

Payday in Australia

A research study of the use and impact of payday lending
in the domestic Australian market

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Executive summary

Profile of payday users

- Payday borrowers in Australia are primarily low to middle income workers. The same is true in other markets in which payday lenders operate.
 - A half of borrowers have households incomes of more than \$35,000 p.a. and a quarter have incomes of more than \$52,000
 - Payday borrowers are more likely than other credit users to be in full time work but also more likely to be single parents and to have a history of financial difficulty.
- A large majority of users have access to other sources of credit
 - Payday forms one component of credit repertoires with small sum short term credit used alongside higher value term loans and revolving credit
 - Payday borrowers also raise small sum cash advances on credit cards (by some margin the leading source of small sum credit for low income credit users overall)
- Three in ten borrowers have no alternative credit options and include both those seeking smaller sums than mainstream lenders' minimums and those with adverse credit history

Segmentation of payday users

Payday users appear to divide into four discrete segments:

- Payday Mainstream (45%). Large and conservative segment with modest levels of both non standard and mainstream credit use and little problem debt
- Mainstream Excluded (19%). Relatively disadvantaged low income segment with constrained access to the credit mainstream who actively avoid use of revolving credit
- Mainstream Strugglers (12%) Small highly pressured segment with serious adverse history using payday to prevent financial difficulties becoming financial break-down
- High income convenience users (25%). Relatively affluent group of heavy credit users using payday more frequently than other borrowers alongside mainstream credit

The dynamics of payday use

- The key attraction of payday borrowing is convenience and ready access to small sums that are difficult to obtain from banks
- Borrowers frequently have an active preference for short term loans that can be kept separate from other financial arrangements.
 - Short term pain preferred to open-ended commitment on revolving credit
 - Believed less likely to lead to escalating or unmanageable debt
- The popular perception of payday borrowing as primarily distress borrowing is overstated.
 - Three in ten loans are distress borrowing to make ends meet through cash shortfalls
 - 40% of loans are applied to household bills and repairs
 - 30% of borrowed funds are used to spread the cost of major purchases

- Payday borrowing plays a critical role in managing cash flow
 - Payday is four times more likely than other forms of credit to be used to forestall cash crises and twice as likely to be used for unexpected expenses
 - Payday borrowers are more likely than other credit users to be unable to cope through common financial pressures without borrowing. Few have savings.
- Taking out a payday loan is usually a considered decision precisely because of the high cost and is often the least bad of alternative choices
 - Payday funds are used to provide essentials when households run out of cash
 - The cost of payday loans can be significantly less than the penalty charges and reconnection fees the loan is taken out to avoid
 - Payday loans enable households to meet major commitments that would otherwise be missed and thus avoid damage to credit histories
 - Half of borrowers use payday to keep up with bills
 - A third use to avoid reconnection charges

The impact of payday on household finances

- The evidence does not support the view that payday borrowers tend to become trapped in a debt spiral of continually extended or renewed loans
- The large majority of payday loans appear to be being paid back within the contract term, with multiple extensions rare
 - Only 7% of borrowers usually re-schedule their loan. Less than one in five (17%) have ever not repaid their loan within the contract term
 - Two thirds of those who claim to have re-scheduled their loan, did so only once with the average number of extensions for those re-scheduling being 1.7 times
 - Few borrowers are thus exposed to additional costs other than that implied by the headline price of the loan. The largest lenders make no charge for rescheduling.
- Few borrowers appear to be continually or near continually in the market.
 - On average borrowers take out a little more than 4 loans per year and are in the market and paying back loans for an average of one third of the year
- Although repayments are undoubtedly hard to find they do not appear to compromise ability to fund essentials and the impact on household budgets appears short term
- Payday borrowers are no more likely to be in arrears on household bills than credit card revolvers or those taking out cash advances on credit cards
- Expenditure on debt service for payday borrowers is very similar to that for other credit users. As a proportion of household income expenditure on debt service for payday borrowers is identical to that for those taking cash advances on credit cards.
- Payday borrowers take the view that without payday they would be less likely to afford essentials or to keep up with commitments and more likely to get into financial trouble.
- The evidence supports this view in that payday users are less likely than those taking cash advances or revolving on credit cards to miss payments on credit agreements or to be exposed to penalty charges. They also pay down card balances more quickly.
- The cost of revolving credit under uneven payment conditions can be close to that of payday loans and can be higher given certain relatively common behavioural traits
- Payday borrowing is a small proportion of overall indebtedness for payday borrowers (15% of the total overall).

- Payday borrowers are significantly less indebted than other credit users, and markedly less so than those using revolving credit or taking cash advances on credit cards

The impact of restriction of payday supply

- The most likely impact of any restriction of payday supply will be to create credit exclusion for some, while diverting others to revolving credit or pawn
- An increase in use of revolving credit by former payday users, many of whom are already struggling with credit card debt, will likely result in greater indebtedness, extended payment terms on revolving credit and increased delinquency and default.
- This in turn will mean that the cost of credit will not necessarily reduce and may increase for some.
- Restriction of payday supply would impact the various segments differently. The impact would be most deeply felt and most negatively experienced by those segments who are excluded from mainstream credit or heavy but struggling users of mainstream credit.
 - Payday Mainstream will see a modest increase in mainstream credit use with similarly modest upswing in delinquency from low levels
 - Mainstream Excluded segment will suffer hardship in cash crises. More distress driven use of pawn likely to pose greater risk to pledged assets.
 - Without lubrication of payday funds financial difficulties may rapidly become financial break-down for Mainstream Strugglers.
 - For High Income Convenience Users the fine balance between coping and struggling is likely to be compromised, creating an increase in serious financial difficulty
- Increased default and financial breakdown will result in more individuals becoming excluded from the credit mainstream.
- In the absence of a high cost credit option for high risk borrowers, the evidence from other markets suggests any credit vacuum may in part be filled by unregulated lenders.
- A minority of payday users may experience a net financial gain from the restriction of payday supply. These are however not vulnerable low income borrowers but rather high income users with ready access to the credit mainstream and high levels of credit use

Policy implications

- The social policy case for price controls and restriction of the supply of payday lending does not appear compelling and there is a significant risk of unintended and detrimental effects attached to any such moves.
 - Consumers appear to be making a rational decision in choosing payday lending as an alternative to other forms of small sum cash credit cash, to keep up with commitments and avoid penalty fees and reconnection charges and to enable the acquisition of essentials in times of cash shortfall.
 - There is no strong evidence of a debt spiral or significant consumer detriment being associated with payday borrowing which appears to play a role in keeping finances on track. This does not mean that payday borrowing does not create a strain on household budgets, but rather that the stress arising is manageable and short term and is probably a more desirable outcome than the alternative - running out of cash, being unable to deal with an emergency or being unable to meet commitments.
 - It is not clear that diversion of small sum cash borrowing from payday to other credit vehicles such as pawn or revolving credit will result in a net social benefit or a financial gain for consumers. The evidence is rather that the reverse will be the case,
 - The sub-set of payday borrowers who may be better off in the absence of payday borrowing are not vulnerable low income payday users but higher income heavy credit users with mainstream credit options.

- Efforts to control the price of payday lending may not reduce the cost of credit to the consumer and may increase it in some cases, primarily for the most hard-pressed, while also significantly increasing the risk of exposure to serious financial difficulty.
- An increase in credit exclusion arising from a restriction of payday supply would be likely to result in hardship for the most disadvantaged.
- The most likely outcome is that restriction of the supply of high cost credit will stimulate an increase in default and financial breakdown both among the high risk borrowers diverted to revolving credit , as has occurred in the US where payday bans have been imposed, and among those denied credit, as has happened in Japan.
- There is a risk also of creating the conditions for black market lending.
- Regulatory activity might be more productively focused and consumer protection most effectively enhanced by seeking to mandate best practice standards and eliminate unfair lender practice, which appears to arise primarily among smaller lenders. This is the approach that has increasingly been taken in the US¹.
- Price reductions might be most effectively achieved not through price controls but through greater stimulus to competition and financial innovation. More private sector provision by payday operators has brought prices down in other markets. Banks and other mainstream providers might also be encouraged to innovate in this area, introducing products to compete directly with payday, as in the US, which should lead in turn to both greater consumer choice and reduced prices.

¹ At the time of writing there is legislation facilitating payday lending in 38 US states. For a detailed description of the regulatory geography in the USA and the broad dynamics and trends in the regulation of high cost credit see Ellison and Forster “The impact of interest rate controls”, Policis, 2008. which outlines the evidence from international markets.

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1.0 Introduction

This study² was undertaken against the background of public debate around how most effectively to modernise the regulatory framework for consumer credit and how best to enhance consumer protection in credit markets in Australia. Governments, at both national and state level, regulators and consumer protection groups are concerned particularly with the position and interests of those on low incomes, felt to be among the most vulnerable credit users.

Much of the debate has centred around the cost of credit for low income, high risk and excluded borrowers and the impact of high cost credit on the household finances, standard of living and quality of life of those borrowers who use “non standard” credit. Concerns arise around “fringe” lending in general and the activities of the “payday” lenders in particular. Although this sector of the market is small relative to the market overall, it attracts disproportionate scrutiny and comment, both because of the perceived vulnerability of the customer base and the high cost of this type of credit. The concern with this type of lending is that it is believed to create a dangerous spiral of debt, in turn damaging consumer finances and thereby creating significant consumer detriment. A series of other issues form the context to this debate, including public concerns around consumer debt and over-indebtedness, financial exclusion and poverty and social equality issues more generally.

Payday lenders in particular, and high cost credit more generally, has been the subject of considerable scrutiny by regulators and consumer protection groups in other advanced credit markets, most notably in the US³, where there is a large and rapidly growing payday lending market, and in the UK⁴, where the high cost home credit lenders have been the focus of extensive examination by consumer groups, regulatory bodies and the Competition Authorities.

To date comparatively little consumer research has been undertaken with payday users in the domestic Australian market⁵, with much of the data and analysis relating

² It is one of a series of three studies undertaken by Policis examining issues around credit market regulation and consumer protection in the domestic Australian market. The others are “The Dynamics of Low income Credit Use” which describes broad patterns of credit use among low income households in Australia and “The Impact of interest rate ceilings” which examines the impact of interest rate ceilings in credit markets in Europe, the USA and Japan and explores the likely impact of interest rate ceilings on credit markets in Australia.

³ In the US, the OCC stopped national banks from participating in arrangements with payday lenders in 2003, FDIC issued revised guidance in 2005 to banks engaged in payday lending to move repeat payday customers (over 6 loans in a 12 month period) to long-term credit products and the Talent Nelson amendment to the Defence Authorization Bill in 2006 capped interest rates at 36% for loans made to military personnel.

⁴ Policis for the Department of Trade and Industry, UK (2004) *The effect of interest rate controls in other countries*; National Consumer Council, Whyley and Brooker (2004) *Home Credit: An investigation into the UK home credit market*; NCC Super-complaint on home credit made to Office of Fair Trading on 14 June 2004; OFT issued its response to super-complaint on 10 September 2004 and referred issue to Competition Commission; Competition Commission (2006) *Home credit market investigation: Inquiry Final Report*; Collard and Kempson, Personal Finance Research Centre at Bristol University for the Joseph Rowntree Foundation (2005) *Affordable credit: The way forward*. Policis and NCC, Whyley and Ellison, *Affordable credit* (2005).

⁵ Dean Wilson Consumer Law Centre Victoria *Payday Lending in Victoria* 2002, MISC Australia commissioned by Consumer Affairs Victoria (2006) *Consumer Credit Report*; Howell, Centre for Credit and Consumer Law, Griffith University. By the same author, CCCL background Paper (2005) *High Cost Loans: A Case for Setting Maximum Rates. Managing the cost of consumer credit in Queensland*, Discussion Paper submitted to Office of Fair Trading, Queensland, 2006. Dean Wilson Consumer Law Centre Victoria *Payday Lending in Victoria* 2002. Rosanna Scutella and Genevieve Sheehan *To their credit: Evaluating an experiment with personal loans for people on low incomes*, Brotherhood of St Lawrence, 2006.

to the payday market sourced from abroad, primarily the US, where a significant body of work has been undertaken, both by consumer activists opposed to high cost credit per se on moral grounds⁶ and by evidence-based researchers and economists from the Federal Reserve Banks⁷, business schools and universities⁸. This study seeks to provide robust and authoritative data on the Australian payday market drawing on a significant body of consumer research with payday borrowers and with low income credit users more widely. Where comparative data is available for international markets, the study compares patterns of payday use arising in the domestic market with those revealed by research undertaken in other markets. It seeks also to highlight the broad conclusions drawn by researchers in other markets where similar issues have been examined.

The intention is to inform public debate around the issues and to support evidence-based policy making as policy makers, regulators and those concerned with consumer protection formulate a view on how most effectively to modernise the regulatory framework for consumer credit in Australia, protect vulnerable consumers and act to prevent and minimise the impact of problem debt.

⁶ Prominent among the anti usury activist groups are the Centre for Responsible Lending in the US, which positions itself as “a resource centre for opponents of predatory lending” and Debt on Our Doorstep in the UK, an organisation whose central agenda is the introduction of a rate ceiling as part of a long standing campaign opposing the UK’s high cost home credit lenders. Activist groups in Europe are less high profile, although there is a strong anti-usury culture. The most long-standing voice has been Professor Udo Reifner’s IFF (Institut für Finanzdienstleistungen) at the University of Hamburg. The Coalition for Responsible Credit, was set up in 2006 by IFF and Debt On Our Doorstep of the UK, among others, as an umbrella group for European consumer activists concerned with financial exclusion and positions its mission specifically as offering “a voice to people at risk of predatory and extortionate lending”.

⁷ Morgan, New York Federal Reserve Staff Report no 273 (2007), *Defining and Detecting Predatory Lending*;

Morgan and Strain, New York Federal Reserve Staff Report no. 309 (2007) *Payday Holiday: How Households Fare after Payday Credit Bans*

Federal Reserve Bank of Chicago (accessed 20 February 2008) *Controlling Interest: Are Ceilings on Interest Rates a Good Idea?* http://www.chicagofed.org/consumer_information/controlling_interest.cfm.

⁸ Staten, George Washington University (2007) *The Impact of Credit Price and Term Regulations on Credit Supply*. Elliehausen, Credit Research Center Working Paper #69 (2006) *Consumers’ Use of High-Price Credit Products: Do They Know What They Are Doing?*; Durkin & Staten (2002) *The Impact of Public Policy on Consumer Credit*; Mann (2006) *Credit Cards, Consumer Credit and Bankruptcy*. *Payday Lenders: Heroes or Villains?* Adair Morse, Ross School of Business, University of Michigan, Dec 2007, *Payday Lending*, Michael A. Stegman, Journal of Economic Perspectives, Volume 21, Number 1, Winter 2007, Pages 169 - 190

2.0 Research aims and methodology

2.1 Aims

2.1.1 Project aims

- To arrive at an authoritative and robust picture of the use of payday loans in the domestic Australian market and the role that payday plays in users' finances.
- To understand the drivers and dynamics of payday loan use and where this sits within the broader context of credit use.
- To establish the impact of payday lending on users' quality of life and financial well-being; particularly to examine the evidence for consumer detriment arising from the use of payday loans and of any associated debt-spiral.
- To explore the policy issues and the implications for consumer protection and market regulation arising from the evidence.

2.1.2 Research objectives

The research set out to explore:

- The profile of users of payday loans and of different segments of the universe of payday users
- The dynamics of payday loan use:
 - Drivers of payday use
 - Applications of borrowed funds
 - Where payday sits in wider patterns of credit use and financial management
- The cost of payday advances:
 - The real cost of credit
 - The incidence of loan extensions
 - The cost of behavioural factors
 - Cost of payday relative to other credit types
- The impact of use of payday loans on consumers' finances, standard of living and quality of life:
 - Ability to afford essentials
 - Ability to service household bills
 - Ability to manage financial difficulties
 - Broader financial well-being
 - The impact of payday borrowing on indebtedness
 - The scale of debt, the risk of over-indebtedness and the potential for financial break-down
 - The evidence for a damaging debt-spiral

Where comparative data was available, the research sought to compare patterns of payday use in the domestic market with those that have been described in markets internationally and to set conclusions drawn from the Australian data in the context of those arrived at by evidence-based researchers elsewhere.

2.2 Research methodology

The study was based on extensive qualitative and quantitative consumer research undertaken in four phases:

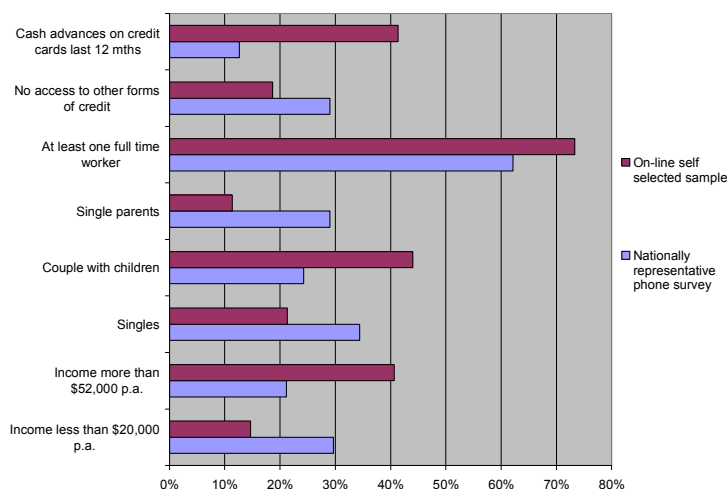
- Qualitative research with low income consumers based on four focus groups with low income credit users, users of payday lending and those with a background of credit related problems, undertaken primarily to inform the design and focus of the quantitative research.
- Quantitative research with a nationally representative 500 sample of low income consumers and a little over 400 low income credit users. This was undertaken by telephone in January 2008 in Adelaide, Brisbane, Melbourne, Perth and Sydney
- Quantitative research with a random nationally representative sample of a little fewer than 320 low income users of payday loans, drawn from the customer bases of the two largest national lenders together representing some 300,000 customers, being close to the estimated total number of payday users in Australia⁹, also undertaken by phone in January 2008 in the same cities.
- An on-line survey of some 150 (self-selected) Australian pay day users undertaken in January 2008 on a national basis.
- The research and data collection was undertaken by Synovate Australia.

There were significant differences in the profile of the two samples of payday users, the key data sources for this report. The nationally representative random sample of payday users was in line with the profile of payday users suggested by the wider nationally representative sample of low income credit users referred to above. It was also broadly consistent with transactional data on the age and income profile of the customer base of the lenders from which it was drawn.

The on-line sample, in which the sample was self-selected, was by comparison with the phone sample, younger and significantly better off (almost two thirds - 64% - had incomes of more than \$35,000 p.a. and 40% had incomes of more than \$52,000 p.a.). Household profiles also indicated a likelihood of greater stability and less pressure on household finances in that the on-line sample had a higher proportion of couples and two parent families and thus a higher incidence also of full time and two full-time incomes. Perhaps unsurprisingly therefore, the on-line sample had greater access to credit and were generally heavier credit users than the phone based sample. Payday use was less central to overall patterns of credit use and was less frequent than for the phone sample and in many cases (40% of the total), ran alongside use of cash advances on credit cards. Significantly, however, the on-line sample appeared also more troubled as credit users, being more likely to have both chronic problems with credit management and serious problems with debt.

⁹ Source: Synovate research with nationally representative sample of 500 low income Australians referred to above, undertaken for Policis January 2008 which indicated that 6.3% of low income Australians had used Payday loans in the last five years.

Chart 1. Differences in sample profile, nationally representative random sample in phone survey and self-selected on-line survey



Source: Synovate phone and on-line surveys of payday users for Policis 2008

These differences were so significant that the researchers took the view that the two samples could not be analysed in aggregate but rather required separate treatment and analysis. We have taken the nationally representative sample throughout as being representative of the total universe of payday users in the domestic market and have used this base for comparison with international data, where this exists. The on-line sample has rather been treated as a sub-set of the universe of payday users, and is analysed separately as such. A segmentation of the universe of payday users is provided, which has been applied across both databases (the questionnaires used in both cases are identical). The differences in the pattern of distribution of the segments indicates where the on-line sample is likely to sit within the wider picture of payday users overall (see segmentation methodology following and discussion of segmentation in section 6 in the main body of the report)

2.3 Segmentation of payday users

The segmentation of payday users was developed using the nationally representative phone sample of payday users using cluster analysis with a cluster solution developed to explain differences between segments across the following key dimensions:

- More or less affluent payday users (using household income as the criteria for greater or lesser affluence)
- Use (or non use) of other credit products
- Reasons for using payday
- Experience of credit and financial difficulties.

The defining characteristics of the resulting four segment cluster solution were then applied on a rule basis to the data arising from the on-line survey, which contained identical questions to the phone survey.

Readers of this study should note that any differences between data provided on payday users in this study and that in our companion study “The dynamics of low income credit use” will rest on differences in the sample base being used in the two studies. The companion study just referred to describes overall patterns of credit use among low income households in Australia and the broad dynamics of credit use across a wide range of commercial credit products and social and informal lending. Where it draws on data for payday users from the phone based survey with payday users referred to above, the base is then payday users with incomes of less than \$35,000 p.a. while the data provided in this study draws on data for the whole universe of payday users, regardless of income, and features additionally extended analysis of the sample of more troubled and more up-market credit and payday users arising from the on-line survey. This report features some analysis of the differences between more or less affluent users of payday loans but readers seeking analysis specifically focused around the low income sub-set of payday users and greater detail on where payday sits within patterns of use of other credit products by low income Australians are directed to our first companion report for supplementary material and additional data: Ellison and Forster, “The dynamics of low income credit use; a research study of low income households in Australia.” Policis, 2008”. Readers seeking more detailed comparisons with other markets in terms of patterns of credit use among low income households or more extended analysis of the likely impact of interest rate controls in Australia, drawing on the experience of interest rate ceilings in other markets, are directed to our second companion report Ellison and Forster “The impact of interest rate ceilings”, Policis, 2008.

3.0 Pay day borrowers

Profile of payday users

- Payday borrowers in Australia are primarily low to middle income workers. The same is true in other markets in which payday lenders operate.
 - A half of borrowers have household incomes of more than \$35,000 p.a. and a quarter have incomes of more than \$52,000
 - Payday borrowers are more likely than other credit users to be in full time work but also more likely to be single parents and to have a history of financial difficulty.
- A large majority of users have access to other sources of credit
 - Payday forms one component of credit repertoires with small sum short term credit used alongside higher value term loans and revolving credit
 - Payday borrowers also raise small sum cash advances on credit cards (by some margin the leading source of small sum credit for low income credit users overall)
- Three in ten borrowers have no alternative credit options and include both those seeking smaller sums than mainstream lenders' minimums and those with adverse credit history

3.1 The profile and characteristics of pay-day loans users

The public perception that payday users are primarily drawn from low income and vulnerable borrowers does not appear borne out by the evidence

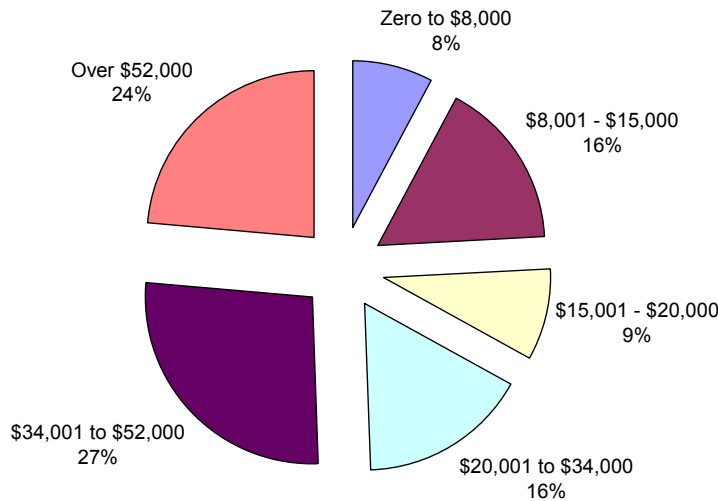
It is frequently assumed that users of payday loans are drawn from the lowest income and most disadvantaged households. In Australia, as in other markets where payday is an important source of small sum short term credit, the payday lending model rests on borrowers being able to demonstrate proof of regular income – typically by means of production of recent pay-slips - and the ability to repay electronically via a bank account. Payday users thus tend to be in work, being primarily blue collar and clerical workers.

