of the Island's Consumer Advice Centre;
- (c) As the operators of the Island's Debt Counselling Service;
- (d) As operators of the Financial Services Ombudsman Scheme.

Whilst these offer the OFT a significant insight into the payday lending market as it affects IOM consumers, once the Board had considered the UK report it was agreed that it would be beneficial to undertake further research in order to ascertain the impact of payday lending on IOM consumers and to enable consideration of the need for enhanced regulation of the market.

The UK Report and the consequent media attention in the national media served to raise the political awareness of the issue of payday lending and at the April sitting of Tynwald a Question was addressed to the Chief Minister on the subject. The Chief Minister advised the Court that "*we are aware of the publicity on this subject currently being generated in the UK and are working with the OFT to assess the extent to which there is a similar*

¹ Payday Lending :Consultation on a market investigation reference March 2013 http://www.of.gov.uk/shared_of/Credit/oft1482.pdf

² http://www.legislation.gov.im/cms/images/LEGISLATION/PRINCIPAL/1991/1991-0006/MoneylendersAct1991_1.pdf

problem on the Island, and if so, the nature and scale of that problem. In that context, Council will make an evidence-based policy decision as to whether legislative change is required, and if so, the nature of such legislative change." The full text of his response can be viewed in Hansard.³

In April 2013 the OFT sought to enhance its insight into the payday loans market as it affected IOM consumers by asking local consumers to share their experiences on a confidential basis.

2. MARKET OVERVIEW

IOM consumers can access payday loans in two ways. Firstly they can borrow locally from local lenders who are registered with the Isle of Man OFT as moneylenders. Secondly, and the OFT believes this is the more common route, they can access payday loans through online and call centre channels from lenders in other jurisdictions. Typically these are UK based because these are the services which are heavily (and based on the UKOFT Report, often misleadingly) marketed in the UK media.

In addition to the above lawful channels there is also the possibility that some IOM consumers are accessing loans from illegal moneylenders operating within the Island. The OFT is currently investigating an alleged illegal moneylender and this is likely to lead to a prosecution. It would be naive to believe that the OFT has apprehended the Island's only illegal moneylender but equally there is no evidence of illegal activity at a significant scale. It is an extremely difficult offence to identify and investigate because borrowers are wary of complaining.

3. REGISTERED MONEYLENDERS

Whilst at present there are 87 registered moneylenders on the Island not all moneylenders are in the payday loans market and many do not lend money in the Island. Registered moneylenders provide, as part of the registration process, a business plan so the Office understands both the types of lending undertaken and the markets. In terms of IOM registered moneylenders there are three established companies whose business model comprises or includes payday lending (as defined in section 1) into the Isle of Man market.

There are also IOM registered moneylenders whose business model comprises or includes payday lending into markets outside the Isle of Man, operating through online and call centre channels and depending upon legislation in the marketplace may also require a parallel "registration" (e.g. an IOM lender operating in the UK market would also require a UK Consumer Credit licence). They also need to comply with local laws in their marketplace.

³ <http://www.tynwald.org.im/business/hansard/20002020/t130416%20RHN.pdf>

This report is solely about payday loans to IOM consumers and does not cover those companies operating into external markets. Nor does it include companies lending into the IOM market with products which are not payday loans.

The OFT has looked carefully at the operation of the registered moneylenders operating payday lending into the home market and is, overall, satisfied that they continue to operate on the basis of responsible marketing and lending. The only area of weakness is the absence of formal complaints procedures providing automatic information about the ability to refer matters to the Financial Services Ombudsman Scheme. The way in which these firms conduct their businesses with face to face interviews forming the backbone of the application process, also leads the consumer to have a reasonable understanding of the terms of the loan. This evaluation presents a stark contrast to the UK Office of Fair Trading findings in relation to their payday lending sector which are summarised in section 4. It is worth noting however that some of the characteristics of responsible lending which the OFT would expect from those whom it registers would not necessarily be viewed as positives by some consumers. Clearly responsible lending requires the lender to be more intrusive about the finances of the applicant which in turn leads to longer decision times and more refusals.

From information provided by the industry it would appear that the total size of the local market of IOM registered moneylenders is of the order of £325,000 per annum involving around 2,000 loan transactions although there will be less individual customers as many will have had multiple loans.

4. UK PAYDAY LOANS

As previously indicated as well as accessing the local market an IOM consumer does also have access to most of the mainstream lenders in the UK market, although some lenders do impose geographic exclusions which include the Island. The Moneylenders Act 1991 (see footnote 2 on page 3) applies to all non-exempt moneylending which takes place in the Island but a UK company with a relevant UK Consumer Credit Licence issued by the UK Office of Fair Trading can sell to an IOM consumer provided that:-

- (a) It does not have a place of business in the Island;
- (b) The loan is not governed by Manx law;
- (c) It does not market itself to IOM consumers.