A half of payday users have household incomes of more than \$35,000 p.a. and a quarter have household incomes of more than \$52,000 p.a.

The average income for payday borrowers would appear to be some \$40,800 p.a. There are clearly low income consumers within the payday loan user base, for whom payday loans represent a key source of credit. However, payday users do not appear to be primarily low income consumers. Only a third of payday users (33%) have household incomes of less than \$20,000 p.a., a little over half (51%) have household incomes of more than \$35,000 while almost a quarter (24%) have income of more than \$52,000 p.a, and 14% have incomes of more than \$65,000. Indeed payday loans users are circa one and a half times more likely to have an income of more than \$50,000 dollars than to have an income of less than \$15,000 (16%), three times more likely to have an income of more than \$50,000 dollars than to have an income of less than \$8,000 (8%) and as likely to have an income of more than \$80,000 p.a. (8%) as to have an income of less than \$8,000 p.a.

Payday loans users are not drawn primarily from the lowest income groups but are rather low to middle income workers

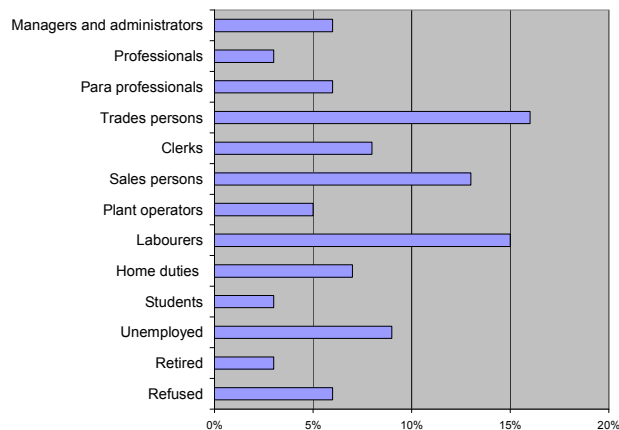
Chart 2. Household income profile of payday loans users



Base: Nationally representative sample of payday loans users
 Source: Synovate research for Policis 2008

Payday users are primarily tradespersons, sales-persons, clerical and manual workers

Chart 3. Occupational profile of payday loans users



Source: Synovate research 2007

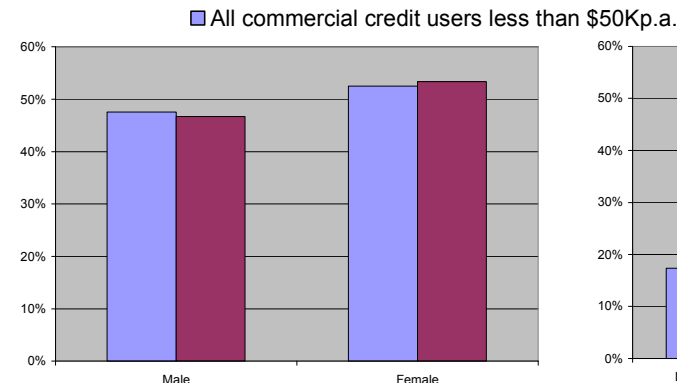
Demographics are broadly in line with those of all credit users but payday users are more likely both to be in full time work and to be single parents

The profile of payday users is broadly in line with that of all credit users. Compared to all credit users in households with income of less than \$50,000, there is a slight male bias but as with credit use more generally payday borrowers are concentrated in the 25 – 55 age range and in family households, where pressures on cash flows are greatest and peaks of expenditure highest. Compared to all credit users, payday users are however more likely to live in households with at least one full time worker (30% greater likelihood), though are less likely than other borrowers to benefit from there being two full time incomes coming into the household. This is in part because payday users are more likely than other borrowers to live in single parent households, with some three in ten being single parents (29%) compared to slightly less than one in five (18%) among all credit users with household incomes of less than \$50,000 .

The age and sex profile of payday uses is very similar to that of other credit uses in similar income ranges

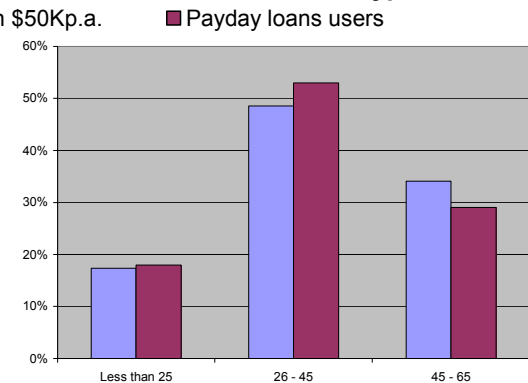
Although payday borrowers are more likely to be in work than other credit users in similar income ranges, they are also more likely to be single parents

Chart 4a. Sex profile of payday users relative to other credit users



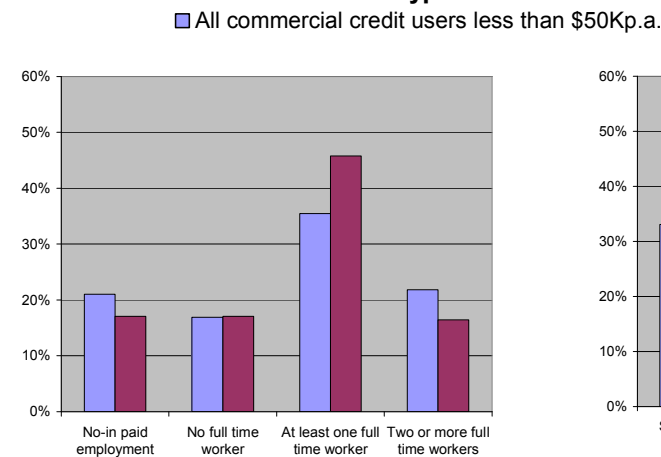
Source: Synovate Research for Policis 2008

Chart 4b. Age profile of payday users relative to other credit user types



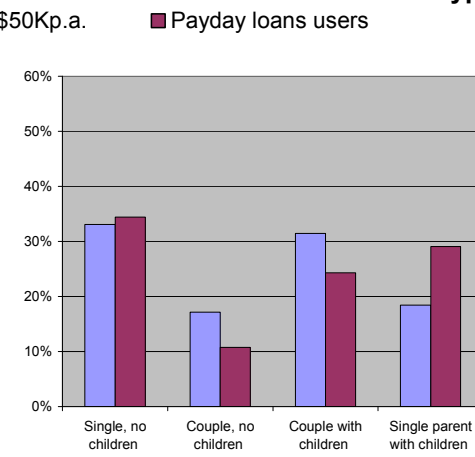
Source: Synovate research for Policis 2008

Chart 5a. Employment profile of payday loans users relative to other credit user types



Source: Synovate Research for Policis 2008

Chart 5b. Household profile of payday users relative to other credit user types



Source: Synovate research for Policis 2008

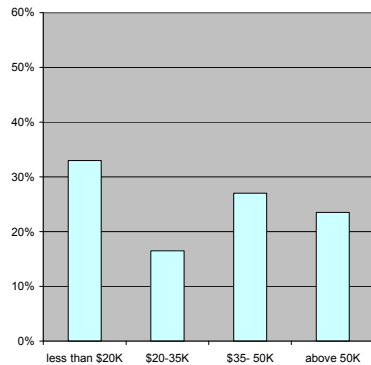
The same pattern holds true in other payday markets such as the US and UK where payday users are also primarily banked manual and clerical workers

A similar pattern pertains in other markets where payday lenders operate. In other international markets also users of payday loans are not the most disadvantaged households, being overwhelmingly in work and banked. As in Australia, payday users are typically manual and clerical workers. Only 7% of US payday users have income of less than US\$15,000 p.a., 17% fall into the US\$15- 30,000 range, 50% fall into the US\$ 25,000 – 50,000 range while a quarter have income of US\$ 50,000 or more.

Users of payday loans in all of the markets where these lenders operate are primarily low to middle income workers rather than the poorest credit users

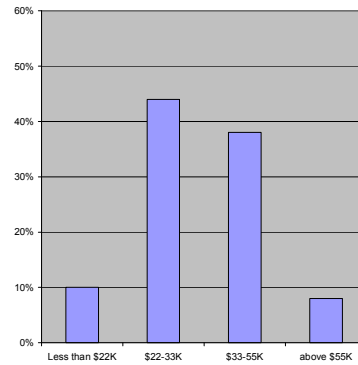
Chart 6: Profile of payday customers by income bracket in Australia, the UK and the US

% of payday customers in Australia



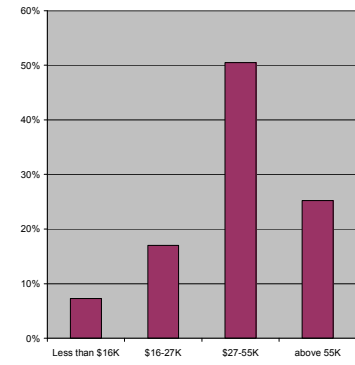
Source: Synovate research for Policis 2008

% of payday customers in the UK



Source: PFRC, University of Bristol¹⁰

% of payday customers in the US



Source: Credit Research Centre Georgetown University¹¹

3.2 Payday borrowing within wider patterns of credit use

A large majority of payday users have access to other sources of credit.

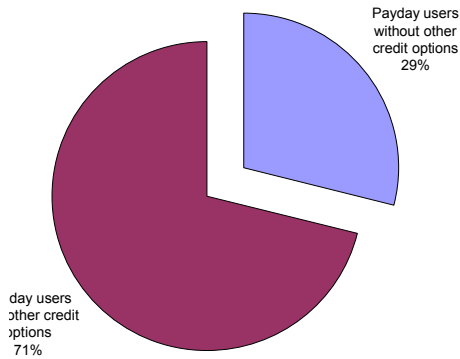
There tends also to be a perception that payday loans users have no mainstream credit options. This appears to be true of only a minority of pay day users, some 29% overall, implying that seven out of ten do have access to other forms of credit. Indeed exclusion from mainstream credit does not appear to be a primary driver of payday use. Payday users without mainstream credit options are only slightly more likely to have used payday lending in the last twelve months (67%) than those with access to mainstream credit (61%). Similarly, while those without credit options do take on more pay day loans (an average of 4.9 loans a year) than those who feel able to access mainstream credit (average 4.4 payday loans a year) the difference in frequency is relatively small.

¹⁰ Dominy and Kempson, "Payday Advances. The companies and their customers". Personal Finance Research Centre, University of Bristol (2003)

¹¹ "Consumers Use of High Cost Credit Products. Do they know what they are doing ?" Gregory Ellihhausen, Credit Research Centre, McDonough Business School, Georgetown University, (2006)

Only three in ten borrowers use payday because they cannot borrow elsewhere

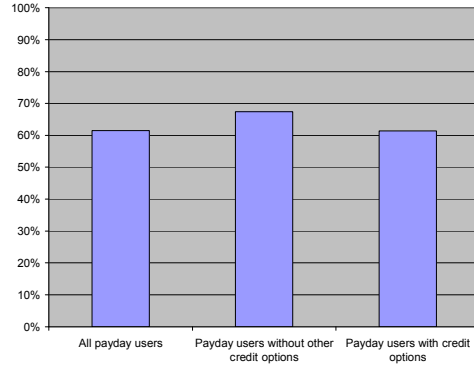
Chart 7a. Whether payday users feel able to access other commercial credit sources when took out most recent pay day loan



Source: Synovate Research for Policis 2008

Payday use is only marginally influenced by borrowers having other credit options

Chart 7b. Use of payday loans in the last twelve months by whether have access to other credit options



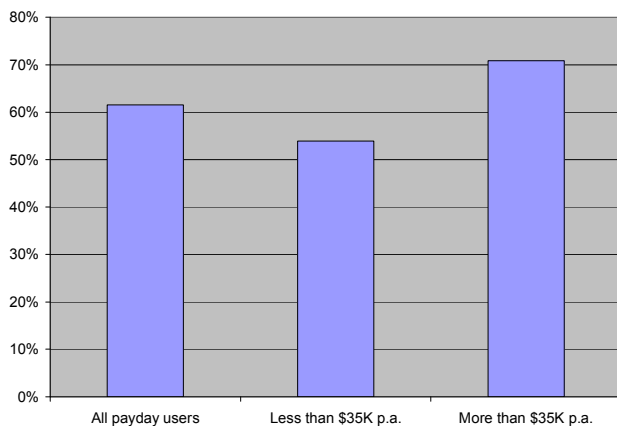
Source: Synovate Research for Policis 2008

Income is a more important driver of the frequency of payday use with high income payday borrowers more active users of payday loans

Indeed, the more important factor regulating incidence and frequency of payday loan use appears to be income rather than access to credit. Perhaps counter to popular perception, among payday users, incidence of payday use is higher among high income groups than among low income users. More than seven out of ten (71%) payday users with incomes of more than \$35,000 p.a. have used payday in the last twelve months compared to a little over half (54%) of payday users with incomes of less than \$35,000 p.a. These patterns reflect greater use of credit more generally among high income groups comparative to those on low incomes, with payday users being little different in this respect to credit users more generally. Among those who are in the market in a twelve month period, the differences between more or less affluent payday users in frequency of use are again relatively small, with payday users with household incomes of less than \$35,000 averaging some 4.4 loans p.a. compared to 4.2 for those with households incomes of more than \$35,000.

More affluent payday users are more frequently in the market

Chart 8. Use of payday loans in last twelve months by income range



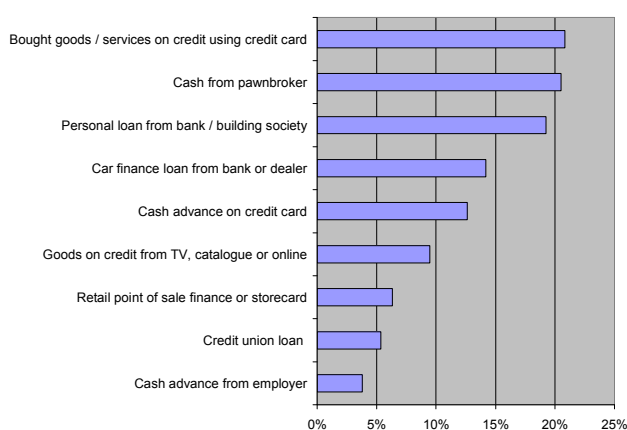
Source: Synovate Research for Policis 2008

For most users, payday forms one component of a repertoire of products with small sum short term credit used alongside longer term higher value loans

Mainstream credit use occurs in parallel to use of payday lending, with use of small sum, short term credit being one component of a wider repertoire of credit products, including both revolving credit and long term high value loans. Indeed payday users as a whole are as likely to use mainstream credit sources as they are to use other fringe lenders. Credit cards are the most important source of credit for payday users overall, with one in five having used a credit card to purchase goods and services in the past twelve months and some 13% having taken a cash advance on their credit card. A similar proportion, again one in five (19%), have had a personal loan from the bank in the last twelve months. Some 14% have taken on a car finance loan. This mainstream credit use compares to one in five (20%) having used a pawn-broker and a little under one in ten having bought goods on credit via mail order.

Payday borrowers use a wide range of other credit products in parallel to payday loans

Chart 9. Use of credit products in the last twelve months



Source: Synovate Research for Policis 2008

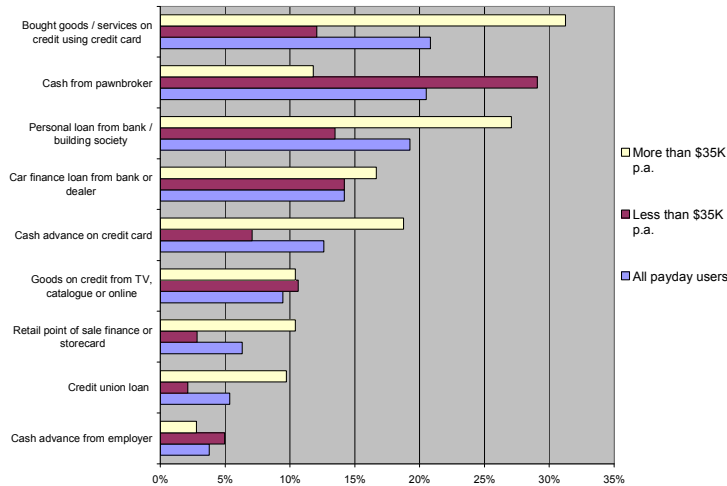
Payday is not the only source of small sum cash credit used with more affluent users raising cash on credit cards and those on low incomes using pawn

There are significant differences between more or less affluent payday users in how far mainstream credit is used alongside payday loans however, particularly in the case of alternative sources of small sum cash credit. Low income households are more likely to use other fringe lenders alongside payday lending to raise small sum credit while high income payday users tend to use revolving credit cards. Three in ten of payday users with household incomes of more than \$35,000 dollars have used credit cards to buy goods and services in the last twelve months, compared to some 12% of their counterparts with household incomes of less than \$35,000 p.a. Similarly almost one in five (19%) of payday users with household incomes of \$35,000 or more have taken a cash advance on a credit card compared to only 12% of payday users with household incomes of less than \$35,000. Conversely, in a mirror image of this pattern, three in ten payday users with household incomes of less than \$35,000 p.a. have used pawnbrokers to raise cash compared to only 12% of payday users with household income of more than \$35,000. The on-line survey with a sample of more affluent, credit-hungry and more credit-troubled sub-set of payday users, suggested a more exaggerated pattern of mainstream revolving credit and payday loans being used in parallel as a source of small scale cash credit. Around half had used a credit card to buy goods and services in the past twelve months, with some 40% raising

cash advances on their credit cards in the same period. Generally, those in this sample were much heavier credit users, not just of commercial credit but also of informal borrowing.

Differences between the wider credit repertoires of more or less affluent users

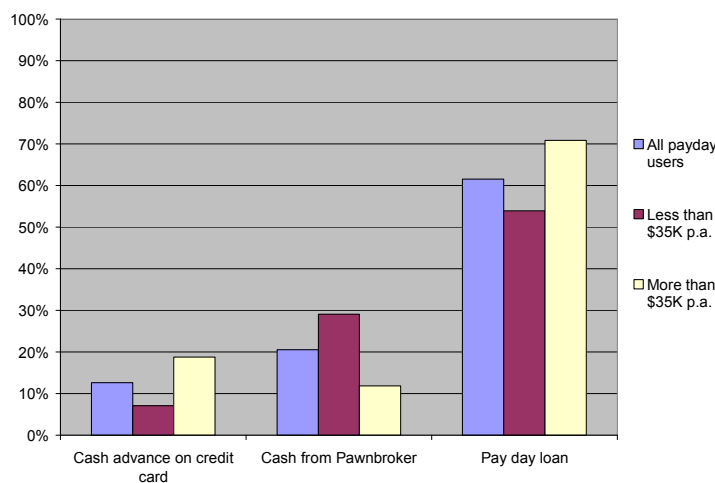
Chart 10a. Payday borrowers use of other credit products in last twelve months by household income range



Base: Payday users
Source: Synovate Research for Policis 2008

Payday most used small sum credit but cash also raised on credit cards and pawn

Chart 10b. Small sum cash credit used in last twelve months by household income range



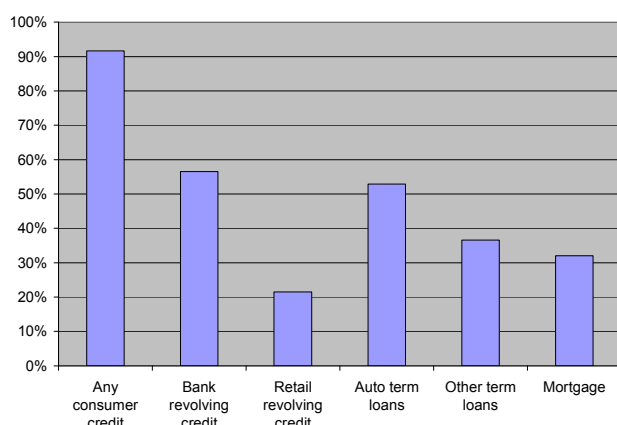
Base: Payday users
Source: Synovate Research for Policis 2008

In the US, the largest payday market globally, payday users also use short term payday loans alongside mainstream credit

Studies in the US have found a similar pattern of payday users using payday alongside mainstream credit, albeit that payday users exhibit lower levels of credit use than the population of credit users overall. The latter is also true in Australia.

US payday users also use a wide range of mainstream credit products alongside payday borrowing

Chart 11: US payday borrowers use of mainstream credit products



Source: Credit Research Centre, Georgetown University ¹²

Among those who use payday because they cannot borrow elsewhere, this is often a matter of having temporarily reached a limit on mainstream credit lines

Even for those who have turned to payday because they were unable to borrow elsewhere at the time that they needed short term cash, access to credit is not necessarily entirely binary, in the sense that individuals either do or do not have access to mainstream credit sources. The pattern is rather that for many such borrowers access to mainstream credit – most typically in the form of credit cards or overdraft facilities - tends rather to fluctuate over the year as card balances are paid down or overdrafts are repaid with incoming salary payments. Even where payday users are unable to access mainstream credit, in a substantial minority of cases the barriers to access to mainstream credit are less absolute exclusion than a matter of having reached the limits of mainstream credit lines. Alternatively, minor delinquency on a current credit agreement – missed payments or breaching credit limits¹³ – may result in temporary suspension of mainstream credit facilities. A significant proportion of those using payday because they cannot borrow elsewhere have used mainstream credit lines in the previous twelve months.

Those who did have mainstream credit options when they last took out a payday loan have higher levels use of a range of other credit products, most notably for long term personal loans, used primarily for big ticket purchases and paid back over an extended period. Significantly, however, for thinking about how most effectively to protect consumers and prevent unmanageable indebtedness, there appears to be

¹² Elliehausen and Lawrence, Payday Advance Credit in America, Credit Research Centre, McDonough Business School, Georgetown University (2001)

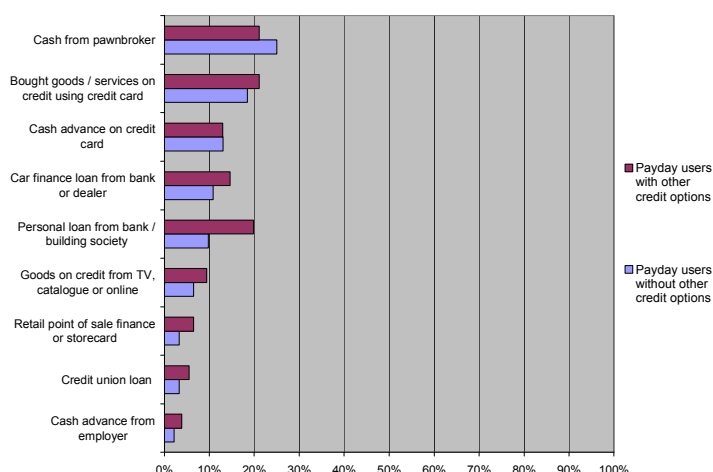
¹³ A pattern of occasionally missing payments on credit and loan agreements is endemic among low income credit users in Australia, as it is in other developed credit markets, with revenues from penalty charges on delinquency often an important component of lenders' business models where this market segment is being served. Some 39% of low income credit users in Australia miss occasional payments on loan or credit agreements, with the average number of missed payments per year for those missing payments being 3 missed payments p.a. . The same pattern can be observed in other credit markets internationally with levels of missed payments remarkably consistent across territories. Source: Synovate survey of 500 low income households in Australia for Policis 2008. "The dynamics of low income credit use; a research study of low income households in Australia" Policis (2008). For evidence on patterns of late and missed payments on loan and credit agreements among low income consumers internationally see Policis for the UK DTI "The impact of interest rate ceilings in other countries" (2004) and Policis "The Economic and social risks of credit market regulation" (2006).

little difference in the use of revolving credit between those who did and did not have access to mainstream credit when they last took out a payday loan. This is most marked in terms of raising cash advances on credit cards, the other major source of small sum cash credit for those with access to the credit mainstream, where the incidence is of taking out such advances is 13% in both cases.

Those using payday and unable to borrow elsewhere at the point of taking on the loan may nonetheless borrow from mainstream sources at other times

Chart 12. Use of other credit products in the last twelve months

By whether payday borrower had other credit options when took out most recent payday loan



Base: Payday users
Source: Synovate Research for Policis 2008

Payday loans are however the only source of credit for a significant and growing minority of users who would otherwise be credit excluded

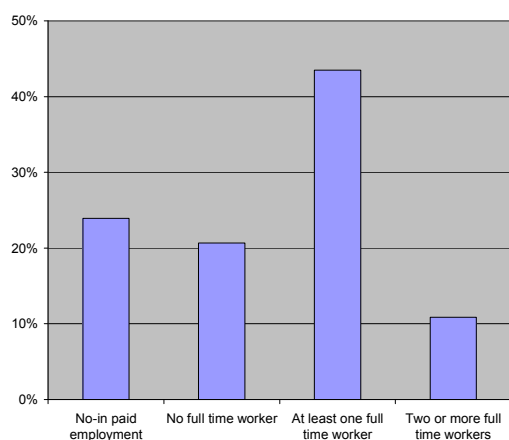
Payday loans are however the only source of credit for a minority of users who would otherwise find themselves credit excluded. These include individuals who would not qualify for a loan from a mainstream institution because they lacked a consistent income or the necessary documentation to pass qualifying hurdles. Equally, it includes a significant body of low income individuals who seek to borrow small sums in proportion to their income, on a scale below the minimum loan sizes which banks find practical and profitable to offer within their chosen pricing structure and lending models.

There is an important segment of significantly disadvantaged credit excluded borrowers for whom payday is their only credit option

In discussing the role that credit exclusion plays in use of payday lending it is important to note that there is an important segment of payday users who do have no mainstream credit options. There is a significant degree of disadvantage associated with these payday users who have no cash credit options other than payday lending. Almost a quarter have no income from employment (24%) while 45% have no income from full time employment. A little short of six in ten (56%) are family households, with three in ten single parent households. Four in ten (41%) have incomes of less than \$20,000 p.a.

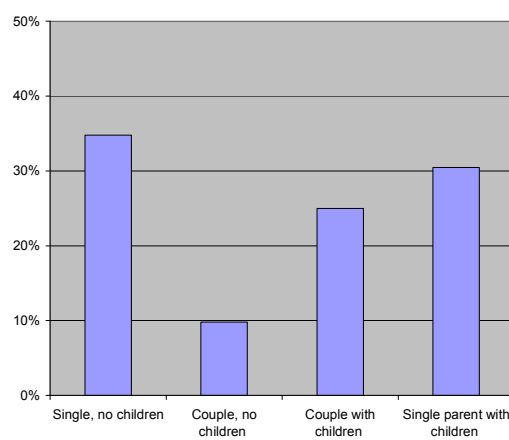
Payday users with no alternative credit options are more likely not to be in work and to be single parents than other payday users

Chart 13a. Profile of payday users with no other credit options
Employment profile



Base: Payday users unable to borrow elsewhere when took out most recent payday loan
Source: Synovate Research for Policis 2008

Chart 13b. Profile of payday users with no other credit options
Household profile



Base: Payday users unable to borrow elsewhere when took out most recent payday loan
Source: Synovate Research for Policis 2008

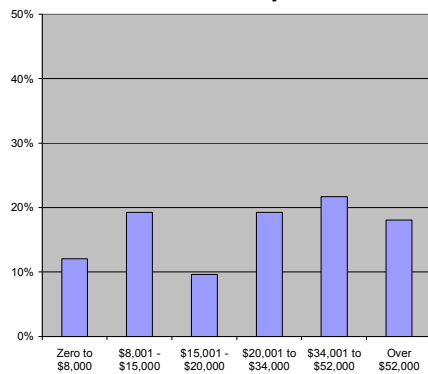
An increasing number of credit users find themselves excluded because of adverse history, including many relatively affluent borrowers

There is also a sub-set of payday borrowers who use payday lenders because they have acquired an adverse credit record, a phenomenon that is increasingly a feature for a significant minority of Australian credit users. This is particularly the case for those on low incomes¹⁴ but is by no means confined to low income borrowers. Four in ten of Mainstream Excluded payday borrowers have household incomes of more than \$35,000 p.a. while almost one in five have household incomes of more than \$52,000. The average income for payday users unable to borrow from the credit mainstream in the nationally representative sample was some \$35,000 p.a. For those participating in the on-line survey, who were generally both more affluent and more likely to have experienced credit difficulties, the average household income for those unable to borrow in the credit mainstream was \$47,000 p.a.

¹⁴ The research undertaken with low income credit users more widely suggests that 22% of low income Australians have been refused credit and that 34% have what they consider to be a bad credit history.

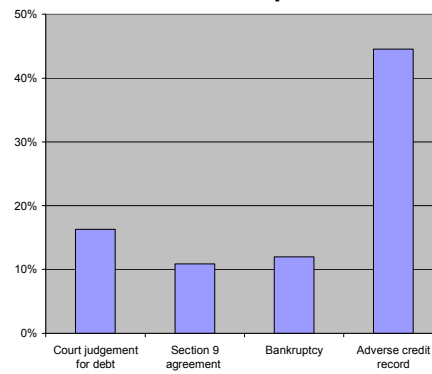
Payday users unable to borrow elsewhere include disadvantaged groups without mainstream access and those who have failed in the credit mainstream

Chart 14a. Income profile of payday users with no other credit options



Base: Nationally representative sample of payday users unable to borrow elsewhere when most recent payday loan taken out
Source: Synovate Research for Policis 2008

Chart 14b. Credit history of payday users with no other credit options



Base: Nationally representative sample of payday users unable to borrow elsewhere when most recent payday loan taken out
Source: Synovate Research for Policis 2008

Overall, payday appears to playing a role both for those unable to borrow from mainstream lenders and those choosing payday as an alternative to revolving credit

Payday borrowing thus appears to play a role in the finances of all of these borrowers, providing cash credit to those who would otherwise be unable to borrow and acting as an alternative to revolving credit or larger longer term loans for those with access to the credit mainstream.

The following chapter examines the drivers and dynamics of payday borrowing, why users borrow from payday lenders and how they apply the funds raised.

4.0 The dynamics of payday borrowing

The dynamics of payday use

- The key attraction of payday borrowing is convenience and ready access to small sums that are difficult to obtain from banks
- Borrowers frequently have an active preference for short term loans that can be kept separate from other financial arrangements.
 - Short term pain preferred to open-ended commitment on revolving credit
 - Believed less likely to lead to escalating or unmanageable debt
- The popular perception of payday borrowing as primarily distress borrowing is overstated.
 - Three in ten loans are distress borrowing to make ends meet through cash shortfalls
 - 40% of loans are applied to household bills and repairs
 - 30% of borrowed funds are used to spread the cost of major purchases
- Payday borrowing plays a critical role in managing cash flow
 - Payday is four times more likely than other forms of credit to be used to forestall cash crises and twice as likely to be used for unexpected expenses
 - Payday borrowers are more likely than other credit users to be unable to cope through common financial pressures without borrowing. Few have savings.
- Taking out a payday loan is usually a considered decision precisely because of the high cost and is often perceived to be the least damaging of available options
 - Payday funds are used to provide essentials when households run out of cash
 - The cost of payday loans can be significantly less than the penalty charges and reconnection fees the loan is taken out to avoid
 - Payday loans enable households to meet major commitments that would otherwise be missed and thus avoid damage to credit histories
 - Half of borrowers use payday to keep up with bills
 - A third use to avoid reconnection charges

This section explores the dynamics of payday borrowing from a consumer perspective. It seeks to understand why and how borrowers use payday lending. As the previous chapter demonstrated, a large majority of those using payday do have other credit options, with payday being used both alongside other types of credit and other sources of small sum cash credit. We seek to understand the drivers for use of high cost payday loans and the applications of funds raised from payday lenders. We look at differences between more or less affluent payday users and between those who use payday alongside other credit types and those who do not have credit options.

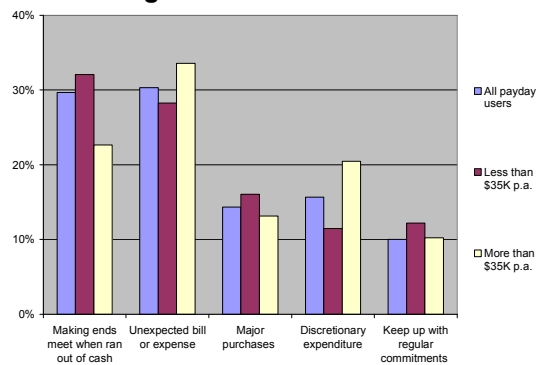
The popular perception of payday as primarily distress borrowing is overstated but nonetheless distress borrowing represents three in ten transactions

The popular perception of payday use is that payday borrowing is primarily distress borrowing. Payday is used, as are other forms of credit, to manage cash flow and to

spread the cost of purchases and peaks of expenditure. Distress borrowing - literally to make ends meet when borrowers run out of cash - appears to account for some three in ten transactions (29%), rising to a third (32%) among payday users with household income of less than \$35,000 p.a.. Borrowing to meet an unanticipated bill or expense accounts for a further three in ten transactions, rising to a third for households with incomes of less than \$35,000 p.a.. Around one in ten transactions is to facilitate meeting regular commitment such as mortgage or rent payments and utility bills. Payday borrowers in households with less than \$35,000 p.a. are more likely than other payday users to turn to payday to address cash shortfalls, to fund major purchases of essentials and to keep up with regular bills and commitments.

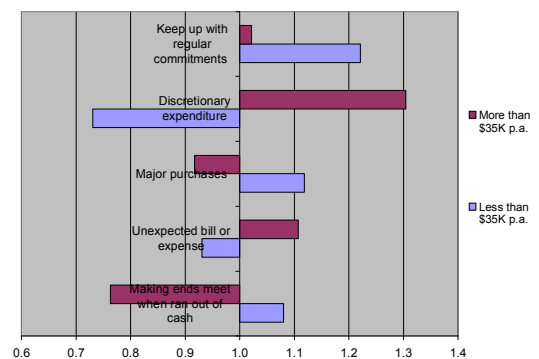
Payday borrowing used most frequently to manage through cash shortfalls and to meet unanticipated expenses

Chart 15a. Applications of most recent payday loan – all payday users and by income range



Source: Synovate Research for Policis 2008

Chart 15b. Application of payday funds relative to average for all payday users – by income range



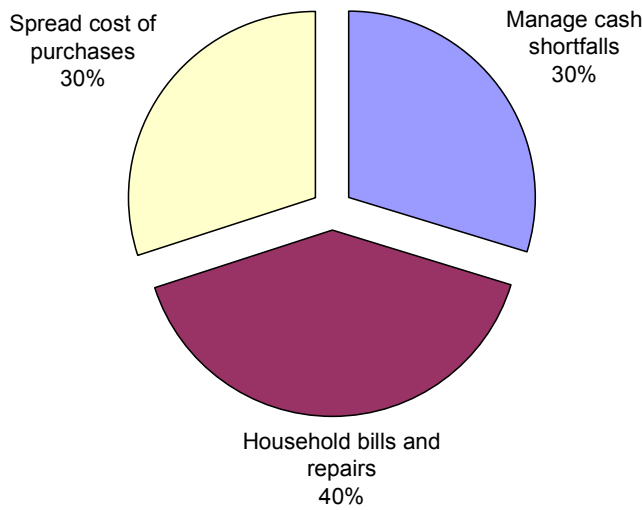
1.0 = average for all payday loans users
Source: Synovate Research for Policis 2008

Four in ten transactions are applied to meeting household bills and regular commitments with three in ten used to spread the cost of major purchases

Payday is also used however, in the same way as other types of credit to spread the cost of both the purchase of major essentials and discretionary spending (Christmas, holidays etc) with low income households more likely to use payday to spread the cost of high-ticket essentials, such as white goods or furniture, and higher income households more likely to use payday to fund discretionary spending.

Payday borrowing plays a key role in managing through financial pressure points and in enabling the purchase of high ticket essentials

Chart 16. Applications of payday borrowing by category



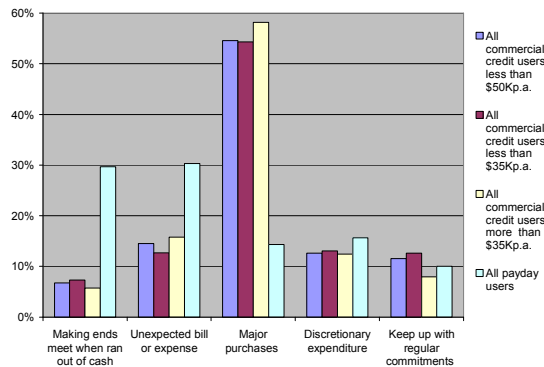
Source: Synovate Research for Policis 2008

Payday is four times more likely than other forms of credit to be used to forestall cash crises and twice as likely to be used for unexpected expenses

This is a significantly different pattern to use of commercial credit more generally, where the majority of transactions are used to spread the cost of major purchases or discretionary spending, including funds spent to facilitate work or study. Among credit users in households with income of \$50,000 or under as a whole, only 7% of transactions are applied to making good cash flow shortfalls and only 14% are applied to meeting unexpected bills or expenses. Payday users are thus four times more likely than all credit users in this income range to be using borrowed funds to avoid cash flow crises and twice as likely to be applying borrowed funds to unexpected bills.

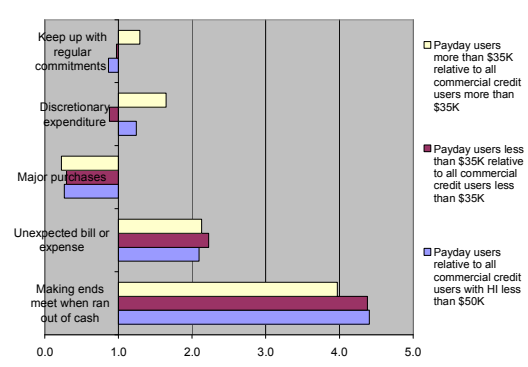
Payday borrowing plays a more critical role in managing cash flows than other forms of credit

Chart 17a. Application of most recent loan, all commercial credit users in households less than \$50K p.a. and payday users



Source: Synovate Research for Policis 2008

Chart 17b. Application of most recent payday loan relative to all most recent credit transactions



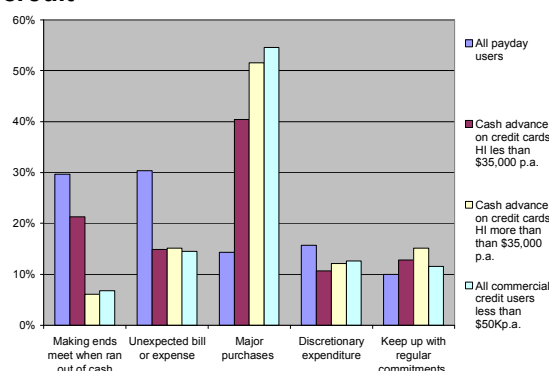
Source: Synovate Research for Policis 2008

Other forms of small sum credit, such as cash advances on credit cards and pawn, are used for similar purposes to payday lending

In part this is a function of the nature of payday as being short term, small scale credit. Patterns of application of cash advances raised on credit cards, the other major source of short term low value credit for payday users, also differ from that of funds raised from other credit products, with funds raised on credit cards also more likely to be spent on addressing cash crises or meeting unexpected expenses – though to a lesser extent than payday loans. This is most pronounced for those on low incomes, among whom one in five (21%) of cash advance transactions on credit cards are used to address cash shortfalls.

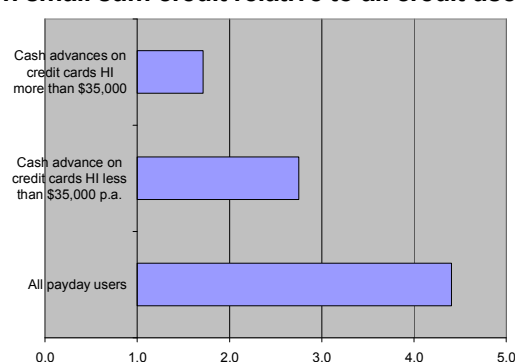
Low income households raising cash advances on credit cards also use these funds to make ends meet, though to a lesser extent than payday borrowers

Chart 18a. Applications of small sum cash credit



Source: Synovate Research for Policis 2008

Chart 18b. Incidence of distress borrowing on small sum credit relative to all credit use



Source: Synovate Research for Policis 2008

There appears to be a specific - and to a large extent an irreducible - need for small sum credit, most strongly felt among lower income households

Payday borrowing – and small sum cash credit more widely – thus appears to be meeting a very real need. There would indeed appear to be a near irreducible level of demand, in that few payday borrowers appear to have savings safety nets and many would find it difficult to manage through a range of commonly experienced financial difficulties without recourse to small sum credit, whether sourced from payday borrowing, cash advances on credit cards or pawn.

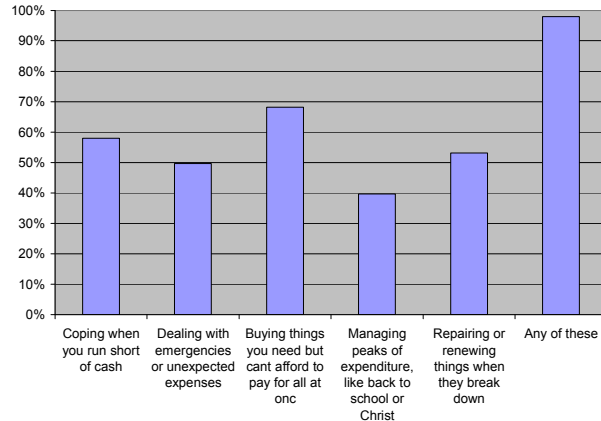
Payday users appear more likely than other credit users to face difficulties in coping with a range of day to day financial pressures without borrowing.

It would indeed appear that payday users are more likely than credit users more generally to face difficulties in coping with a range of day to day financial pressures without borrowing. Six out of ten payday users say that they would have difficulty coping when they run short of cash unless they were able to borrow (58%), a half say they would have difficulty coping with an unexpected bill or cash emergency without borrowing and a similar proportion (53%) that they would have difficulty repairing or renewing items that broke down. Seven out of ten (68%) say they would find it difficult to purchase things that they need but cannot afford to pay for all at once and four in ten (40%) that they would have trouble managing peaks of expenditure such as children going back to school or Christmas. Only 2% claim that they would have no difficulty handling any of these common pressure points without borrowing. To put

this in context, among all users of commercial credit with household income of less than \$50,000 p.a., 36% claim that they would be able to handle any of these pressure points without borrowing, as would 25% of all commercial credit users with household incomes of less than \$35,000.

Very few payday borrowers are able to cope with financial pressure points without recourse to borrowing

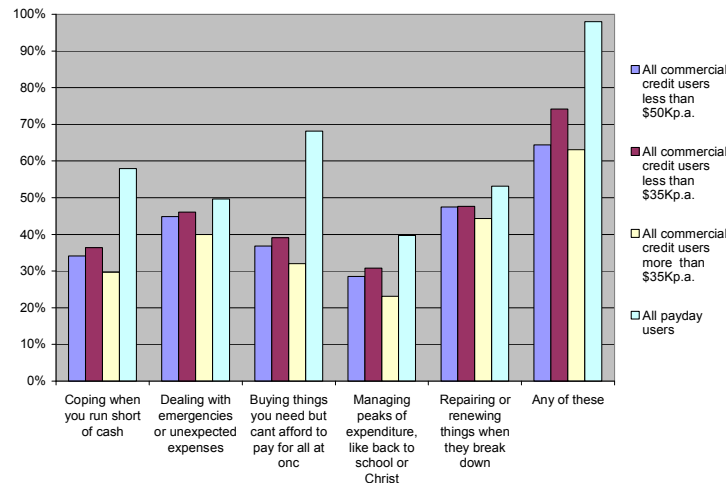
Chart 19. Payday users – financial pressure points which would find difficult to cope with without borrowing



Source: Synovate Research for Policis 2008

Payday borrowers are more likely than other credit users to need to borrow both to manage cash shortfalls and to spread the cost of purchases

Chart 20. Financial pressure points which would find difficult to cope with without borrowing, all credit users and payday borrowers



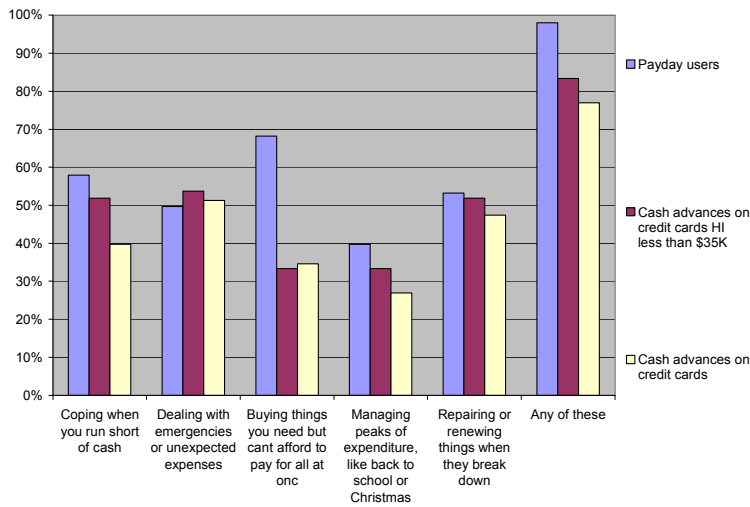
Source: Synovate Research for Policis 2008

A similar pattern can be observed among low income households raising cash advances on credit cards

A similar, though less extreme, pattern can be observed for low income borrowers taking cash advances on credit cards. More than half of those taking cash advances on credit cards in households with incomes of less than \$35,000 p.a. would find it difficult to cope with a cash shortfall or an unexpected bill or expense without borrowing.