In the latter case advertising can be through media accessed from the Island, such as national press and television, but not via local media such as the local radio stations or newspapers.

In March 2013 the UK Office of Fair Trading published a report '*Payday Lending: Consultation on a market investigation reference*' (see footnote 1 on page 3) into the payday loan industry in the UK. In introducing the Report the UK Office of Fair Trading Chief Executive Clive Maxwell said "*We have found fundamental problems with the way the payday market works and widespread breaches of the law and regulations, causing misery and hardship for many borrowers. Payday lenders are earning up to half their revenue not*

from one-off loans, but from rolled over or re-financed deals where unexpected costs can rapidly mount up."

Key conclusions of the UK Report included:-

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

The situation in the UK has moved forward considerably since that Report and in June 2013 the UK launched a formal reference to the Competition Commission citing:-

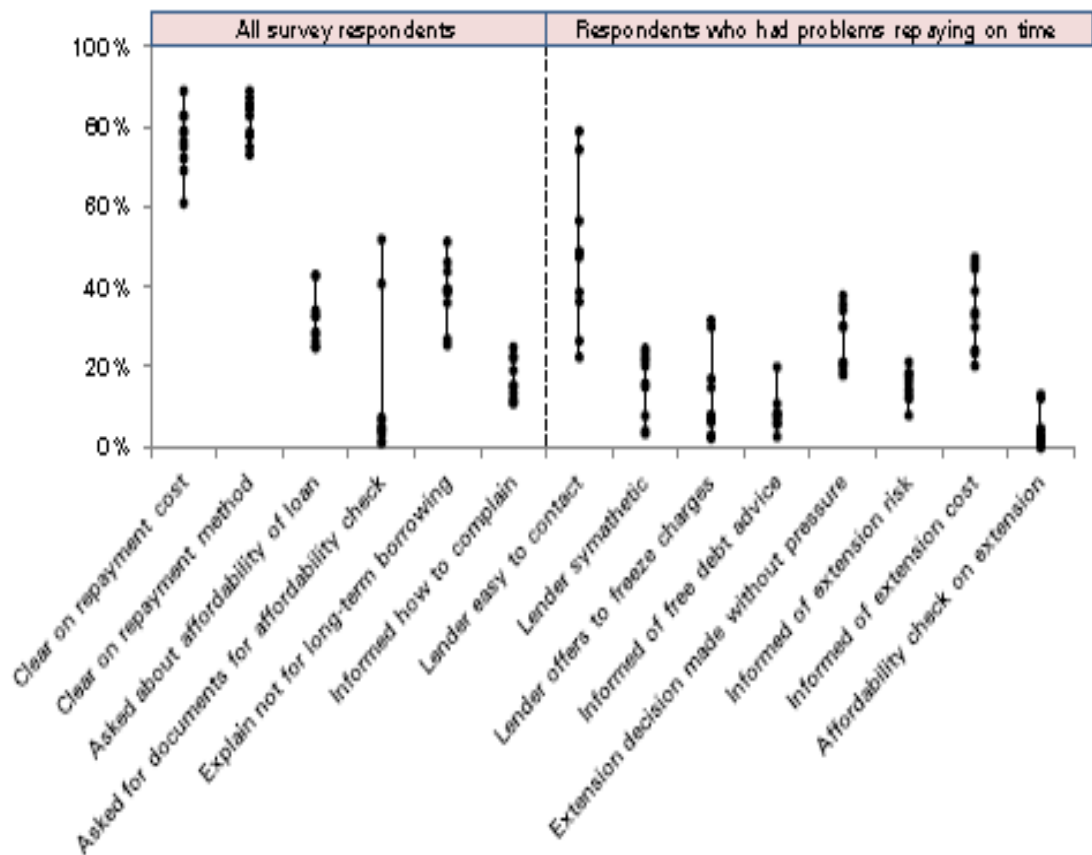
- Practices that make it difficult for consumers to identify or compare the full cost of payday loans, undermining competition over price for loans.
- Barriers to switching between lenders when loans are rolled over that prevent other lenders competing for this business.
- Variable levels of compliance with relevant laws and guidance leading to firms that do invest time and effort complying being at a competitive disadvantage to firms that do not.
- A significant proportion of borrowers have poor credit histories, limited access to other forms of credit and/or a pressing need to borrow. The cost of the loan may therefore be a less significant factor for borrowers, which may weaken competition on price between lenders.

The reference decision is set out in full in the document *Payday Lending – Final Decision on making a Market Investigation Reference*⁴.

⁴ http://www.ofc.gov.uk/shared_ofc/markets-work/payday-MIR.pdf

One of the most telling representations of the extent of non-compliance within the market is the following chart contained in the reference but itself derived from research in the UK by Citizens Advice.