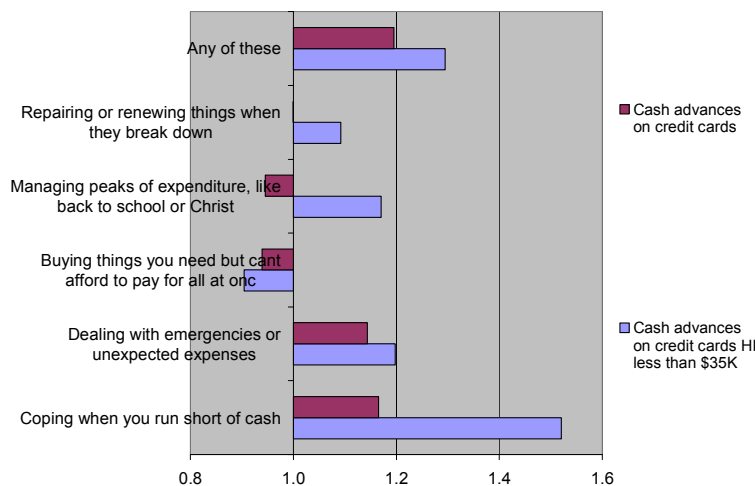
Those taking advances on credit cards also face difficulties with managing cash shortfalls and unanticipated expenses without borrowing

Chart 21. Financial pressure points that difficult to manage without borrowing, users of small sum cash credit



Source: Synovate Research for Policis 2008

Chart 22. Financial pressure points which would find difficult to deal with - users of small sum cash credit relative to all commercial credit users



1.0 = average for all credit users

Source: Synovate Research for Policis 2008

Budgets tend to be tight and for payday users on lower incomes often just adequate to service outgoings

These quantitative data were reflected in the sentiments expressed in the focus groups, most strongly by the lower income payday users. There were important differences between respondents at different life-stages, those with greater or smaller incomes and with differing financial histories (see later discussion of segmentation of payday borrowers in section 6.0), but the common theme was broadly one of income being barely adequate to needs and life-style with budgets often too tight to accommodate peaks of expenditure or emergencies. The finances of many of the older respondents particularly appeared to feature a background of a change in circumstances, usually associated with a reduced income, typically relationship break-down, reduced hours or unemployment, family formation, the onset of illness

or disability or business failure. Younger payday users were often at an early stage in their career or working life, with corresponding entry level incomes and facing the financial pressures of establishing an independent life, setting up a home etc.

“I’ve had very little support from my kids’ father, so I’ve always found it really hard having a large family and trying to feed them all, trying to keep up with things.”

“I manage OK most of the time...I struggle sometimes with petrol...I haven’t been to a dentist in four years.”

“I have \$200 a week for living expenses which is what I have to live on and the rest gets put onto bills. With that \$200, that’s gotta go to petrol, food, smokes and it’s got to last me. That’s why I don’t take cash out ‘cause I’ve already got a tight budget and my budget’s already done. I’ve got health insurance, car insurance, all my utilities to pay and my credit card.”

“Bare minimum really, I’m just making it (paying rent and bills)...But that leaves me absolutely nothing. I don’t drink at all and I don’t go to parties.”

An adverse life-change such as divorce, unemployment or business failure may have left a long hangover of ongoing debt service

In some cases, an adverse change in circumstances, particularly relationship breakdown and business failure, is associated also with a long hangover of debt. The consequences for payday users in this situation participating in the focus groups ranged from additional pressure on incomes caused by long term ongoing debt-service, through adverse credit histories which precluded borrowing in the financial mainstream all the way to financial breakdown and insolvency (for a discussion of scale for these groups and effects see section 5.0 following on the impact of payday on debt and indebtedness and section 6.0 which describes a segmentation of payday users).

“When my husband left me, I was left with a massive amount of debt. And when I lost him I also lost my job because we had our own business, so I had to raise the kids, pay off the debt. It’s taken me seven years.”

“The biggest killer is when you’re on a big income and you take out all these loans and credit cards or whatever...and you get dropped down on to a lower income, and you know, I’ve had illness, injury stuff like that.”

“I’m not super behind. I’m not sinking any deeper into debt but I’m not catching up either. It’s very slowly I’m paying that down. I think it’s going to be ten years before I can call myself debt-free. I don’t have a mortgage or a car or anything like that. I only have the credit cards.”

“After a divorce, I had inadvertently guaranteed his debts, on our credit cards. I signed something in the bank. I came within a hair of going bankrupt...so I negotiated with everybody and spent years paying it off.”

Few payday borrowers had much in the way of savings safety nets although some more affluent payday users had savings kept separate from borrowing

Some payday users, primarily in the more affluent groups, had savings which they managed alongside borrowings. Some of the younger borrowers at an early stage of their career were also saving regularly towards a goal, such as buying a property, with these savings kept separate from all other aspects of their finances. For the majority, however, particularly families and single parents but also older people, budgets were so tight that saving was simply not an option, so that few had a savings net against cash emergencies.

"No, I have not saved since I was at school. My eldest son is twenty seven now so I have been doing this for a long time."

"Yeah I can save. Her and I have saved because she works as well. We've saved enough money to put down a substantial deposit on a house. It's going well...she keeps that. It's all separate. She's fastidious about money."

"I've got virtually no savings, no. It's all tied up in superannuation, but nothing in the bank, no."

Individuals can simply run out of cash for essentials if payment for work is delayed or work is only intermittently available

Against this background, individuals can simply run out of cash for essentials, such as food or utilities. In this situation payday loans can provide the cash to enable individuals to manage through a short term cash flow shortfall and prevent it becoming a crisis.

"I get very embarrassed if I have to go there...and I try to borrow as least money as possible. And it's just to cover my bills and try to get through, you know, because I've got a three year old boy and I have to provide for him...So I need that money for food and stuff like that. But it doesn't happen often."

"Sometimes if you haven't got any other choice, you just have to do what's available to you. You know the interest rate is high, but you don't have any other choice. Sometimes it's just a matter of putting food on the table or not putting food on the table and worry about the consequences later."

"To pay an electricity or gas bill or buy food. You never just do it so you can go out...I just don't personally do it so I can go out or buy a dress or whatever. It's to make sure that something gets paid or...it's always for a reason"

"It's kind of like that desperate need. I need to put food on the table or like I really need to get these people (creditors) out of the way. So I'll walk into Cash Converters and I'll pay that interest rate."

Incomes are frequently unpredictable and fluctuating with individuals needing nonetheless to service fixed commitments such as mortgages and utilities

Incomes were frequently unpredictable and fluctuating, often because individuals were self employed or because work was temporary or insecure. Individuals nonetheless tended to have regular commitments, including mortgages in many case, some of which had been taken on in different circumstances when income was at a level higher than currently.

"Yeah, well. I've got a six hundred dollar mortgage to pay, you know, and sometimes when I don't get enough work coming in, that always leave a shortfall, you know. And another week, I might have more work in. So, Yeah. It's up and down with my work."

"If I don't get enough work in, you know, and I'm a bit short on the mortgage, yeah, I'll go in (to the payday loan shop). I try very hard to keep my mortgage up to scratch. Even though I might be short on other bills, or lay-by, or something like that. Yeah. It's not often I'm short on the mortgage but I'll let everything else go just to get that through."

"Yeah I'm constantly looking for extra work, to meet that mortgage and people say 'you should sell your house' but I'm never going to do that. So I'm just hanging in"

there. Sometimes you have the good weeks and then you get the really, really bad weeks. It's tough sometimes."

Even the most carefully managed budget can be derailed by unanticipated expenses arising from car or equipment break-down or medical or dental bills

Under these circumstances, householders may be able to manage day to day finances effectively and keep up with payments as they fall due but budgets can be derailed by unexpected expenses such as doctors' bills, automobile accidents or the breakdown of essential equipment such as washing machines, heating or plumbing systems, cars etc. Alternatively a period of unanticipated sickness or caring responsibilities can leave individuals with insufficient income to cover outgoings. Very few have the resources to accommodate such spending or interruptions to income flows. Borrowers then turn to payday to help manage these peaks of expenditure, to maintain life-styles and even to ensure – in the case of vehicle repairs for example – that they can continue to work and earn.

"The huge bills that you don't plan for, you know, like \$1000, when someone smashed into my car."

"Bills and that, I'm pretty good at managing them. Well the phone bill is hard because that goes up and down but sometimes a doctor's bill comes in or my son's dentist bill, that's when...(implication is that is when uses payday lending)"

"My bills are taken care of. It's the unexpected ones and I've had a lot of trouble, been in and out of hospital you know and suddenly you've got all these bills."

"You'll have those times when you're doing fine and then something big will happen – the car will break down, the hot water system will break down."

The decision to take on a payday loan is often carefully considered but can be the best or only option to maintain life-styles and manage cash emergencies

In these cases, the decision to take on a payday loan is not taken lightly. Borrowers are aware of the cost of the loan but see a high cost short term loan as either their only option or the most manageable way to accommodate the cash emergency.

"I've been a couple of times, It might have been a phone bill at the wrong time or a repair. I look at the figures and think 'Oh, this is going to hurt. That \$50 interest is going to bite me in the bum down the track. But you can't ride a bike with only one wheel. So you swallow your pride and get on down there."

"My income basically covers my expenses but emergencies they knock me out of kilter. Like I had a decision to make just before Christmas whether to put my dog down or spend \$1000. Of course I spent the money but that sort of thing is very difficult. I spent the money because the children would have been heart-broken. But I had to think about it a great deal. It's those sorts of things. Like when I had a major car break-down."

The cost of the pay-day loan may be significantly less than the cost of reconnections or penalty fees the loan is being taken on to avoid

In some cases, the decision to take on high cost credit to facilitate payment of other commitments is weighed against the cost of the consequences of not being able to meet those commitments. These are both financial – reconnection fees associated with having utilities cut off and reputational – the impact on a payment or credit record of non payment.

"If it's a choice between having it (utilities) cut off and paying that loan, you'd rather pay the loan...It's not cheap but it is less money than you will pay if they cut you off and it is less hassle."

"It depends what situation you're in (context is whether take on payday loan, knowing the cost of doing so). For example with electricity or basics you need to pay it (bill) off to avoid fees and charges, you need that."

"If you have your electricity cut off they charge you another \$200 to put it back on. You already don't have the money to pay the bill. And it's the same with the gas. You've gotta pay the whole bill plus the reconnection fee up-front."

Borrowers also value the confidentiality associated with payday borrowing and that this type of borrowing does not impact credit records

The latter has financial implications in any case, in that borrowers are highly aware that their credit record will influence both their ability to raise mainstream credit and the cost of that credit, and equally, their ability to raise a mortgage in the future. This latter consideration is a major issue for younger people hoping to get on the housing ladder or older home-owners seeking to move or extend their homes or use housing equity to support secured loans. Payday is seen as offering a confidential and discreet means of managing payment irregularity on mainstream credit and other commitments, with this being a major component of the appeal of this type of borrowing.

"I want to buy a house one day. We're saving for that. So to me I don't want anything on my credit record. So to me it's worth it to keep that up."

"Well, I'm coming to a part of my life where a credit rating and those sorts of things are very important and I don't want to have any problems getting the loan for my house."

"I've spent a long time fixing up my credit record. And I don't want anything to mess that up...So you can take a loan from Cashies and there's no come-back on you for that."

The choice of payday can rest on an active preference for short term low value credit on a scale too small to be obtained from mainstream sources

The majority of payday borrowers in the focus groups did have other credit options in the sense that they were running a more or less full suite of financial services products, including credit cards and loans. For these borrowers use of payday could be a matter of discretion and confidentiality, as described above, or, more commonly, a matter of convenience and preference for small scale limited term borrowing over open ended or long term commitments.

"Yes, because it's (payday borrowing) over and done with quick. Otherwise you go with the banks and it goes too long. I've had bank cards and you start off with \$1000 bank card and the next thing it's a \$5,000 bank card and, you know, you get into trouble with it."

"I swore I'd never go back in again, but I needed a small amount of money so I went back. And, you know, the banks won't help you with that. Commonwealth, I think the minimum is \$5,000."

"Banks won't help you, you know with small amounts of money like that, just to keep you going. It always has to be a certain amount...It's pain for two weeks or a month and then it's over. You're done."

“A payday loan is usually only for two pays. And they’re not for large amounts. It’s not for ever, you know.”

“But they (payday lenders) do give you, like, loans for small amounts. So, banks, unless you’re talking like, \$5000, \$10,000, they don’t really want to do business with you.”

Convenience and rapid access to cash was also a key component of the appeal of payday lending

“And another thing I like about it is there’s no hassle. You don’t have to argue with them. It’s not like going to a bank.”

“It’s easy you know. I’ve been a few times because that was quite easy...They just sort of did it on the day. It was pretty simple...Like the banks, you’re going to need to have all the papers and stuff like that. Quick and simple over a month, quick pay-back.”

Payday borrowers who had previously struggled to pay down credit card balances can choose payday as less likely to create unmanageable debt

Some borrowers had made an active choice of payday over alternative sources of small sum credit. Payday loans were widely felt to be much more convenient, predictable and comfortable than pawn. However many users also saw payday lending as safer than cash advances on credit card, on several grounds. Firstly, revolving credit was felt too tempting, as likely therefore to lead to escalating debt. Cash advances on revolving credit were also seen as potentially leading to long term debt that could be very difficult to pay down. Those who had some history of getting into difficulties with credit cards or who had spent a long time paying down credit card balances were particularly likely to feel this way.

“The only thing you can do with the banks is open up a credit card and do the cash advance. But then you got that temptation when you’ve got that card in front of you. Whereas with (named payday lender), you can go back again for more, but you’ve got to physically go to that place. Instead with the card, you can use it anywhere.”

“The moment you get a credit card, you’re lost. Budgeting goes out of the window. You’re better off not doing that. I had one but I destroyed it, and I’ll never get another one.”

“In one way I would much rather use the credit card (for small amount of cash) because I know it’s a lower rate of interest...but then again I’m still trying to get my credit card down a bit”

“They (credit cards) are a trap. Once you get into it, it’s very hard to get out of it. ...Payday is just two pays or a month and you’re done.”

“You get into the minimum payment. It’s too hard. The minimum payment kills you...It’s too easy and then it’s too hard. Honestly, I’d rather (implication is use payday).”

Some payday borrowers with adverse credit history had simply had no other options

Some payday borrowers, particularly those who had previously run into financial difficulties with mainstream credit had no credit options other than payday lending.

These borrowers often did not even consider applying for credit to mainstream lenders on the grounds that applications had little chance of success.

“So you go into a bank and you apply for a loan or a credit card and you get knocked back. But they (lenders)...as long as you’ve got your income statement or whatever, they give you the cash of what you’re able to pay off per week.”

“My credit rating is not fantastic. Banks won’t help you. They won’t lend you small amounts of money...they want to know the ins and out.”

“It’s not worth the effort. You spend three days filling out forms and you still get a no and realistically they could have told you in fifteen minutes.”

“I did have a credit card. My credit rating’s totally shot now. No one’s going to lend me any money. I had to cut mine up. But I’m still paying them off.”

Payday could also be seen as greatly preferable to Informal borrowing

Most people with constrained credit options saw payday borrowing as preferable to asking friends and family for loans. Borrowers were often reluctant to discuss their finances with family members and typically found it humiliating to ask for a loan.

“Like, I would go there (payday lender) before ringing my mother. If I’m desperate, then I would ring her but she makes you feel so god-damned guilty.”

“My family is way too judgemental. No way could I ask them, no way.”

A sub-set of payday borrowers with poor management skills or lacking in financial responsibility tended to have problems with other types of credit also

Most of the payday borrowers recruited specifically for the sub-set of the qualitative research undertaken with individuals who had experienced problems in repaying payday loans had few, if any, other credit options and many had run into problems with repaying mainstream credit as well as payday borrowing. In most cases, this was a matter of adverse circumstances rather than poor management or fecklessness. In some instances, however, usually in the case of young borrowers, individuals clearly either lacked financial management skills or were simply unable to resist temptation, thinking only in terms their immediate needs and desires. Alternatively, individuals had found themselves saddled with an irresponsible or inadequate partner. These borrowers had often first run into problems with credit cards – with difficulties in most cases still extant – before turning to payday loans.

“I don’t budget my money. As long as I’ve got money, and I can afford to have a beer and go fishing, I’m not really phased if I go in and get a cash loan just for a week or two well, that’s the way I live. And I enjoy while I can”.

“My partner tends to break my budget, so before I get the chance to go and spend the money on paying on all my bills, um, he’s already spent half of my pay check.”

“He doesn’t think about, you know, all the different bills we have in the house, and sort of, paying all the bills and stuff like that, when, you know, budgeting...he just goes and spends it if the money’s there.”

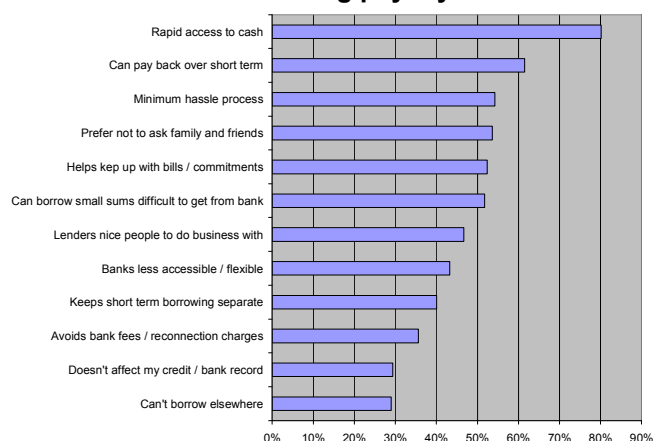
“And then I started meeting chicks, so then I started partying with the credit card. And then I got another credit card and...that’s how I ended up where I am. It was just after high school.”

The top three reasons for using payday lenders centred on the core characteristics of the model – rapid access to small sum short term cash

The dynamics suggested in the qualitative data were given some scale by the quantitative research. The top three reasons for using payday were all to do with the core features of the lending model, being rapid access to cash, the ability to repay over a short term and minimum process barriers and, cited by 80%, 62% and 54% respectively.

Convenience, minimal process hurdles and short terms loans are the core attraction for payday borrowers

Chart 23. Reasons for using payday lenders



Source: Synovate Research for Policis 2008

Being unable to borrow elsewhere was the least important reason for using payday lenders

Being unable to borrow elsewhere, by contrast was the least important reason for borrowing from payday lenders, coming last out of list of twelve possible options, and cited by three in ten borrowers.

Payday lenders were also chosen as being more flexible and accessible than banks and more willing to lend on a small scale

Around half of all borrowers cited being able to borrow small sums difficult to get from a bank and a little over four in ten that banks were less flexible and accessible than the payday lenders, while close to half (46%) opined that the payday lenders were “nice people to do business with”.

A half of borrowers used payday to keep up with bills and commitments and more than a third to avoid reconnection fees and penalty charges

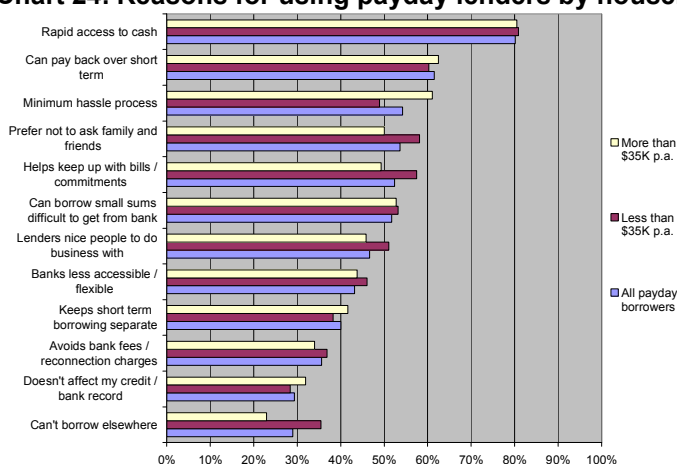
In terms of motivation for using payday lending, a little over half (52%) said that payday lending helped them to keep up with bills and commitments, and some 35% that payday loans were used specifically to avoid reconnection fees or bank charges which they might otherwise incur. Some four in ten claimed to use payday lenders because this enabled them to keep short term borrowing separate from the rest of their financial arrangements while three in ten claimed to borrow from payday lenders in part because such borrowing did not impact on their credit record or record with their bank.

Very little variation between more or less affluent payday users in their pattern of motivation for using payday

There was little difference between more or less affluent payday users in these patterns other than those on lower incomes were more likely to value the accessibility and flexibility of the payday lenders relative to the banks and were more likely also not to have other credit options.

Core product features appeal across the income range

Chart 24. Reasons for using payday lenders by household income range



Source: Synovate Research for Policis 2008

A similar dynamic but in more exaggerated form can be observed among US payday users

Similar patterns and dynamics, but in a more exaggerated form, are also found among payday users in the US. In a US study¹⁵ with a nationally representative sample of payday users, a large majority of US payday borrowers cited the reason for using payday as covering an unexpected expense (84%) and avoiding late charges on bills (73%) with 62% seeking to bridge a temporary income shortfall. Around a third (34%) claimed to use payday for planned or discretionary expenditure.

Two thirds of US Payday users use payday to avoid bouncing checks and incurring associated bank charges

The high incidence of seeking to avoid late charges on bills is explained by the prevalence of penalties for late payment in US charging models, which apply not only to financial products but to a range of other services, such as utilities. In the US, behaviour driven charging¹⁶ on credit and other financial products is significantly more developed than in the domestic Australian market, with revolving credit also a

¹⁵ Cypress Research Customer Satisfaction Survey for the CFSA (the payday lenders trade association) 2004. in which a nationally representative sample of 2000 randomly selected payday uses was interviewed.

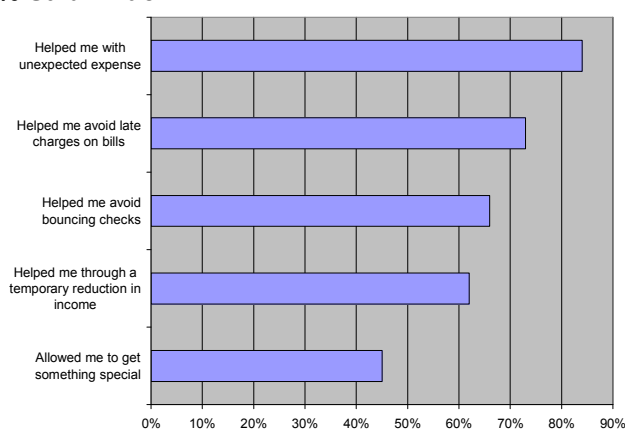
Payday Advance Credit in America, Monograph 35. Elliehausen and Lawrence, Credit Research Centre, McDonough Business School, Georgetown University (2001)

¹⁶ Behaviour driven pricing is one of the big global trends in credit pricing and rests on items such as penalty charges for exceeding credit or overdraft limits or for making late or missed payments, a syndrome which work to increase the cost of credit for higher risk borrowers on apparently low APR products while compromising price transparency. For this reason, the terms and conditions attached to credit products are increasingly a focus of interest for regulators in jurisdictions across the world.

more important component of the credit repertoires of those on low incomes. US banks particularly make significant monies not only from NSF fees (Non-Sufficient Funds - essentially fees associated with bounced cheques and breaching overdraft limits) but also from insurances designed to protect against these charges – in the form of “bounce protection” and “overdraft protection” policies¹⁷. These charging models form the background to US payday borrowers’ use of payday and their stated reasons for doing so. Some two thirds of payday users claim to use payday to avoid bouncing checks (66%) while one in five (20%) of payday borrowers cited reasons for using payday variously as “payday is cheaper than other short term cash” (i.e. bounce protection or cash advances on credit cards), that payday does not involve revolving debt and that payday is less likely to impact credit records.

US payday borrowers use payday in much the same way as those in Australia to meet unanticipated expenses, avoid penalty charges and meet commitments

**Chart 25. In the past year, getting a cash advance has....
% Said ‘True’**



Base: 2000 nationally representative US payday users Source: Cypress Research for CFSA

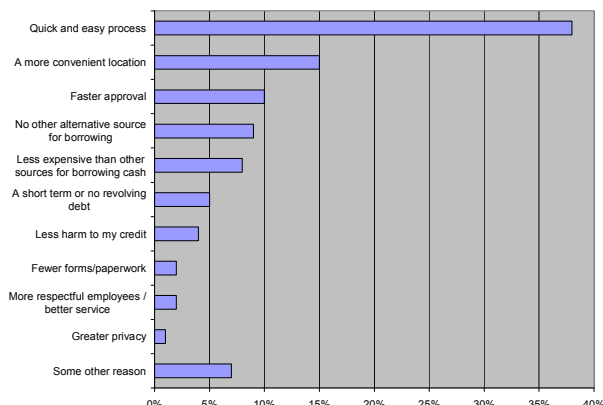
Accessibility, convenience, confidentiality and the desire to protect a mainstream credit record are also major drivers for US payday borrowers

As in Australia convenience and rapid access to cash are important drivers of payday use, with 65% of US borrowers citing convenience-related factors as a reason for using payday. Four in ten US payday borrowers (38%) point to a quick and easy process as a reason for using payday while 15% cite convenient location and 10% a fast approval process.

¹⁷ A number of US commentators have suggested that the profitability of these products and the importance of the revenues associated with NSF fees – which can be seen as competing directly with payday loans – are the primary reason why the US banks have not developed payday lending products of their own. Source: Stegman Payday Lending, Journal of Economic Perspectives, Volume 21, Winter 2007, Pages 169 – 190. Hidden Consumer Loans. Analysis of Implicit Interest Rates on Bounced Cheques Fusaro, Department of Economics, East Carolina University. Contrasting Payday Loans to Bounced Cheque Fees, Lehman, Wesleyan University, Indiana (2005). Consumers Use of High Cost Products: Do they know what they are doing? Working Paper No 69, Elliehausen, Credit Research Centre, McDonough School of Business, Georgetown University, Washington DC (2006)

As in Australia, ready access to small sum credit is the critical factor in payday lending's appeal to consumers

Chart 26. Reason for choosing a cash advance



Base: 2000 nationally representative US payday users Source: Cypress Research for CFSA

Taken together it would appear that payday borrowing and small sum credit more generally is meeting a critical need

In sum therefore, the evidence suggests that payday borrowers in particular, and to a lesser extent users of small sum credit generally, have an irreducible need for short term, small scale credit to help manage a range of commonly experienced financial pressure points. Payday appears to have a role to play in meeting this need, which in large part explains its rapid – and demand driven - growth. In both Australia and the US.

Some of payday borrowing is being undertaken to avoid potentially higher costs elsewhere

The major attraction of payday is clearly the accessibility and convenience the model offers, together with the appeal of a short term contract. There is evidence, however, both from Australia and other payday markets internationally, that some borrowers use payday as an alternative to incurring potentially more expensive penalty charges for delinquent behaviour on bills or mainstream financial products and to protect mainstream credit records. To this extent therefore consumers appear to be weighing the benefits and costs of using payday relative to alternative products and courses of action and thus to be making rational choices. We examine the rationality of these choices and the relative costs of different options in a following chapter, see section 5.0

Payday users unable to borrow elsewhere are among those least able to cope with a range of common financial pressure points without credit

Equally, however, it is clear that payday is the only option for some borrowers, primarily those on the lowest incomes and those with a history of financial difficulties, including problems with credit. These payday borrowers are among those most likely to need to borrow in the sense that they would be otherwise unable to manage though a range of pressure points.

5.0 The real cost of payday borrowing and the impact of payday on indebtedness, financial well-being and quality of life

The impact of payday on household finances

- The evidence does not support the view that payday borrowers tend to become trapped in a debt spiral of continually extended or renewed loans
- The large majority of payday loans appear to be being paid back within the contract term, with multiple extensions rare
 - Only 7% of borrowers usually re-schedule their loan. Less than one in five (17%) have ever not repaid their loan within the contract term
 - Two thirds of those who claim to have re-scheduled their loan, did so only once with the average number of extensions for those re-scheduling being 1.7 times
 - Few borrowers are thus exposed to additional costs other than that implied by the headline price of the loan. The largest lenders make no charge for rescheduling.
- Few borrowers appear to be continually or near continually in the market.
 - On average borrowers take out a little more than 4 loans per year and are in the market and paying back loans for an average of one third of the year
- Although repayments are undoubtedly hard to find they do not appear to compromise ability to fund essentials and the impact on household budgets appears short term
- Payday borrowers are no more likely to be in arrears on household bills than credit card revolvers or those taking out cash advances on credit cards
- Expenditure on debt service for payday borrowers is very similar to that for other credit users. As a proportion of household income expenditure on debt service for payday borrowers is identical to that for those taking cash advances on credit cards.
- Payday borrowers take the view that without payday they would be less likely to afford essentials or to keep up with commitments and more likely to get into financial trouble.
- The evidence supports this view in that payday users are less likely than those taking cash advances or revolving on credit cards to miss payments on credit agreements or to be exposed to penalty charges. They also pay down card balances more quickly.
- The cost of revolving credit under uneven payment conditions can be close to that of payday loans and can be higher given certain relatively common behavioural traits
- Payday borrowing is a small proportion of overall indebtedness for payday borrowers (15% of the total overall).
- Payday borrowers are significantly less indebted than other credit users, and markedly less so than those using revolving credit or taking cash advances on credit cards.
- There is a sub-set of payday users who feel that they would be better able to manage their finances if they did not use payday loans. These are not vulnerable low income users but rather more affluent borrowers using payday for convenience in parallel to heavy use of mainstream credit.

The major concerns among regulators and consumer protection groups in relation to payday lending centre on the high cost of payday loans and the perceived potential for consumer detriment associated with this type of borrowing. Payday borrowing is widely believed to create a “debt spiral” or “debt trap”, i.e. to lead to unmanageable debt resulting from the continual extension of the term of payday loans which borrowers cannot afford to repay, with such renewals resulting in a series of charges

and thus to escalating and very high cost debt. Beyond this, the use and cost of payday loans is thought to compromise borrowers' ability not only to afford essentials but also to meet household bills and other financial commitments. This in turn is thought to lead to an increased likelihood of financial stress, default on commitments and, ultimately, to financial break-down and insolvency. The latter is itself thought to result in increased cost to the state in the form of support and social welfare costs.

This section examines the evidence in relation to repayment behaviour on payday loans in order to establish the real cost and impact of payday borrowing on payday users' finances. It seeks also to examine the evidence for a debt spiral and to understand the nature of any consumer detriment arising both from use of payday in general, and from any debt spiral in particular. Analysis sets the effects of payday use in the context of those arising from use of other credit products by borrowers with similar income profiles and references also conclusions about the impact of payday loans drawn by evidence-based researchers analysing similar issues in international markets.

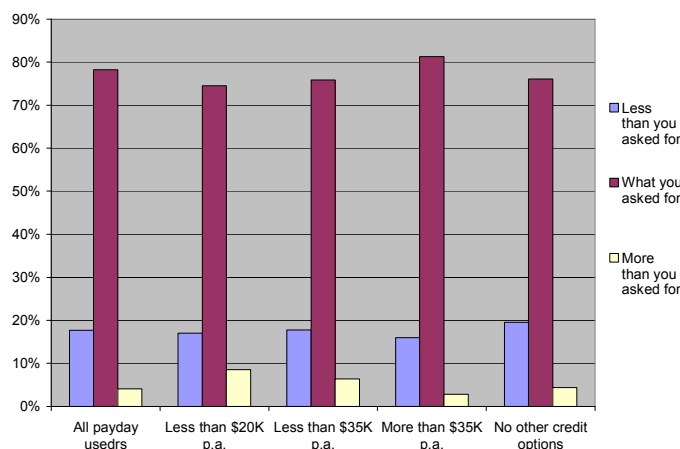
5.1 The evidence for a debt spiral

Payday borrowers do not appear to be encouraged to take out more credit than they can afford

We set out first to establish whether payday lenders are encouraging borrowers to take out loans that they cannot afford to repay and whether borrowers are under pressure to take out loans larger than they need or intended. The data does not support either hypothesis in that the proportion of borrowers taking out larger loans than they were originally seeking is small (4%) while in the qualitative groups prospective borrowers reported that lenders lent on the basis of loan to proven income ratios that were strictly observed. The quantitative research indicated that while eight out of ten borrowers (78%) were able to borrow the sum they sought, more borrowers were able to borrow less than they had initially asked for (18%) than borrowed more than they had originally asked for (4%). The least affluent borrowers and those who had fewer credit options were slightly more likely than other borrowers to get less than they had originally been seeking.

Lenders more likely to lend less than borrower sought than to over-sell

Chart 27. Value of most recent payday loan relative to value of loan borrower sought



Source: Synovate research for Policis 2008

Despite the minimal application process, lenders appear strict in insisting on ID and systematic and cautious in their evaluation of ability to repay

As was discussed in the previous section, a large part of the attraction of payday is that cash loans are available with minimum process hurdles. This has led to concerns around responsible lending and the extent to which lenders ensure that borrowers are in a position to repay their loans. The qualitative research suggests that access to credit is granted only after borrowers have satisfied quality and identity checks. Payday borrowers reported that although the application process was quick and relatively stream-lined, lenders were strict in requiring ID and documentary proof of a secure and predictable income.

“Well, you’ve got to have all the ID requirements and the pay slips, particularly the pay slips or you’re not getting your loan.”

“I think payday lenders, hock shops, that sort of stuff. You’ve got to do what I call doing it properly. So you don’t go in there with insufficient ID. You back up your income. If it’s a new place, call up and check with them what they want to see.”

“They want a driver’s licence, bank statements and that’s it. They check on your last bank statement that your pay is in there and it’s done. No hassles.”

“The thing is they won’t take into account any other income. They won’t take like my kids pay board and stuff. They only take what’s on your bank statements.”

There would appear to be differences between the practice of the larger lenders and national chains and those of some small local lenders

The larger lenders and national chains appear to be more scrupulous in their observation of ID and responsible lending formalities, with lending evaluation and criteria more likely to be systems based and automated. Some smaller local lenders, and particularly “mom and pop” type enterprises, appear to be more relaxed about documentation and to rely more heavily on relationships and track record.

“I used to ring up and he’d answer the phone and go ‘What do you want?’ And I’d go ‘I’m coming in’. ‘Alright, we’ll have it all ready’. And I just pull up with my truck. ‘Thank you’. And away I went. No ID, no nothing. No squat.”

“I’ve made a big effort to get a good relationship with the Asian couple that run the one in (named location) and because I sort of make an effort to sort of not muck them around, and to sort of make friends with them, you know, sometimes, they might sort of bend the rules a little bit for me. And they’re sort of not quite so strict looking after their customers.”

“Sometime like, my pay hasn’t come through yet and they’re sort of, some times they’ve sort of let it go. If it’s like a continuation of an existing loan or something that I’ve got with them. Yeah, because I know them, I’ve got a, a good relationship with them. They’re pretty good.”

“Some are really casual about it. And some are very polite, but they’re really tight with their money too. You pay for anything extra.”

Borrowers appear to be lent only modest sums initially

Borrowers in the qualitative research reported that new customers were offered relatively low value loans, being required to demonstrate a track record of regular payment before qualifying for larger loans.

“What your income is has to be in your bank statements...and then the computer works out what you’re allowed. The first one is \$150, no matter what, as long as your income allows. After that they just look at your last four pays and your direct debits.”

“They’re not going to lend you \$600 first up until you’ve been back to them a few times. And then maybe after your seventh loan or something, you get a 15% discount on the interest.”

“They tell you that you are only going to get one third and then two thirds of the maximum you can lend. Prove to us that you’re going to repay it and the longer you are with us, the more you’ll get close to the full amount.”

Majority of users are very conscious of the high cost of payday loans and seek to contain rather than increase their borrowing over time

The majority of borrowers reported however that, once they had got to the point where they were able to borrow the sums they needed (typically \$300 – 400), they had not tried to keep increasing the amount they borrowed as the relationship with the lender became more established. Indeed the research rather suggested that borrowers were all too conscious of the cost of credit, with most payday users actively trying to limit their payday use as a result. Most borrowers claimed that they tried to borrow only what they needed and that they left as large an interval as possible between loans, with the lowest income borrowers most likely to feel this way.

“Oh, I try not to go over at least \$550 or \$600 a max. I try very hard not to. You know? Because I find it’s just the repayments, like, the interest, you know, it’s an extra thing I’ve got to try to take out of my income.”

“I never get any more than, like, \$300. That way I know that I’d never pay more than a \$100 interest. And if I have to pay any more than \$100, it just seems like way, way, way too much money.”

“I’ve been really careful there not to miss a payment so they’re there when I need them...But I’m also really careful not to borrow more than I absolutely need.”

“I usually go in and borrow whatever is the minimum they’ll give me. Like most payday places have a minimum, they won’t do less than \$50, \$75, \$100.”

More affluent borrowers with adverse history more likely to borrow larger sums and to use multiple lenders to maximise credit lines

This pattern is much less true, however, of relatively high income payday users with a history of credit difficulties. As access to the mainstream becomes more constrained in the wake of account delinquency or as the limits of credit lines are reached, these borrowers appear to make increasing use of payday, and to take out more frequent and larger loans. Where users were borrowing large sums from payday lenders, this appeared less to be a matter of irresponsible lending as borrowers sourcing loans from multiple suppliers. This was most common among the relatively high-income payday borrowers with a history of serious adverse credit or financial breakdown. Such borrowers had frequently had a history of heavy credit use and continued to want and /or need credit on a regular basis. These borrowers also often wanted to borrow sums in line with the value of loans that they had previously sourced from the credit mainstream, typically much larger sums than usually available from payday lenders. In the absence of mainstream credit options, use of multiple lenders had become their only route to maximising credit lines and obtaining larger sums.

"If I go to all the payday lenders that I use at once, I can pull \$2,500, \$3,000 at one time."

"There aren't that many options if you need real cash. Then you're going to have to go to more than one shop to get it...It's not very convenient and it really hurts for six weeks or so but if it's an emergency, then that's what you're going to do."

"The main way I've got into trouble is if you see three and four payday lenders and get trapped that way."

"Like, I go for big ones. You know, like (named lender). I go there for about \$900 and I might go and get \$700, \$800 off someone like (another named lender) or something. You know, yeah, so I do play the money field a bit."

Low income borrowers using multiple payday lenders are more likely to be doing so because they have had payment problems with a previous lender

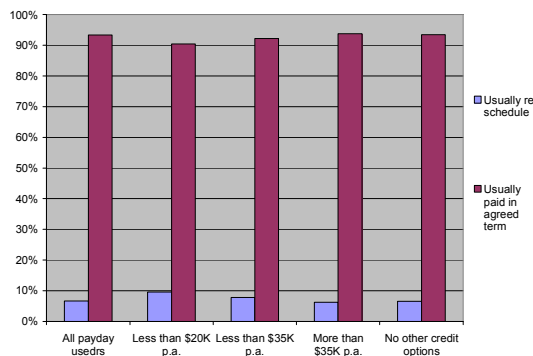
Lower income borrowers using multiple payment sources tended to exhibit a different dynamic. These borrowers also often had a background of repayment problems, not only in the credit mainstream but also with fringe lenders. Such borrowers were more likely to use multiple payday lenders because of an ongoing debt to an existing source or because previous lenders were no longer willing to extend credit to them.

The large majority of Payday loans appear to being paid back within the contract term, with multiple extensions rare

The research evidence suggests that the incidence of repayments on payday loans being re-scheduled is relatively low, with only 7% of users claiming that they usually extend their loans, with little difference between more or less affluent users in this regard. Indeed less than one in five (17%) had ever had to miss or re-schedule a payment on a payday loan. Again variations between more or less affluent borrowers were not large, in that incidence of ever having had to re-schedule peaking at 20% among the lowest income payday users (household income less than \$20,000 p.a) and fell to 15% among more affluent borrowers (more than \$35,000 p.a). Of those who did re-schedule their loan, three quarters claim to have re-scheduled their loan payments only once. The average number of times that the loan had been re-scheduled, for the minority that had re-scheduled payments on their loan, was 1.7 times.

Most loans repaid to contract term

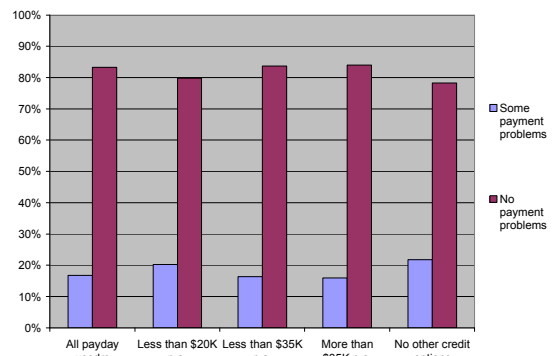
Chart 28a. Whether usually need to re-schedule payday loan



Source: Synovate research for Policis 2008

Few borrowers have missed or made late payments on their payday loans

Chart 28b. Whether have ever had repayment problems on a payday contract



Source: Synovate research for Policis 2008

It would appear that few borrowers are being exposed to additional costs other than that implied by the headline price of the loan

Of those who re-schedule, over four in ten (43%) claimed not to have been charged for doing so, and a quarter (25%) to have been charged once, 13% to have been charged twice or more for with almost 20% not knowing whether they had been charged or not. Where no charge was made for re-scheduling, the average number of times it was free to re-schedule payments was 1.4. Payment difficulties with short term payday loans do not appear therefore to be having long term financial impacts for the borrower in the sense that delinquency appears relatively low and the incidence of re-scheduling of the loan also appears low, with relatively few of those who do run into difficulty being exposed to charges and even fewer to multiple charges.

Lenders are reported as tolerant and flexible in the face of payment difficulties with the large national chains less likely to charge for re-scheduling

The qualitative data also indicates that there are differences between chains in their approaches to re-scheduling, with the largest national chains seeming to be those most likely to re-schedule without penalty. The overwhelming majority of those payday borrowers who had needed to re-schedule reported that if borrowers communicated with the lender, lenders were tolerant and flexible in accommodating payment difficulties and that these arrangements were frequently made without additional charge.

“They are really good with re-scheduling if you get caught or stuck. You can ring and they’ll re-schedule. They’ll try and help out when they can. I’ve never had any trouble with them. They’ve always been really helpful.”

“If I have got into difficulties at any stage, they’ve always been really helpful and you know...even if they’ve gotta take you to another fortnight or split into 2 extra payments or something like that. I’ve never had any trouble with them anyhow.”

“They allow you 2 changes (without charge, like...’cause I did mine fortnightly, so if you can’t do it one fortnight, you can ring them and they’ll move it around for you.”

“If something happens, they’re OK. One time when my payment hasn’t gone through, they’ll ring me and say you know, it’s sort of bounced. And we sort it out from there.”

“Yeah, they’re pretty easy to approach with, if you want to vary your repayments and so forth. If you need to skip a payment”.

Some lenders make penalty charges for re-scheduling payments or treat loan extensions as new contracts with additional set up charges

As with loan evaluation and quality control practice, there appears to be significant variation in the way that different lender types approach payment difficulties and pricing on re-scheduled loans. The larger enterprises appear not to permit roll-over style refinancing. Some of the smaller lenders appear more likely to seek to generate additional revenue from payment difficulties, albeit that such practices appear to apply to only a small proportion of total transactions.

“Some of them are more flexible, than others. Like with (small local payday lender). I once phoned them up and I said ‘Hey, I want to put one of my payments back for a fortnight’, and ‘No worries, that’s \$11’ and I said ‘What?. You know, I wasn’t going to pay \$11 for them to put it back a pay day for me. Yet you can go

to someone like (named national chain) and say 'Hey, wow, can I put it back for a fortnight?', and they'll say 'No worries' and they don't try and take more money off you for that."

"The others are not nearly as easy to use as (named national chain). If you try and renegotiate the direct debits, there's no free ones. They charge you \$30 straight up."

"The thing I don't like about it is, say you take it out over a month and then after a fortnight you want more money, you've gotta start again and take out a whole fresh new loan. You can't extend it. You pay a new set of fees, on top of the fees you've already paid. I don't mind paying the interest – that doesn't matter. But it just seems a bit stupid. A whole set of papers and everything."

Borrowers try to avoid renewing loans as they are repaid, and do not appear to be pressured by lenders to do so

If loans are not being continually extended, the other mechanism by which a debt trap or debt spiral might be created would be if loans were continually renewed as they were paid off. Some borrowers are clearly taking on loans more frequently than they would like while others feel overly dependent on high cost credit to manage their finances. However the evidence does not support the hypothesis that loans tend to be continually renewed as they are paid up. Outside of standard marketing activity, there also appears to be little evidence of undue pressure or encouragement from lenders to either renew loans as they are repaid or to take on further loans. The impetus for renewals and taking on further loans appears rather to come from the borrowers' circumstances, being primarily unexpected expenses, cash shortfalls, peaks of expenditure etc, as discussed in the previous section.

"It depends. Depends on what's going on. Mine sort of goes, I might get one and then when that's finished I might get another one and then I won't get anything for six or seven months and then I'll go back again. I try not to."

"It gets a bit tricky sometimes because they will re-lend straight away. As soon as your last payment has been made, they'll re-lend. Sometimes I think I need that money now, so I re-draw straight away so you can get a bit caught...I try not to do that often."

"Don't you hate those letters? 'You are entitled to whatever', you know. Every time I say 'I'm not going down, I'm not going down'. But you don't throw the letter away."

"Oh, looking over the year, about four. Yeah, anything between three to five times a year. Yeah. Very hard not to go down there sometimes, but three to five"

The high cost of credit itself acts a powerful deterrent to being drawn into a continual cycle of borrowing

Most borrowers are reluctant to take on more loans than they need or to be continually in the market precisely because they are aware of the high cost of this kind of short term credit.

"The interest was high, the establishment fee was out of proportion to the loan but I guess beggars can't be choosers. It was tough paying it off, but I actually have just finished last week... so it wasn't too bad but I wouldn't want to be doing it too often."

"Sometimes it's hard to make that payment without re-drawing on it straight away, and then starting all over again. And the interest is fairly high. If you borrow say \$400, you end up paying like \$520 back so I don't re-draw unless I've got no other choice."

“The interest kills you so just now and again when I’m caught short, you know, really need that cash.”

Loans are not so much extended as taken out frequently, with the average borrower being in the market and paying back debt for 18 weeks p.a.

It appears that the pattern is not of loans being frequently extended or continually renewed but rather that payday borrowers take on a number of low value loans over the course of the year, each of which are paid back over a very short term. The average appears to be a little under four and a half loans per year, rising to circa five loans a year for those who do not have other credit options. Product terms and structures will vary between lenders but on the basis of one the most common products (Fee \$35 per \$100 loaned on 4-week basis) in the market place, this will imply that the average payday borrower will be making payments for 18 weeks of the year, borrowing an average of \$307 a time, \$1,391 a year and paying back on average, allowing for re-scheduling of charges based on the pattern described above, of \$1,910 per year at an average of \$108 p.w. for those weeks over which the loan is being repaid.

Payments are difficult to make during the contract term and will often have a hangover effect thereafter but pain appears relatively short term

As discussed at some length in section 4.0 the qualitative groups indicated that borrowers had consciously chosen short term pain over longer term debt. The qualitative evidence suggests that keeping up payments to the payday lender will have imposed a degree of pressure both during the period of the contract term and for a period thereafter, one of the reasons why taking on payday loans is usually a carefully considered decision. The disruption to household budgets and the associated financial pressure does appear to be short-lived however, even allowing for the impact to be felt beyond the contract term of the loan.

“Even if I’m only paying it back over 2 weeks, it could take a 4 month recovery period, where I’ve pushed things aside.”

“Then it would be a tight couple of months to pay it back, you know, six weeks or whatever, but um, it (payday) gives you that access to that size (of loan) in an emergency. You pay for it a bit and you’re going to feel it for a while.”

“So, then each fortnight, not only do I have to allow so much for my mortgage and food, then I have to take either out of my food, or another bill, to allow for that interest. So, yeah. You have to always take something else. Something else suffers... You may be repaying those four week but you’re juggling for three months afterwards.”

Borrowers budget carefully and need to juggle competing priorities but repayments do not appear to compromise ability to afford essentials

The impact of loan repayments appears however to be primarily a matter of juggling competing priorities and careful budgeting rather than the sacrifice of essentials. Repayments did not appear to create real hardship, in the sense that repayments were prioritised over food or fuel or bills essential to household security. Indeed the evidence is rather that where essentials were at risk (where obligations to make utilities payments competed with payday commitments, for example), the most likely outcome was that the payday loan was re-scheduled.