Figure 1: Responses to Citizens Advice survey questions: average values by lender with 40 or more survey responses (higher percentage means more compliant)



Source: Citizens Advice survey data

Note: The individual markers represent a level of reported compliance for an individual lender and the vertical lines represent the range of reported compliance for the industry as a whole.

Given that the majority of the companies included in this research provide online and call centre payday loans to IOM consumers it necessarily follows that those consumers are being exposed to the self-same risks that have resulted in the UK Office of Fair Trading referring the market to the Competition Commission. The OFT has no way of gaining a real understanding of the number of IOM consumers who utilise payday loans from off-Island sources.

5. LOCAL MARKET INSIGHT – DEBT COUNSELLING

If there are major problems with payday loans in the Island one of the first places where those problems should become evident is the Debt Counselling Service operated by the OFT. Whilst not unsurprisingly payday loans do feature in the aggregated debts of those consumers seeking confidential debt advice to the casual observer the extent would perhaps be surprisingly low. In fact only just over 5% of clients of the Debt Counselling Service have a payday loan outstanding. It is interesting to compare this level with a debt counselling service in the UK where almost 19% of clients have payday loans.

The service does give at least an insight into the sources of payday lending on the Island with 88% of those loans being borrowed from lenders outside the Island. The sample is really too small to be statistically relevant but it does offer a broad indication.

It is also worth noting that where there are debts to UK lenders there is no evidence of the over-vigorous pursuit of those debts which was a feature of the UK research.

6. LOCAL MARKET INSIGHT - CONSUMER ADVICE

The second place that the OFT would expect to see evidence of any problem over payday lending is through its Consumer Advice Service. Even if consumers were not in a position where they needed to seek assistance in relation to debt management we would expect to see consumers seeking advice about issues such as contract terms, cancellation rights, debt collection – the sort of enquiries which are dealt with week in week out on a wide range of consumer transactions. Over the last three years the Consumer Advice Centre has dealt with over 8,700 enquiries but not one has related to payday lending.

Similarly if there are problems in the local payday lending market the OFT would expect to see disputes being referred to the Financial Services Ombudsman Scheme (FSOS). The FSOS would itself only be applicable to lending by an IOM company and if an IOM consumer had cause for complaint in respect of a loan contract by a UK lender under UK law that complaint would quite properly be a matter for the UK Ombudsman. In the 11 years since the IOM FSOS came into being it has not received any complaints about payday loans.

7. LOCAL MARKET INSIGHT – CONSUMER SURVEY

In an endeavour to enhance its understanding of payday loans as they affect IOM consumers the OFT launched a public survey. The purpose was to elicit from local consumers their first-hand experiences of having a payday loan whether from an IOM lender, from a UK lender via a website or call centre or even from an illegal loan shark. This was not a consultative exercise but rather an attempt to confidentially gather the experiences of those who had used the services to inform the review. The survey and the review did get considerable local publicity but despite this there was a low level of response

to the survey. Only 23 people actually started the survey and of these only 15 completed the majority of the questions. From a statistical perspective it would be difficult to regard the results of the survey as representative. The broad indications were, however, consistent with other parts of the review in that those who had dealt with local moneylenders appeared to have had a more rigorous examination of their applications and have been better informed about the loan than those who used UK lenders.

Whilst the OFT recognises the reluctance of people in debt to talk about their problems (or indeed even accept that there is a problem) it is still surprising that if there were indeed a significant problem in the Island in relation to payday lending there was such a low response. Furthermore given the extent of the publicity over a period of months more general consumer feedback might have been expected.

The political dimension of concern about the issue of payday lending had been raised by Mr P Karran MHK through his question at the April 2013 sitting of Tynwald. In the anticipation that Mr Karran's concerns had some local foundation the Chairman of the OFT met with Mr Karran. Whilst he did indicate that he was aware of a "number" of issues and agreed to encourage people to either complete the survey or contact the OFT he was unable to give any specifics on the concerns other than "exorbitant interest rates" and "targeting the vulnerable".

8. MARKET INSIGHT – NON-USERS

Having actively sought to identify concerns from actual consumers of payday lending products, and having failed to identify any significant issues, the OFT can only conclude that the "problems" around payday lending in the Island are largely perception rather than reality.

Nonetheless there remains a groundswell of opinion that payday lending is a bad thing and that lenders are ripping-off the most vulnerable in society. Much of that concern seems to rest in the high levels of APR (Annual Percentage Rate) being quoted by payday lenders.

Consumers who access payday lending products are often people for whom other lines of credit are, for whatever reason, restricted. Certainly that has been shown to be the case in the UK market and whilst the OFT does not have empirical evidence to support that conclusion in the Island it does seem to be common sense. In its role of Consumer Adviser the OFT would always encourage consumers to plan their finances and avoid short-term borrowing. All forms of short-term borrowing tend to be expensive and payday loans are certainly no exception. Nonetheless there are consumers who find themselves in need of short-term credit, and whatever its reputation, the payday loan industry has grown to meet a demand.