"It certainly doesn't affect my food budget, but it would be - say the amount I would set aside that week for my phone bill, that doesn't go into the bank. That's what I mean when I say it takes awhile for me to catch up. It becomes a juggling exercise."

"So then I fit that (repayment to payday lender) into the budget, and then I'll be a lot stricter on budgeting, you know. Like, so maybe this week we can't go out and get this done, like, this week, and you're like, this month, fewer smokes and no going out splurging and getting drunk."

"Sometimes I had, you know, it's like, my gas is due at the same fortnight, at the same time that the Cash Converters is due. The gas and power, I've got to pay that. So sometimes I've rang up Cash Converters and said 'Look, can you make it next fortnight', and usually they go 'Yes'."

"You get a demotion for a little while, and then you get a pay rise. Do you know? It's like, your new boss has demoted you... You just think 'Oh, I've only got \$800 pay this week. And then all of a sudden, you think 'Alright, I'm getting paid a grand again'."

"It's \$50 less drinking money on a Saturday night. I can live with that."

Most borrowers see budgeting discipline as the key to avoiding a vicious circle of continual loans

Nonetheless, although repayments are manageable and do not appear to compromise the ability to afford essentials, for those on low incomes and very tight budgets particularly, they are undoubtedly hard to find. Against this background, the temptation is to take on additional loans to facilitate cash flow. The quantitative evidence suggests that the great majority of borrowers are not continually or near continually in the market, however. The qualitative data also suggests that most borrowers make strenuous efforts to borrow from payday lenders as infrequently as possible, with discipline and careful budgeting seen as the key.

"And it's a vicious circle. That's how I see it. You can beat it, but, it's easier to slip into it, if you don't sort of really discipline yourself."

"The interest just kills you. Get the money to get your short, cover your short fall. Then you've got to take the extra money out to pay the extra interest. If you do that you're no better off down the track. So that way, couple of months, you're back there doing it again. You just gotta be really careful that you don't borrow more than you need and that you budget to pay back so you're not back there again. It's kinda down to circumstances but it's also kinda down to you as well."

"You've just got to have a bit of a discipline of it. And when I first started, I didn't. I just went totally nuts with it, and then it sort of, I had big debts, and I lost all my stuff at hock, and it was a really bad experience. But since I decided to pull my finger out and sort of act my age, and sort of approach it with a bit more of a professional attitude, it's been a really positive experience."

The evidence does not support view that payday lending creates a trap in which borrowers owe increasing sums which they are unable to pay down

Payday is indubitably high cost credit and many borrowers no doubt find average repayments of \$108 p.w. hard to find during the third of the year in which payments are being made. Taken together, however, the evidence would not appear to support the popular perception that payday borrowers tend to become trapped in a spiral of continually extended and escalating debt. The data rather indicates that pay-day debt

is repaid within a clearly defined and very short term, at a cost to the borrower consistent with expectations and headline pricing, with borrowers in the market on average for one month in three.

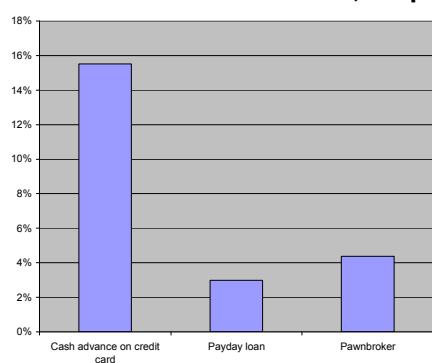
5.2 The real cost of payday borrowing

We turn now to examine the real cost of payday borrowing relative to borrowing small cash sums from other lender types, given the behaviours revealed in the research.

For the purposes of comparison we have worked up the real cost to the consumer of small sum credit obtained both from payday lenders and by means of taking cash advances on credit cards. Cash advances on credit cards are the most significant source of small sum credit for households with income of less than \$50,000, by some considerable margin. Payday users use fixed term payday loans in preference to revolving credit but a significant minority of more affluent payday users use cash advances on credit cards in parallel to payday. Lower income payday users are more likely to turn to pawn.

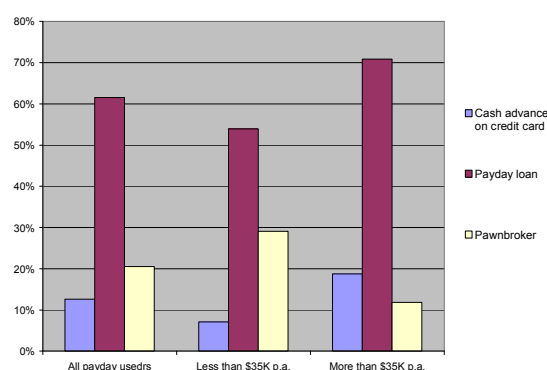
Cash advances on credit cards are the leading source of small sum credit with some more affluent payday users using these alongside payday borrowing

Chart 29a. Sources of small sum cash credit for households less than \$50,000 p.a.



Source: Synovate research for Policis 2008

Chart 29b. Payday users, use of other types of small sum credit in last 12 months



Source: Synovate research for Policis 2008

Estimates of cost are based on averages for payday borrowers, average borrowing values over average terms, average number of missed and late payments, average incidence of re-scheduling payments, average number of times that payments are re-scheduled, and average charges levied for such re-scheduled payments. Similarly, the estimates for the cost of credit for cash advances on credit cards (by some margin the leading source of small sum cash credit for Australian consumers with household income of less than \$50,000 p.a.) are based on average values of payday loans for households in the same income range, average outstanding balances and payment patterns, average incidence of missed and late payments on card accounts and average number of missed payments, for those who miss payments.

Price transparency is seen as one of the virtues of payday borrowing and is contrasted with penalty charges and fees on mainstream credit

Payday borrowers in the focus groups tended to describe price transparency as one of the virtues of payday lending. Borrowers acknowledged the high cost of borrowing but contrasted the predictability of the charges on a payday loan with the uncertainty associated with penalty charges on overdrafts and mainstream loans and credit agreements

“Well, it’s all there in black and white. You know. How much don’t you understand about you’ve got to pay 30% back?”

“He just went through it, no worries. Just truck driver simple, you know? Put it in Australian terms. I mean, I’ve got no problems with that...And, you know, you can change it if you need to a couple of times, if you let them know, so no worries. It’s all there.”

Many payday users have paid penalty charges on mainstream credit which escalate the cost of credit for those with uneven payment patterns

The value placed on the perceived price transparency of payday in part derived from borrowers’ experience of penalty and other charges associated with mainstream credit and overdrafts on bank accounts. This was particularly front of mind for the higher income payday borrowers more likely to be heavy mainstream credit users, a significant minority of whom had missed or made late payments on loans and credit agreements (28%) or been subject to penalty charges on credit agreements (33%).

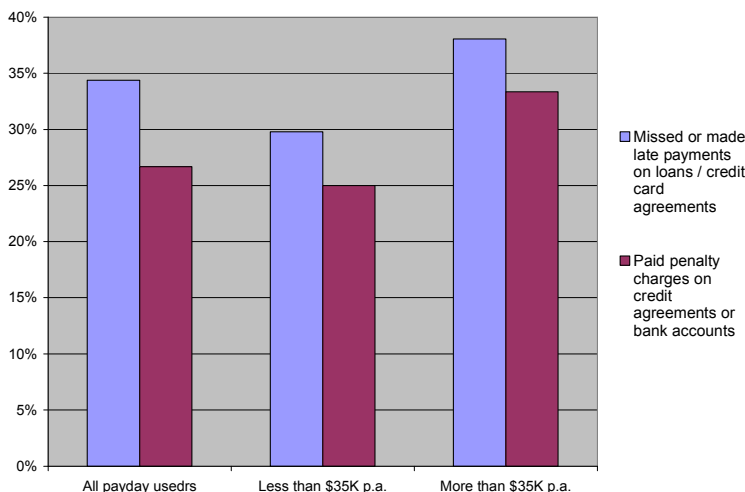
“In some ways it seems to me almost like (named national payday lender) are more honest then the banks in that I constantly have fights with the bank over their reference fees or if you check the balance and that doesn’t add up or this and that.”

“I get charged a \$30 fee even it goes \$20 over. If you take \$200 and you forget the direct debit comes out and then you’re overdrawn so it can work out quite expensive.”

“They’re (payday lenders) ripping you off but at least you know what you are in for. On the credit card and it’s automatic charges right there if you’re short. It adds up. Sometimes you can’t help it and there’s nothing you can do to stop it. You’re stuffed both ways.”

Payment irregularity is endemic among low income credit users with penalty charges on mainstream credit products adding significantly to their cost

Chart 30. Payday users. Penalty charges and delinquency on credit agreements by income range



Source: Synovate research for Policis 2008

In order to illustrate the real cost of using the different sources of small sum credit, including the impact of behavioural factors such as re-scheduling payday loans or delinquency on revolving credit cards, we here provide worked examples to illustrate each of several common scenarios:

Scenario 1. Four week payday loan paid to contract term

We assume that the borrower takes an average loan for those with household income of less than \$50,000¹⁸ and that it is paid four weeks later to term, with assumptions on the basis of the market leading lenders' pricing at time of writing.

Key conditions	
Fee per \$100 borrowed	\$ 35.00

Key results	
Cost of Credit	\$ 96.95
Fees	\$ 96.95
Cost per \$100	\$ 35.00
Observed APR	146.0%
Amount advanced	\$ 277.00
Over term	4 weeks
Remaining balance	\$ -

Scenario 2. Two week payday loan paid to contract term

Assumptions

We assume that the borrower takes on the average loan for those with household income of less than \$50,000 p.a. of \$277 and that it is paid two weeks later to contract time.

Key conditions	
Fee per \$100 borrowed	\$ 20.00

Key results	
Cost of Credit	\$ 55.40
Fees	\$ 55.40
Cost per \$100	\$ 20.00
Observed APR	969.9%
Amount advanced	\$ 277.00
Over term	2 weeks
Remaining balance	\$ -

Scenario 3. Pay day loan with extended term

Assumptions

We assume that the borrower takes on the average loan of \$277, as above, but that the term is extended once (a little less than the average number of extensions at 1.4). A significant proportion of loan extensions do not incur charges, but we assume in this case that charges are applied once (as was the case in three quarters of cases revealed by the research).

¹⁸ Readers seeking similar worked examples based on averages for households with incomes of less than \$35,000 p.a. are referred to our report "The dynamics of low income credit use – A research study of low income credit users in Australia", Policis 2008

Key conditions	
Fee per \$100 borrowed	\$ 35.00

Key results	
Cost of Credit	\$ 193.90
Fees	\$ 193.90
Cost per \$100	\$ 70.00
Observed APR	603.3%
Amount advanced	\$ 277.00
Over term	8 weeks
Remaining balance	\$ -

Scenario 4. Cash advance on a credit card

For the purposes of this example, to enable ready comparisons with the payday case, we take the probably unrealistic scenario of the card holder not having any outstanding balance and raising a cash advance equivalent to the average payday loan four times over the course of a year, again the average number of times a payday loan is taken out. We assume orderly payment and that payments are partial but above the minimum and in line with the debt service outgoings revealed by the research.

Key conditions	
Minimum payment (% of balance)	2%
Actual payment	\$ 20.00
Interest rate	16.28%
Own network ATM fee (\$)	\$ 1.88
Own network ATM fee (%)	2.2%
Other network ATM fee (\$)	\$ 2.16
Other network ATM fee(%)	2.1%

Key results	
Cost of Credit	\$ 257.49
Fees	\$ 23.40
Interest	\$ 234.09
Cost per \$100	\$ 23.24
Observed APR	17.5%
Amount advanced	\$ 1,108.00
Over term	2 years
Remaining balance	\$ 885.49

Scenario 5. Cash advance on a credit card

For the purposes of this example, we again assume cash advances taken out over the course of the year but in this case assume there is a background credit card balance in line with that for the average for those raising cash advances on credit cards and having household incomes of less than \$50,000.p.a.

Key conditions	
Starting balance	\$4,934.95
Main interest rate	14.69%
Minimum payment	2%
Actual monthly payment	\$ 200.00
Interest rate	16.28%
Own network ATM fee (\$)	\$ 1.88
Own network ATM fee (%)	2.2%
Other network ATM fee (\$)	\$ 2.16
Other network ATM fee(%)	2.1%

Key results	
Cost of Credit	\$ 1,502.99
Fees	\$ 23.16
Interest	\$ 1,479.83
Cost per \$100	\$ 24.87
Observed APR	18.5%
Amount advanced as cash	\$ 1,108.00
Total credit	\$ 6,042.95
Over term	2 years
Remaining balance	\$ 2,745.93

Scenario 6. Delinquent payment pattern on a credit card

For the purposes of this example, we assume an existing balance in line with the average for households with incomes less than \$50,000 p.a., as in the previous examples, but in this case also factor in three missed payments per year, again in line with the average for those who miss payments, over a period of five years.

Key conditions	
Starting balance	\$ 4,934.95
Main interest rate	18.50%
Minimum payment	2%
Actual monthly payment	\$ 150.00
Fees	
Annual fee	\$ 35.00
Bounce charge	\$ 20.00
Late Payment fee	\$ 25.00

Key results	
Cost of Credit	\$ 4,193.28
Annual fees	\$ 175.00
Bounce charges	\$ 300.00
Late payment fees	\$ 375.00
Interest	\$ 3,343.28
Cost per \$100	\$ 84.97
Observed APR	23.4%
Total credit	\$ 4,934.95
Over term	5 years
Remaining balance	\$ 2,378.23

5.3 The impact of using payday on household finances

We turn now to examine whether payday borrowing and debt service on payday loans compromises borrowers' ability to afford essentials and manage their finances effectively to any greater extent than other commonly used sources of credit.

Dynamics in payday use differ significantly between more or less affluent users

There are significant differences in the dynamics of payday use between more or less affluent segments and between those with and without ready access to the credit mainstream (see extended discussion following in section 6.0 which describes a segmentation of credit users). Among lower income households, payday users tend to be under more financial pressure than other credit users and to be relatively modest users of credit, with a significant minority having constrained access to the credit mainstream. The dynamic is slightly different among higher income payday users, where payday users are more likely to be heavy credit users across a range of categories, with a significant minority having a history of difficulties with mainstream credit. These differences will feed into the impact of payday use on household finances. Analysis of the role of debt service on household finances and the impact of use of different types of credit is therefore perhaps best undertaken with a degree of discrimination between more or less affluent households.

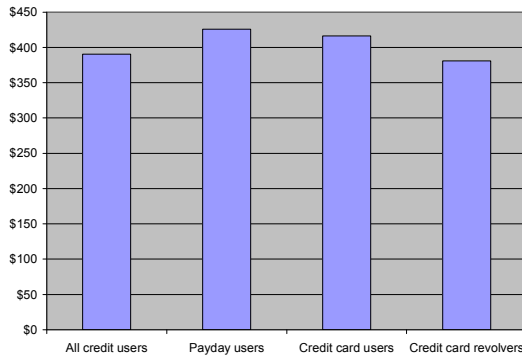
Payday users' overall spend on debt service is a little higher than for credit card revolvers but is broadly in line with that of all credit card users

Payday users appear to spend slightly more on debt service than other credit users but the striking factor in analysing spend on debt service by those using different credit vehicles is rather that expenditure is remarkably similar regardless of the credit vehicle used or the approach taken to managing payment. Payday users spend an average of \$426 p.m. on servicing debt across all their borrowings (i.e. all revolving

credit, fixed term loans and payday) compared to \$390 for all credit users with household incomes of less than \$50,000 p.a. and \$416 for credit card users.

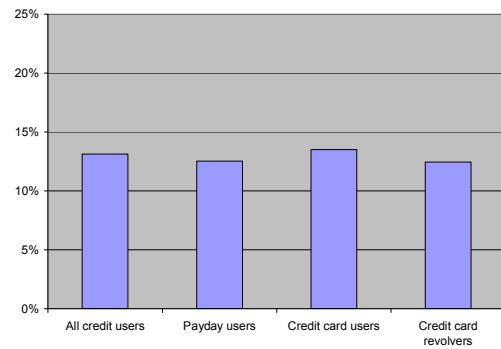
Total expenditure on debt service both in absolute terms and as a proportion of income is strikingly similar for those using different credit vehicles

Chart 31a. Total expenditure on debt service by credit user type



Base: Households with annual income of less than \$50,000 p.a.
Source: Synovate research for Policis 2008

Chart 31b. Total expenditure on debt service by credit user type



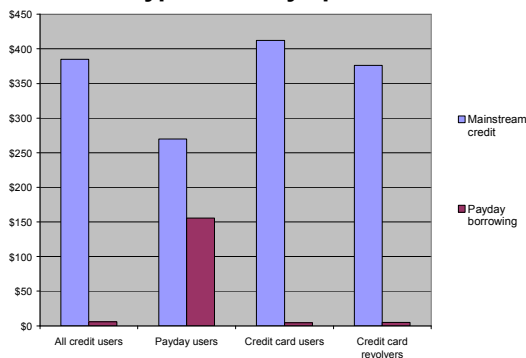
Base: Households with annual income of less than \$50,000 p.a.
Source: Synovate research for Policis 2008

Spend on mainstream credit represents the lion's share of expenditure on debt service for payday users

The similarity in overall expenditure on debt service between credit card users and payday users is the more remarkable because payday users and credit card users are using very different credit vehicles with very different pricing structures. For payday users, spend on mainstream debt service represents the lion's share of monthly outgoings on debt service, being almost two thirds (63%) of the total, at \$270 p.m., while average expenditure on servicing payday loans¹⁹ is some \$156 p.m. Among credit users and credit card users as a whole, service of payday loans represents only around 1% of total expenditure. For those using a range of different vehicles and approaches to managing debt, expenditure on debt service represents a remarkably similar share of income. The proportion of income devoted to debt service by payday users is 13%, in line with that for all credit users in households with income of less than \$50,000.

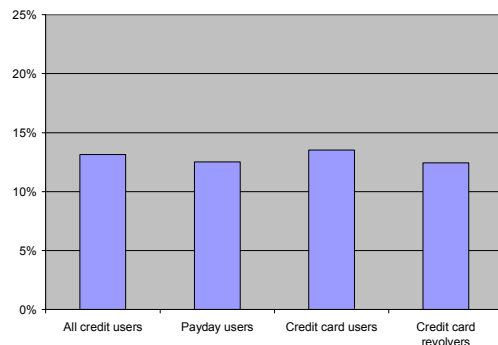
Expenditure on mainstream credit represents two thirds of payday users spend on debt service

Chart 32a. Total expenditure on debt service on mainstream and payday borrowing by credit user type. Monthly spend \$



Base: Households with annual income of less than \$50,000 p.a.
Source: Synovate research for Policis 2008

Chart 32b. Expenditure on debt service relative to household incomes



Base: Households with annual income of less than \$50,000 p.a.
Source: Synovate research for Policis 2008

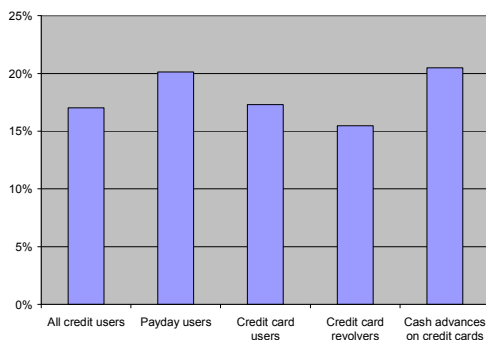
¹⁹ On the basis of annualised spend on servicing payday debt, assumed spread across the year.

Debt service represents a higher share of income for low income households

Among low income households, expenditure on debt service is much lower than among higher income households but represents a significantly higher share of income. Low income payday users spend on average a little less on debt service (\$295 p.m.) than all low income credit users (\$308) but this represents a higher share of income (20%) than is the case with all low income credit users (17%). Significantly however, the share of income represented by debt service for payday users is the same as that for low income borrowers taking cash advances on credit cards (20%). Low income borrowers taking cash advances on credit cards tend to be a little better off than their counterparts using payday but are subject to a similar degree of financial pressure²⁰. Expenditure on debt service among households with household incomes of more than \$35,000 represented a much smaller share of income overall, some 11% of the total, with little variation between users of different credit vehicles

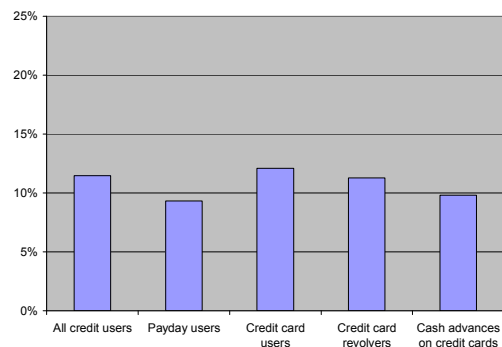
Debt service represents 20% of household income for both payday users and those taking cash advances on credit cards

Chart 33a. Expenditure on debt service relative to household income. Households less than \$35,000 p.a.



Base: Households with annual income of less than \$35,000 p.a.
Source: Synovate research for Policis 2008

Chart 33b. Expenditure on debt service relative to household income. Households more than \$35,000 p.a.



Base: Households with annual income of more than \$35,000 p.a.

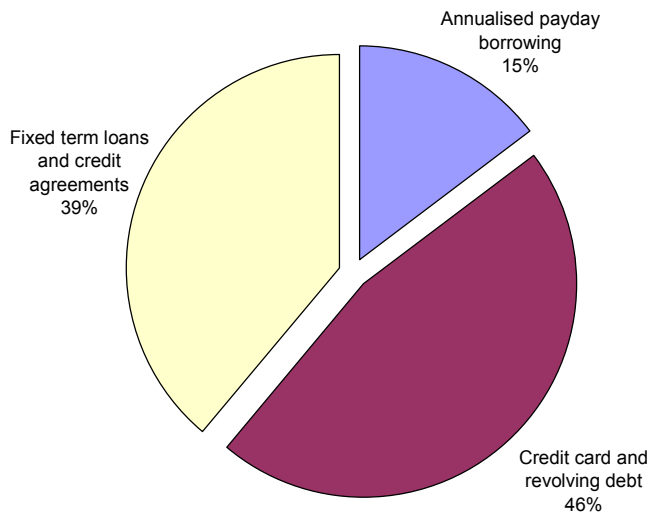
Payday borrowings represent a small share of total indebtedness for payday users

Payday borrowings represent a relatively small share of overall indebtedness for payday borrowers, with annualised borrowings being some 15% of total indebtedness. Again there are significant differences between low income borrowers with little access to the credit mainstream and other payday user types, with payday borrowing tending to represent a higher share of total borrowings for those on low and insecure incomes, who are more likely to use pawn alongside payday rather than mainstream credit. These differences are discussed in some detail in the chapter on segmentation following.

²⁰ For a detailed description of the circumstances and needs of low income borrowers using different credit vehicles see "The dynamics of low income credit use – A research study of low income households in Australia, Policis, 2008.

Outstanding revolving credit balances are the major component of payday users' indebtedness

Chart 34. Payday users - Payday debt as proportion of all debt



Base: All payday users
Source: Synovate research for Policis 2008

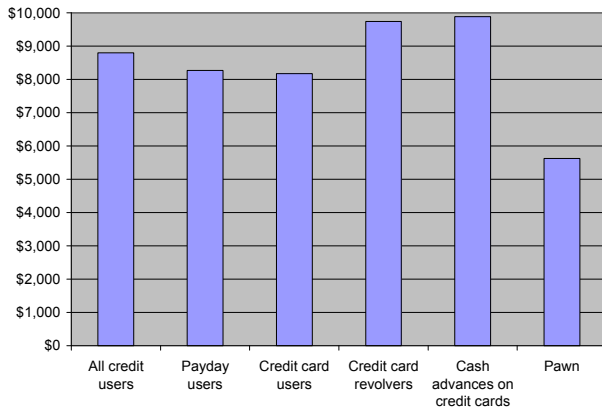
Payday users have significantly lower overall indebtedness than credit card revolvers or those taking cash advances on credit cards

In all of the income ranges examined monthly expenditure on debt service by credit card revolvers tended to be lower than for other credit users and indeed other credit card users, while representing a similar share of income. The flip side of this relatively low expenditure on debt service is, however, that revolvers tend to have higher overall indebtedness. In choosing not to, or being unable, to pay down debt, revolvers are by definition extending the term over which they pay for credit. If borrowers continue to utilise revolving credit lines, the tendency is then for debt to escalate, particularly so in the case of those taking cash advances or those making only partial payments on outstanding balances.

As a result, indebtedness is highest among credit card revolvers and those taking out cash advances on credit cards, averaging a little less than \$9,750 for credit card revolvers and a little less than \$9,900 for those taking cash advances on credit cards, compared to some \$8,800 for all credit users with household incomes of less than \$50,000 as a whole. Payday borrowers' overall indebtedness, on the other hand, on average a little less than \$8,300, is slightly lower than average for all credit users with household incomes of less than \$50,000, and some 20% lower than for credit card revolvers and those taking out cash advances on credit cards. This pattern holds true across the income ranges but is most pronounced among the higher income payday users making greatest use of credit cards.

Payday users owe 20% less than their counterparts taking cash advances on credit cards

Chart 35. Total indebtedness by credit user type



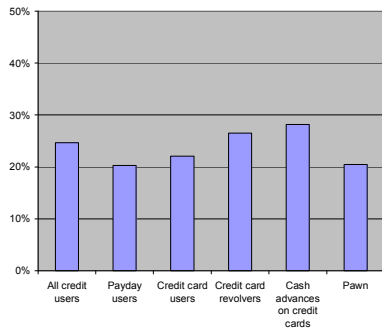
Source: Synovate research for Policis 2008

Total indebtedness as a proportion of income is also lower for payday borrowers than for other credit user types

Debt also appears lower as a proportion of household income for payday users than for other borrower types, with total indebtedness being some 20% of income for payday users compared to 25% for all credit users in households with incomes of less than \$50,000. Indebtedness as a proportion of household income peaks among those taking cash advances on credit cards, at some 28%. As with debt service, however, indebtedness as a proportion of household income is highest among those on low incomes and is highest for those credit users least able to manage financial pressure points and most in need of small sum credit, i.e. low income credit users taking out payday loans or cash advances on credit cards. As with debt service as a proportion of income, debt as a proportion of income is very similar for both groups, being 41% for low income payday users and 40% for low income credit users taking cash advances on credit cards.

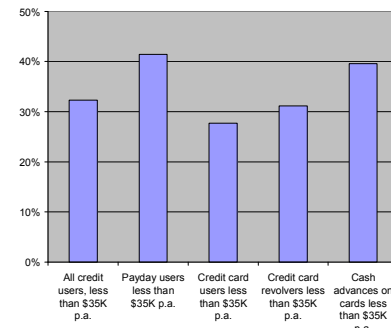
The effect is greatest in higher income range with greatest access to revolving credit - payday users are significantly less indebted than other credit users

Chart 36a. Debt as a proportion of household income



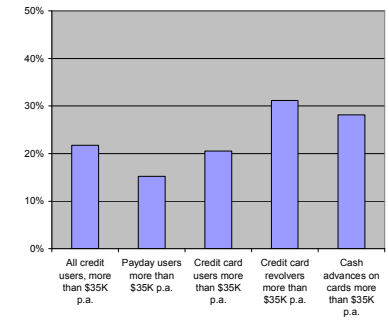
Source: Synovate research for Policis 2008

Chart 36b. Debt as a proportion of household income



Base: Households with annual income of less than \$35,000 p.a.

Chart 36c. Debt as a proportion of household income



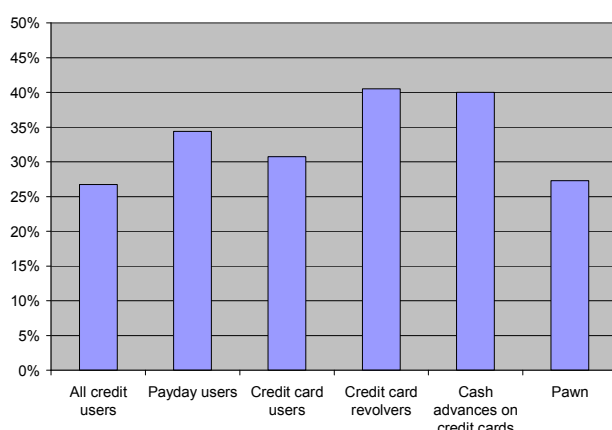
Base: Households with annual income of more than \$35,000 p.a.

Payday users are less likely to miss payments on mainstream credit than users of revolving credit or those taking cash advances on cards

We now turn to examine the incidence of repayment difficulties and the extent to which users of different types of credit are more or less exposed to drivers of increased cost on mainstream credit. The incidence of account delinquency is higher for payday users, a third of whom (34%) have missed or made late payments on credit cards, than for all credit users in households with incomes of less than \$50,000 p.a., a little over a quarter of whom (27%) have missed or made late payments on credit agreements. However, payday users are significantly less likely than those using revolving credit or taking cash advances on credit cards to miss or make late payments, with four in ten of both the latter groups having done so. Higher income credit users (i.e. those with incomes of more than \$35,000 p.a.) are more likely to have missed payments on mainstream credit than their lower income counterparts but high income payday users also exhibit less account irregularity than card revolvers and those taking cash advances on credit cards. Some 38% of payday users and 44% and 42% of card revolvers and those taking cash advances respectively admit to missing or making late payments on credit cards and loans.

Delinquency on mainstream credit is 20% lower for Payday users than for credit card revolvers or those taking cash advances on credit cards

Chart 37. Incidence of delinquency on loans and credit card agreements



Source: Synovate research for Policis 2008

Consequently payday users are less likely than other credit users to have paid penalty charges and bank fees associated with account delinquency

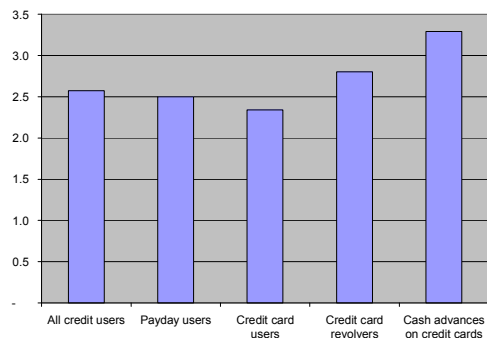
Both the qualitative and quantitative analysis suggested that some payday borrowing is used to avoid penalty charges on mainstream credit or bank accounts and damage to credit histories. There is some evidence that payday users have less exposure to penalty charges than for borrowers using credit cards as a source of small sum credit. A little over a quarter of payday users have paid penalty charges for late payments on credit cards compared to a third of all credit users in households with income of less than \$50,000 p.a. More than four out of ten of both credit card revolvers (41%) and those taking out cash advances on credit cards (44%) have paid penalty charges on credit cards.

Payday borrowers who do miss payments on mainstream credit also miss fewer payments than other borrower types

Payday users who do miss payments on loans and credit agreements also appear to miss fewer payments than other credit user types. Payday users who miss payments on mainstream credit averaged 2.4 missed payments a year, compared to 2.6 payments per year for all credit users missing payments. Card revolvers miss 2.8 payments per year while those taking cash advances on credit cards miss 3.3 payments per year.

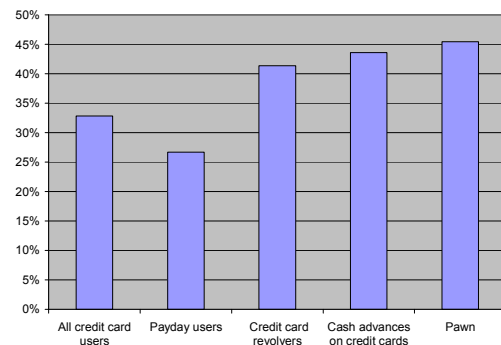
Payday users miss fewer payments on mainstream credit, pay down balances faster and pay fewer penalty charges than other users of revolving credit

Chart 38a. Number of missed payments on loans and credit card agreements p.a.



Source: Synovate research for Policis 2008

Chart 38b. Penalty charges on credit cards



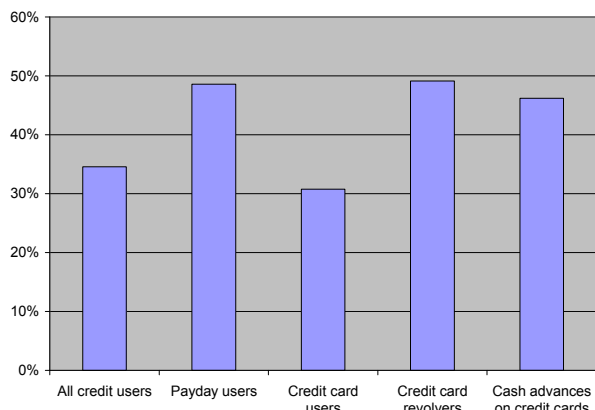
Source: Synovate research for Policis 2008

Payday borrowers do not appear any more likely than those using revolving credit or taking cash advances on credit cards to fall behind on household bills

Payday users appear to be more likely than other credit users to have found themselves falling behind on rent and mortgage payments, household and utility bills. Almost half of payday users (49%) have been in arrears on such payments at some point compared to a little over a third (35%) of all credit users with household incomes of less than \$50,000 p.a. This does not appear to be a function of payday use itself but rather of constrained incomes and competing pressures on budgets typical of those needing small sum cash credit or unable to pay off revolving credit balances. The incidence of arrears on household bills among revolvers on credit cards (49%) and those taking cash advances on credit cards (46%), as discussed earlier the leading source of small sum cash credit, is very similar to that among payday users.

Payday borrowers no more likely to have arrears on household bills than users of revolving credit or those taking cash advances on credit cards

Chart 39. Incidence of arrears on household bills (rent, utilities, phone)



Source: Synovate research for Policis 2008

Payday does appear to be playing a role in preventing payment difficulties on mainstream credit leading to default and financial break-down

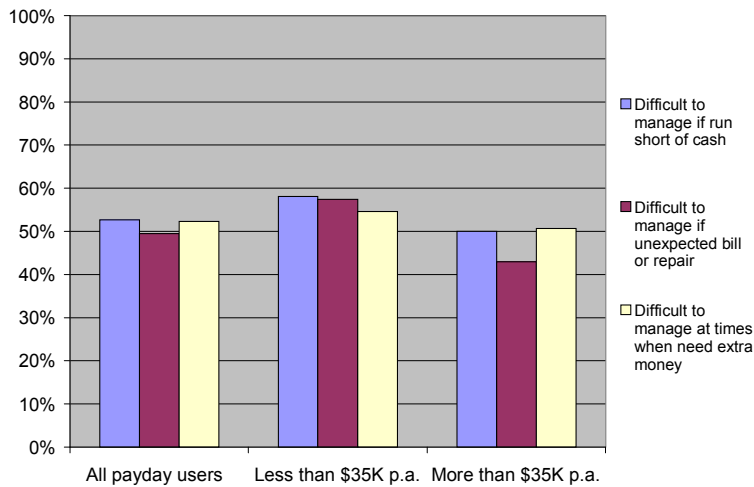
The quantitative data just described supports the qualitative evidence that some payday users are using short term credit in preference to cash advances on credit cards as part of a strategy to avoid escalating debt on revolving credit vehicles. The quantitative data also supports the qualitative evidence that some of payday borrowing is used to prevent payment difficulties on mainstream credit resulting in penalty charges, damage to credit records or, for those struggling to cope with mainstream credit, to prevent payment difficulties deteriorating to the point of default and even financial breakdown.

Payday users themselves take the view that payday has a positive role to play in managing cash flow, meeting commitments and preventing financial crises

Payday users themselves take the view that, on balance, despite the high cost of credit, payday has a positive role to play in enabling borrowers to afford essentials, keep up with bills and commitments and avoid getting into serious financial trouble, with lower income users most likely to feel this way. More than half believe that without payday it would be difficult to manage in the event of a cash shortfall or unexpected expense or through times of peak expenditure. Four out of ten believe that without payday they would be more likely to miss bills and other commitments and three out of ten that without payday they would be more likely to get into trouble financially.

More than half of payday users would find it difficult to manage through cash shortfalls, unanticipated expenses or peaks of expenditure without payday

Chart 40. Impact of withdrawal of payday on financial pressure points



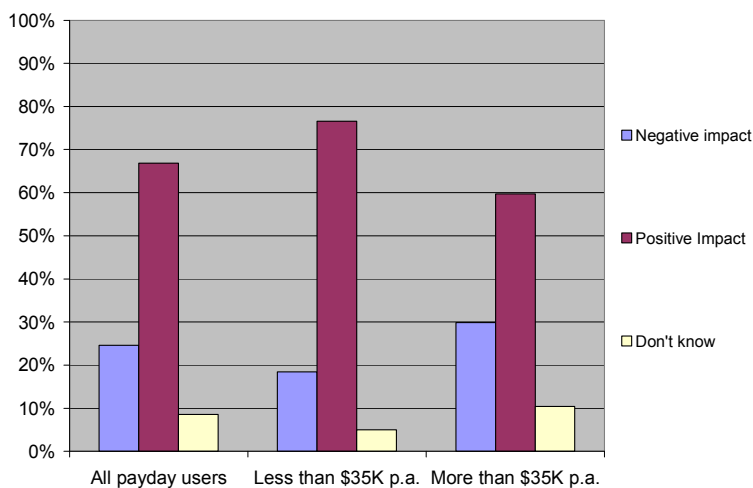
Source: Synovate research for Policis 2008

Two thirds of payday users and eight of ten low income payday users see payday as having a positive impact on their finances and quality of life

When asked “On balance, bearing in mind the high cost of pay day loans as well as the convenience of quick access to credit, would you say that pay day loans have a negative impact or a positive impact on your finances and quality of life?”, two thirds of payday users, rising to eight out of ten (77%) of low income pay day users took the view that payday had a positive impact compared to a quarter who took the opposite view.

Low income payday users are most likely to take view that payday has positive role to play in finances

Chart 41. Perceptions of overall impact of payday on finances



Source: Synovate research for Policis 2008

There is ambiguity in perceptions of the impact of payday on finances in that a quarter of payday users feel payday has a negative impact on finances

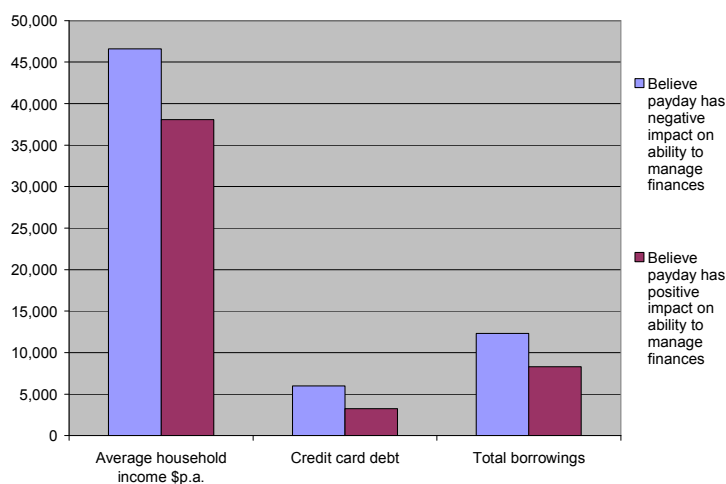
There is clearly some degree of ambiguity in perceptions of the impact of payday in that, while the balance of views is heavily weighted towards the view that payday has a positive impact on household finances, a significant minority - a little less than a quarter of all payday users, rising to three in ten of those with household incomes of more than \$35,000 p.a. - feel that payday has a negative impact on their finances. We turn now to try and understand more about these borrowers and how they differ from other payday borrowers.

Borrowers who believe payday impacts their finances negatively are more affluent than other payday borrowers and are heavy mainstream credit users

Borrowers who believe that their ability to manage their finances is negatively impacted by payday are significantly more affluent than other payday users. These borrowers have an average household income of circa \$46,600 compared to circa \$38,000 for those who see payday as having a positive impact on their ability to manage their finances. They appear more likely than other payday borrowers to be heavy users of both payday loans and mainstream credit products. Their behavioural signature on credit cards also suggests a pattern of greater pressure than for other credit card and payday loans users. These borrowers have an average of \$6,000 dollars of credit card debt and are more likely to be making partial or minimum payments on credit cards than other payday or credit card users. Where minimum payments are being made, the length of time over which minimum payments have been made is also longer than average, at 2.3 years.

Those who believe that they would be better off without payday are high income households with higher than average debt

Chart 42. Household income for payday users by whether believe payday has positive / negative impact on ability to manage finances



Source: Synovate research for Policis 2008

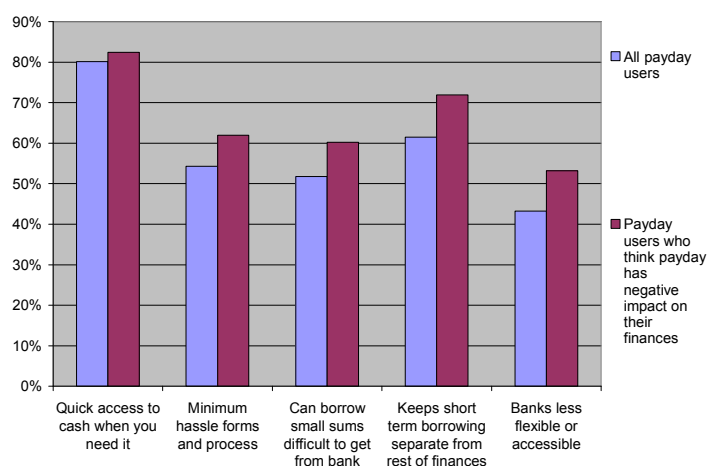
Payday borrowing is less distress-driven and greater value is placed on ready access to a convenient source of short term small scale cash credit

Borrowers who take the view that payday has a negative impact on their finances appear to be using payday in a slightly different way to those who feel that payday has a positive influence on their finances. The balance of emphasis in their

motivation for using payday is also different. Payday borrowing is less likely to be distress borrowing, borrowers are more likely to be single men or dual income family households and less likely to be single parents or reliant on uneven income. Payday is less likely to be used to make ends meet in the event of a cash shortfall or unanticipated repair and more likely to be used to avoid missing rent, mortgage or utility payments and to avoid reconnection charges. The convenience and ready access inherent in the payday model is also more important to this group than to other payday users and borrowers place greater value on being able to keep short term lending separate from the rest of their finances. It may well be that these more affluent borrowers who place a greater premium on convenience and who appear to be using payday in a rather more discretionary way are also less considered in their decision to take on a payday loan than those for whom repayments will be more painful.

Convenience-oriented borrowers using payday for discretionary purposes who feel they would be better off without payday less cautious in taking on loans

Chart 43. Features of payday model which appeal to payday users by views on whether payday has positive or negative impact on ability to manage finances



Source: Synovate research for Policis 2008

Payday appears to be meeting a genuine need for short term cash credit which acts to facilitate cash flow and minimise the impact of minor financial crises

Taken together, both the qualitative and quantitative evidence suggests that payday meets a clear need for short term low value credit and that, on balance, for most users, short term credit has a broadly positive impact despite its acknowledged expense. It appears to facilitate cash flow, enabling users to provide essentials which might otherwise be very difficult to obtain at times of financial pressure and acting to prevent temporary financial difficulties becoming crises. For some users, typically over-stretched users of mainstream credit at risk of slipping into default, payday would appear also to be acting as a buffer against financial break-down.

The hypothesis that payday creates a debt spiral among vulnerable borrowers and compromises their ability to afford essentials does not appear supported

Payday is clearly high cost and borrowers' budgets are indubitably under some pressure during the period in which repayments are being made, and in some cases, for some while thereafter. This would indeed appear to be why the use of payday is carefully considered particularly by the most pressured and lower income borrowers.

That said, the evidence indicates that the hypothesis that payday users become trapped in a debt spiral is not supported by the facts. Borrowers are frequently - but a long way from continually - in the market, most contracts are repaid to term and at the anticipated price, loan extensions are rare, very short term and in a significant minority of cases do not generate additional costs for the borrower.

Payday borrowers expenditure on debt service appears very similar to that of other credit users while levels of indebtedness are lower

The evidence also is that while repayment of payday loans may cause borrowers to make some sacrifices and tighten their belts, it does not compromise users' ability to afford essentials, indeed rather the reverse. Payday borrowers' expenditure on debt service appears very similar to their counterparts using other credit vehicles. Payday users appear less indebted than other credit users, are less exposed to penalty and reconnection charges and are no more likely to have problems meeting major commitments and household bills than other users of revolving and small sum cash credit.

Those borrowers who feel that payday has a net negative impact on their finances are better off mainstream credit users using payday for convenience

The high cost of credit appears rather to be acting as a disincentive to use for hard low income payday users households. These borrowers appear to consider carefully before taking on a payday loan, doing so only when repaying a payday loan is a better option than being unable to afford essentials or running into financial difficulties. There is a significant sub-set of convenience-oriented users who feel that they would be better off without using payday but it would appear that these are not in fact the most vulnerable borrowers but rather more affluent borrowers taking on payday loans in parallel to heavy use of mainstream credit.

6.0 Segmentation of payday users

Segmentation of payday users

Payday users appear to divide into four discrete segments:

- **Payday Mainstream** (45%). Large and conservative segment with modest levels of both non standard and mainstream credit use and little problem debt
- **Mainstream Excluded** (19%). Relatively disadvantaged low income segment with constrained access to the credit mainstream who actively avoid use of revolving credit
- **Mainstream Strugglers** (12%). Small highly pressured segment with serious adverse history using payday to prevent financial difficulties becoming financial break-down
- **High income convenience users** (25%). Relatively affluent group of heavy credit users using payday more frequently than other borrowers alongside mainstream credit

A segmented perspective on demand environment adds significant insight on the underlying dynamics and likely impact of policy moves

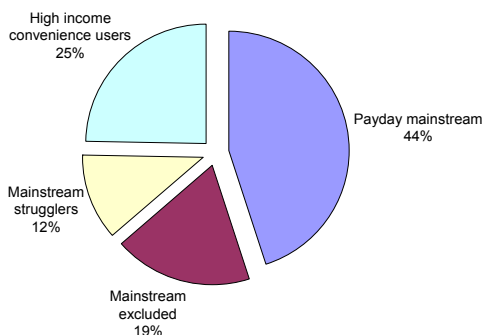
Segmentation of the market is essential to understanding not only the needs of low income and high risk borrowers using high cost credit but also the likely impact of policies intended to influence the provision of credit at the high cost end of the market. This section sets out to describe an effective segmentation of payday users in order to provide some insight into the needs and characteristics of different segments of the market and how regulatory approaches to regulating payday lending might impact different groups of high cost credit users.

The various market segments bring different circumstances, attitudes and needs to their use of payday

The market segments clearly into four discrete segments with distinctive characteristics and needs, which we describe as follows.