9. CONSUMER PROTECTION

In concluding its review of payday lending as it affects IOM consumers it is necessary for the OFT to consider whether there is a need to enhance consumer protection in the area.

In overall terms whilst recognising the broader community concerns about payday lending the OFT feels that there is a limited market demand for those type of products and that it would not be in the interests of those consumers to close down the market. In reaching that conclusion the OFT is mindful that the practical alternative to regulated short-term credit may well be a return to the days of unregulated and illegal moneylenders.

In terms of payday lending into the IOM market by lenders registered under the Moneylenders Act 1991 there appears to be little evidence to suggest that the local lenders are acting irresponsibly and indeed it seems that local lenders are behaving much better than their UK counterparts. Certainly there is evidence that local lenders are taking reasonable precautions to assure themselves of ability to repay and also that when things do go wrong they act responsibly in agreeing to sensible repayment schedules. This is a stark and pleasing contrast to their UK counterparts who are heavily criticised for using captive rollover as a primary means of profit generation.

The OFT believes it is vital that in all forms of lending the consumer is provided with a clear understanding of the transaction. In relation to short-term credit whilst notional APR is useful the key data is what the consumer has to repay and when, and what the consequences of failure are. Again this is an area where registered moneylenders are effective.

One area of weakness which this investigation has identified is the absence of clear complaints policies with linkages to the Financial Services Ombudsman Scheme operated by the OFT. This weakness will be addressed with the registered moneylenders but if necessary the OFT does have powers to impose conditions of registration.

In addition to the local market IOM consumers do also have access to most of the lenders operating in the UK market. Clearly the UK Office of Fair Trading has concluded that the UK market is not working in the best interests of consumers and it is to be hoped that the reference to the Competition Commission will result in changes which will benefit consumers, including IOM consumers.

The OFT has given consideration as to whether it should promote legislation which requires all companies which lend to IOM consumers to be registered under the Moneylenders Act 1991. This would in many ways parallel the UK approach – an IOM moneylender providing loans to UK citizens requires both registration in the Island under the 1991 Act and a parallel Consumer Credit Licence issued by the UK Office of Fair Trading. Whilst this, in theory, sounds an interesting concept, the OFT is concerned that in practice major UK operators would simply exclude Isle of Man residents from the market rather than pursue parallel registration to open up such a small market segment.

The OFT will await the outcome of the Competition Commission reference before considering whether it would be desirable to introduce primary legislation to force parallel registration. In principle, however, the OFT feels that it is in the interests of IOM consumers to continue to have access to the UK markets provided that such market is genuinely working in the interests of consumers.

Finally the OFT has been asked to consider whether it would be in the interests of consumers to introduce some form of cap on the rate of interest recoverable in the Manx Courts. At the outset it is pointed out that there is little evidence of the recovery of short-term consumer credit through the Court system. Attention is, however, drawn to the provisions of section 11 of the Moneylenders Act 1991 which provides:

"11 Reopening of transactions

- (1) In any proceedings arising out of a personal credit agreement or a related transaction, (including proceedings on an application for the exercise of the Court's powers under this section), the High Court may, if it finds any such transaction extortionate, reopen the agreement and any related transaction, or any one or more of those transactions, so as to do justice between the parties.*
- (2) A transaction is extortionate if under it any party (other than a party by whom money is lent or agreed to be lent) is or may be required to make payments which are exorbitant or unfair, having regard to —*
 - (a) the general level of interest rates and other charges at the time the transaction is entered into;*
 - (b) the age, experience, business capacity and state of health of that party;*
 - (c) his financial state at the time of the transaction;*
 - (d) the value of any goods or services which he or any other party receives under the transaction or any other transaction referred to in subsection (1);*
 - (e) the degree of risk undertaken by any other party to the transaction; and*
 - (f) any other matters appearing to the Court to be material.*
- (3) In reopening any agreement or transaction the Court may relieve a party from payment of any sum above that which is fairly due and reasonable, and for that purpose may —*

- (a) direct accounts to be taken between any persons;*
- (b) set aside the whole or any part of an obligation imposed on that party;*
- (c) require any other party to repay any money paid under the agreement or transaction to that party or any other person;*
- (d) direct the return of any property provided under the agreement or transaction; or*
- (e) alter the terms of the agreement or transaction”*

It will be seen that there are already significant powers, albeit rarely used, for Courts to deal with unfair transactions including extortionate interest rates. These apply not just to cash loans but to all forms of personal credit agreement. Section 11 does not, of course, apply to loans taken out with UK lenders which are governed under UK law and enforceable in UK Courts.

The OFT has concluded that there is no need to introduce further legislation in this regard.