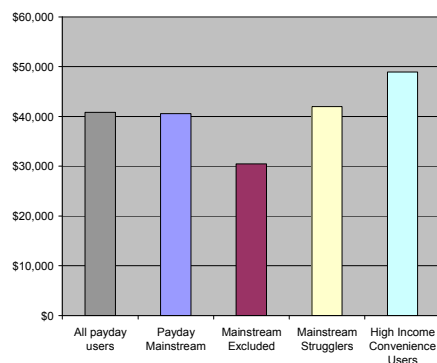
- Segment 1. (45% of total) "Payday Mainstream"
- Segment 2. (19% of total) "Mainstream Excluded"
- Segment 3. (12% of total) "Mainstream Strugglers"
- Segment 4. (25% of total) "High Income Convenience Users"

Chart 44a. Distribution of segments within payday population



Source: Synovate Research for Policis 2008

Chart 44b. Average incomes by segment

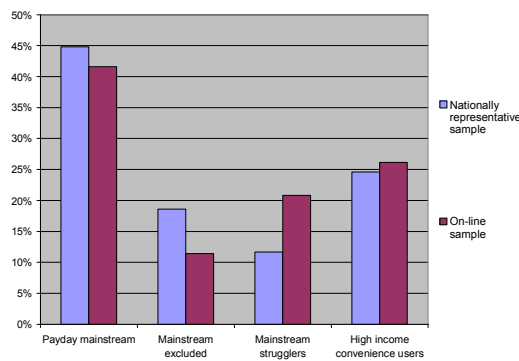


Source: Synovate Research for Policis 2008

The distribution of the segments within the total population is based on the nationally representative sample. The more affluent and more troubled sample which arose from the self-selected online survey sample showed a different distribution of the segments, with far fewer mainstream credit excluded individuals (40% fewer) and far more borrowers (1.8 times as many) with significant mainstream credit problems. That said, this sample also suggested that a little over four in ten fall into the “Payday Mainstream” segment and that around a quarter are “High Income Convenience Users”, a near identical distribution to that found in the nationally representative phone survey.

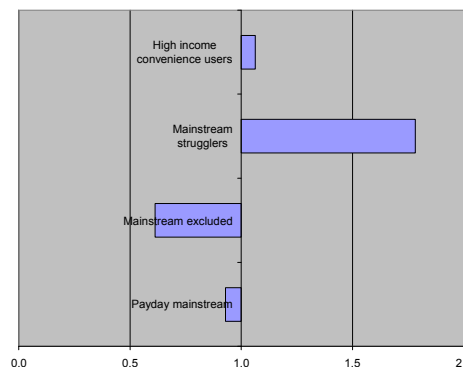
Online survey suggests similar distribution of major segments but exhibits fewer excluded borrowers and more of those with mainstream credit problems

Chart 45a. Distribution of segments for nationally representative and on-line sample



Source: Synovate Research for Policis 2008

Chart 45b. Segment distribution online sample relative to nationally representative sample



1.0 = equal balance between nationally representative and online sample
Source: Synovate Research for Policis 2008

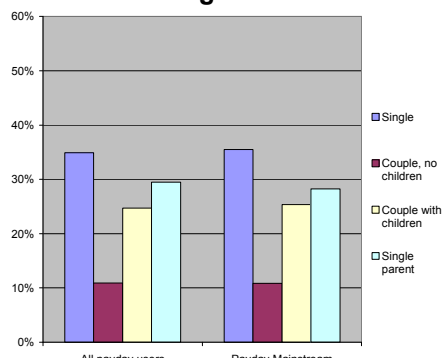
The “Payday Mainstream” segment

A large and conservative segment with modest levels of both non standard and mainstream credit use and little problem debt

So called because this segment represents the mainstream of payday users, and at just under half the total (45%), the largest single group within the universe of payday users. The key characteristics of this segment compared to other payday users are low levels of credit use generally, with a relatively low incidence also of problem debt or arrears on household bills. These borrowers have access to the credit mainstream and appear to use credit in a considered, careful and relatively modest manner, using payday primarily as a source of short term cash to manage cash flow.

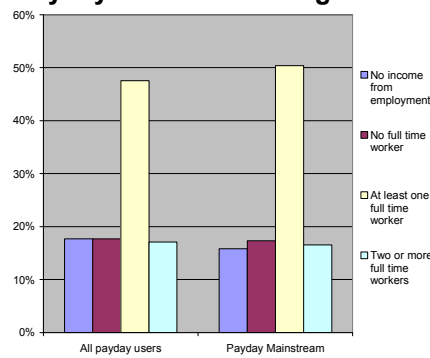
Demographics broadly in line with those for payday users as a whole

Chart 46a. Household type for “Payday Mainstream” segment



Source: Synovate Research for Policis 2008

Chart 46b. Employment profile for “Payday Mainstream” segment



Source: Synovate Research for Policis 2008

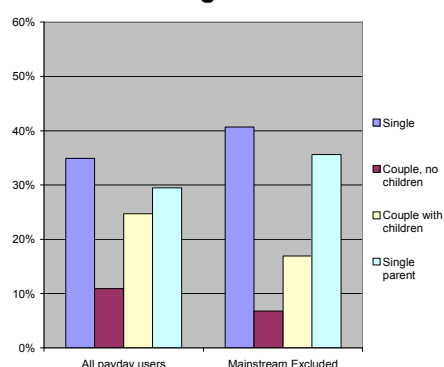
The “Mainstream Excluded” segment

A relatively disadvantaged segment with few mainstream credit options characterised by their avoidance of revolving credit

These borrowers, circa one in five of the total, are more disadvantaged than other payday users. Average incomes are significantly lower than other payday users, with a higher proportion of single parents and fewer full time incomes. More than half borrow from payday lenders because they have no other credit options. A key characteristic of this segment is that they are not credit card or revolving credit users. The segment is more likely than other borrowers to be distress borrowers, turning to payday in the face of cash emergencies and shortfalls.

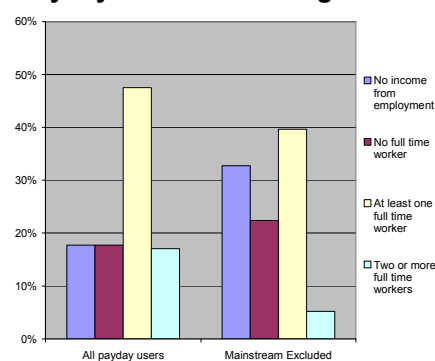
More single parents and fewer full time workers than other segments

Chart 47a. Household type for “Payday Mainstream” segment



Source: Synovate Research for Policis 2008

Chart 47b. Employment profile for “Payday Mainstream” segment



Source: Synovate Research for Policis 2008

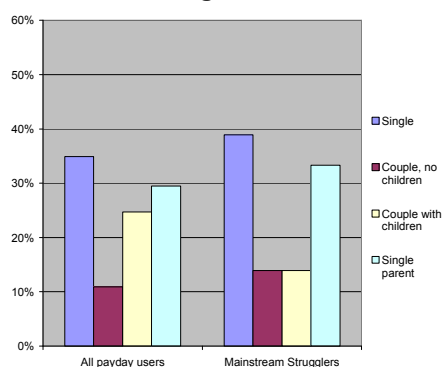
The “Mainstream Strugglers” segment

A small, highly pressured segment of heavy credit users with serious adverse history using payday to prevent financial difficulties becoming break-down

A little over one in ten of the total, this segment have incomes in line with the average for payday users and, like the majority of payday users, tend to be in work. They exhibit high levels of credit use generally, across both the credit mainstream and non standard sectors. Their defining characteristic is that they exhibit high levels of credit and financial difficulties, and appear under significant financial pressure. Many are barely coping with - or have failed to cope with - mainstream credit use, with credit difficulties arising primarily on credit cards. Nine out of ten have at some point been three months or more behind on credit agreements. Eight out of ten describe themselves as “maxed out” on credit cards, either currently or in the past. Two thirds have been making minimum payments on credit cards for more than three years. For some of these borrowers payday has become their only available source of credit. Many are using payday to prevent financial pressure points and difficulties becoming financial break-down – essentially to prevent slipping over the edge. Payday is used to keep up with commitments, credit and otherwise, to preserve credit records and as an essential lubricant of cash-flow where budgets are often stressed and over-stretched.

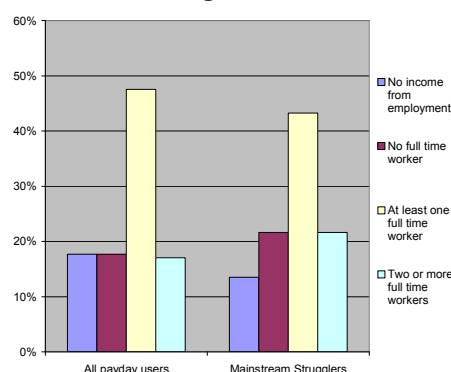
More singles and single parents than other segments but large majority in full time work

Chart 48a. Household type for “Payday Mainstream” segment



Source: Synovate Research for Policis 2008

Chart 48b. Employment profile for “Payday Mainstream” segment



Source: Synovate Research for Policis 2008

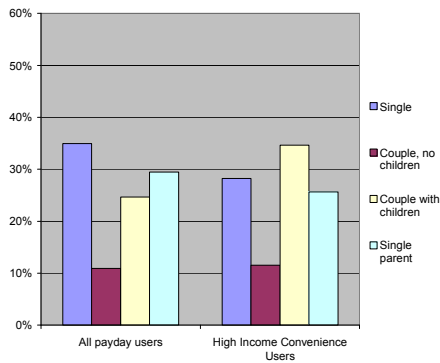
The “High Income Convenience User” segment

High income heavy users of both mainstream and non standard credit using payday alongside other forms of small sum short term credit

These are significantly higher income group than other payday users, representing a quarter of the total, with this group being among the most active payday users and relatively heavy mainstream credit users also. The segment contains a significant minority of individuals who have struggled with mainstream credit but the key difference between this segment and the “Mainstream Strugglers” segment is that this group is not only more affluent but also that they are coping with credit more effectively, even if they sometimes sail close to the wind. Only one in twenty (5%) have faced serious problems with credit repayments i.e. been three months or more behind on credit agreements, the point at which most such agreements would be treated as in default. For this segment, payday is used in parallel with mainstream credit but has a distinct role to play in the wider credit portfolio. Payday is used as accessible short term, low-value borrowing which can be kept separate from the rest of individuals’ or households’ finances. This segment deploy payday specifically to avoid fees and charges on credit agreements, overdrafts or utility bills and to keep up with mortgages and other commitments, often as part of a strategy of avoiding damage to credit records and thus maintaining ready access to low cost mainstream credit and, most importantly, mortgage borrowing.

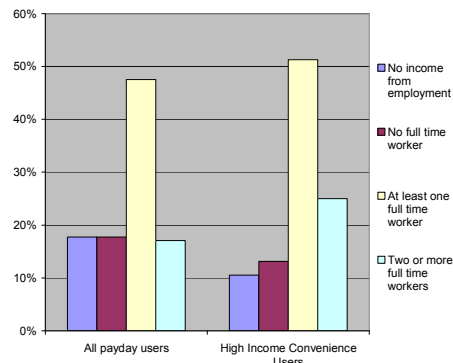
Better off than other payday users, more likely to be couples and families and more likely to be dual income households

Chart 49a. Household type for “Payday Mainstream” segment



Source: Synovate Research for Policis 2008

Chart 49b. Employment profile for “Payday Mainstream” segment



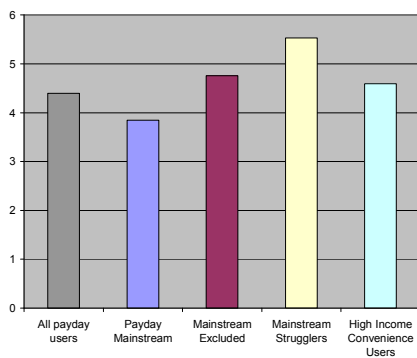
Source: Synovate Research for Policis 2008

“Payday Mainstream” segment borrow least often and in more considered way while higher income borrowers are most frequently in the market

The generally modest credit use segment “Payday Mainstream” take out fewer payday loans (average 3.8 p.a) and with longer intervals between loans than other payday users, with slightly less than six out of ten (58%) having been in the market for a payday loan in the last twelve months. Frequency of use and number of loans is higher among the more affluent segments, with the “Mainstream Strugglers” segment averaging 5.5 loans per year and almost eight out of ten (77%) of High Income Convenience Users having taken out a payday loan in the last twelve months.

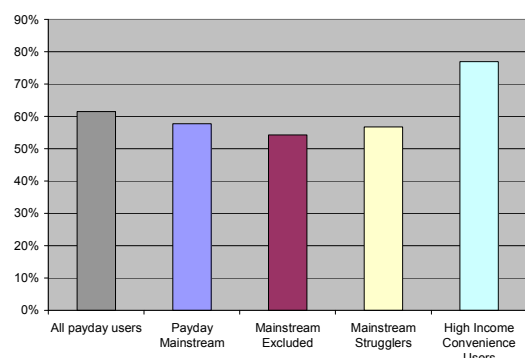
Higher income mainstream credit users most frequently in the market

Chart 50a. Average number of payday loans p.a. by segment



Source: Synovate Research for Policis 2008

Chart 50b. Frequency of payday use by segment % using payday lending in last 12 months



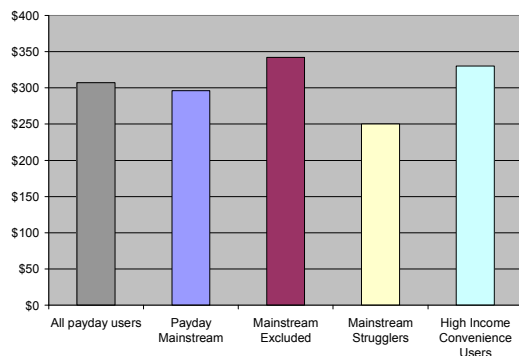
Source: Synovate Research for Policis 2008

The “Mainstream Excluded” segment with fewer alternative credit options take out the largest loans and so borrow most over the course of the year

Overall, however, it is the most disadvantaged “Mainstream Excluded” segment, for whom payday is most central to overall credit use, who borrow most over the course of the year, taking out the largest single loans (averaging \$342) and borrowing a total of \$1,627 p.a.

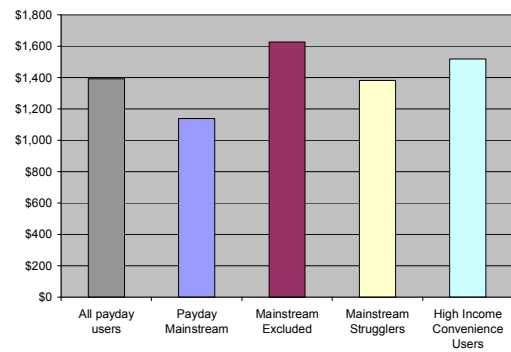
Most disadvantaged segment take out larger loans and borrow most over year with this borrowing representing largest share of all debt

Chart 51a. Value of most recent payday loan by segment



Source: Synovate Research for Policis 2008

Chart 51b. Annualised value of payday borrowing by segment



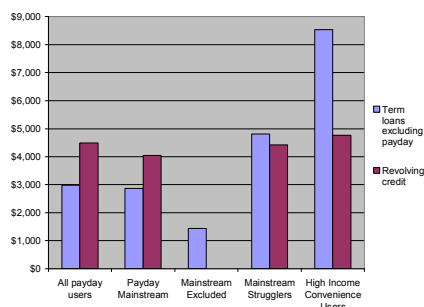
Source: Synovate Research for Policis 2008

Payday use most central to credit use for “Mainstream Excluded” segment but represents only a small share of debt for other payday users

For these “Mainstream Excluded” borrowers, payday borrowing represents more than half (53%) of all debt, with total indebtedness, at a little over \$1400, very much lower than for all other payday user segments. For the other payday user types, payday is much less pivotal to credit repertoires and payday borrowing represents only a small share of indebtedness, being between 10% and 15% of the total in each case. Term loans and credit agreements (including car loans) represent the largest share of debt for the two higher income segments, varying between a little under half for the “Mainstream Strugglers” to some 58% for the “High Income Convenience Users”. Revolving credit debt, on the other hand, represented half of total debt for the “Payday Mainstream” whereas term loans accounted for little more than a third for that segment. Total indebtedness is highest among the “High Income Convenience Users” at a little more than \$14,800, being circa \$10,600 for the “Mainstream Strugglers” and circa \$8,900 for the “Payday Mainstream” segment. For all of the segments with credit cards, revolving credit debt was in excess of \$4,000 with relatively little variation between segments. Balances outstanding were circa \$4000, \$4,400 and \$4,800 for the “Payday Mainstream”, “Mainstream Strugglers” and “High Income Convenience User” segments respectively.

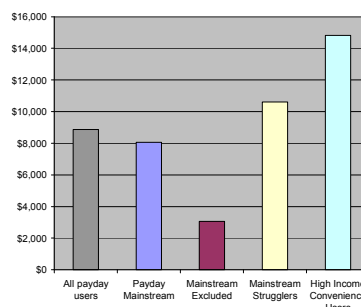
Payday small component of indebtedness with exception of “Mainstream Excluded” segment

Chart 52a. Debt values by segment and credit type



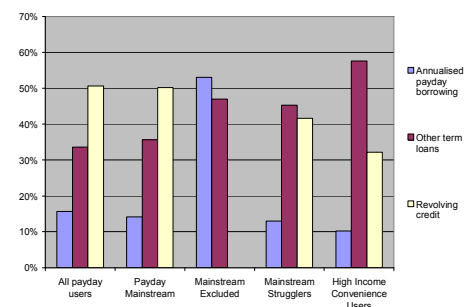
Source: Synovate Research for Policis 2008

Chart 52b. Total value of indebtedness by segment



Source: Synovate Research for Policis 2008

Chart 52c. Payday borrowing within wider picture of indebtedness



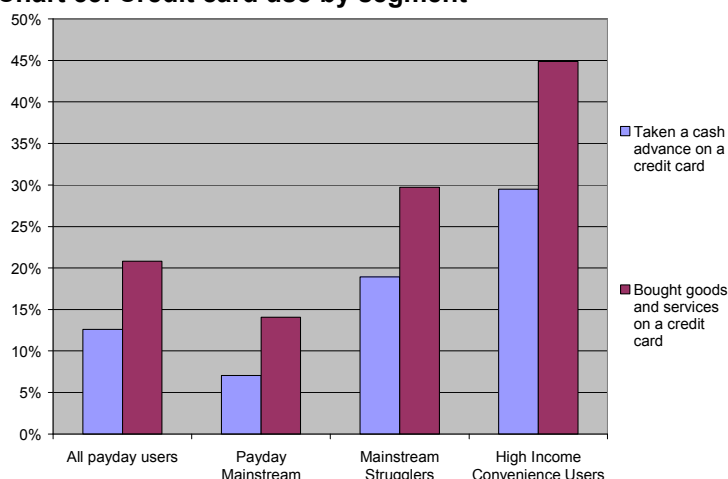
Source: Synovate Research for Policis 2008

“Payday Mainstream have modest levels of card use but “Convenience Users” and “Mainstream Strugglers” make significant use of cash advance on cards

Patterns of mainstream credit use, particularly revolving credit use, varied significantly between the segments, however. As noted earlier, credit cards were not a feature of the credit use of the “Mainstream Excluded” group. Among the “Payday Mainstream” segment, credit card use was modest, with only 14% using cards to buy goods and services in the past twelve months and only 7% having taken a cash advance on a credit card in the same period. Both the more upmarket heavy credit user segments had significantly higher levels of credit card use and were much more likely also to raise small sums of cash through cash advances on credit cards in parallel to their payday borrowing. Among the troubled “Mainstream Strugglers” segment, three in ten had bought goods and services on a credit card and one in five (19%) had taken a cash advance in the last twelve months. Among the “High Income Convenience Users” credit cards played an even more significant role in credit repertoires, with 45% having bought goods and services on a credit card in the last twelve months and three in ten (29%) having raised a cash advance.

Cash advances on credit cards are a significant feature of the segments making heavy use of mainstream credit alongside payday borrowing

Chart 53. Credit card use by segment



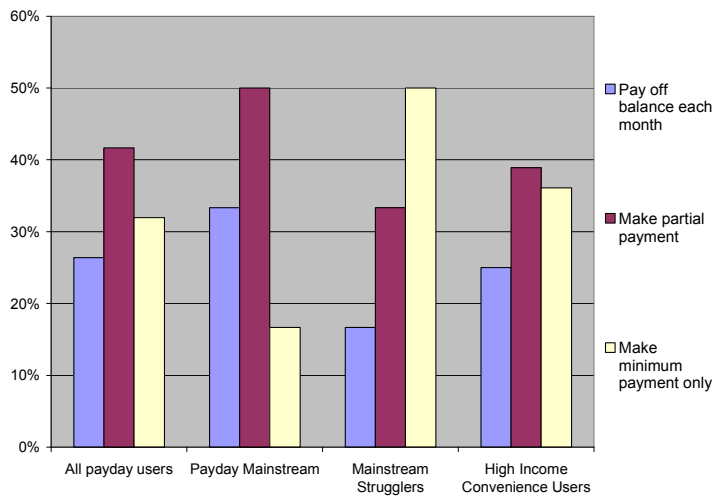
NB: Defining characteristic of Mainstream Excluded segment is that they do not use revolving credit and credit cards so this segment is not shown in this series relating to credit cards
 Source: Synovate Research for Policis 2008

Payday Mainstream have greater control over card debt while other card using segments more likely to have maxed out cards or to make minimum payments

The three segments also managed their credit cards in rather different ways. The generally modest and cautious credit users in the “Payday Mainstream” segment were more likely to be paying down and seeking to minimise balances while the other segments had a greater incidence of “revolving” credit but also of making minimum payments on outstanding balances. Among the “Payday Mainstream” segment, a third paid off outstanding balances on their cards each month and half made partial payments, with only 17% making minimum payments only. By contrast among the “Mainstream Strugglers”, the reverse pattern held true, with half making minimum payments (having done so for an average of a little over two years) and a third were making partial payments on balances. “High income convenience” users exhibited a not dissimilar pattern, but in less extreme form with more than a third (36%) making minimum payments (on average for some fifteen months), four in ten making only partial payments and a quarter paying down balances monthly.

Segments making heavy use of mainstream credit in parallel to payday exhibit high levels of “revolving” and of making minimum payments on credit cards

Chart 54. Management of revolving credit by segment



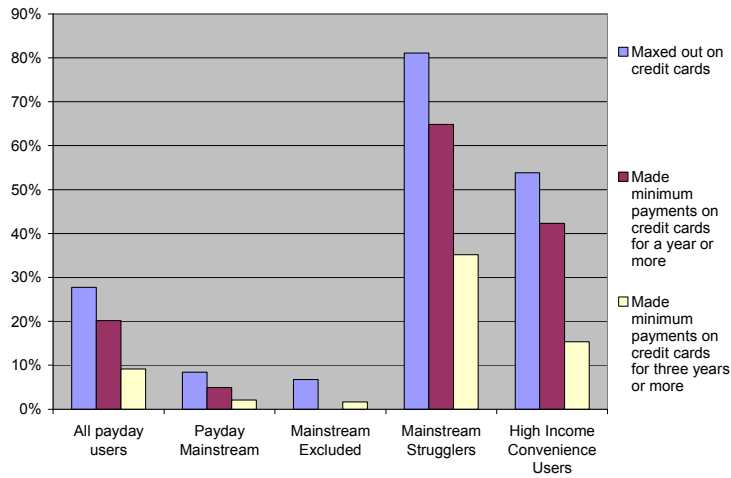
Base: Payday users with credit cards
 Source: Synovate Research for Policis 2008

Serious difficulties most heavily concentrated in “Mainstream Strugglers” but significant minority of other segments also struggle with revolving credit

The discussion section in 5.0 suggested that a significant minority of payday users had run into problems with mainstream credit, and revolving credit in particular. From a segmented perspective, it can be seen that these difficulties are concentrated in certain segments, most notably the “Mainstream Strugglers” segment. More than eight out of ten (82%) of those in this segment describe themselves as having been “maxed out” on credit cards, with two thirds having at some point made minimum payments for more than a year and a third having made minimum payments for more than three years at a time. A significant minority of the “High Income Convenience User” segment, though coping better overall, have also been through periods of barely coping with revolving credit, with more than half (54%) claiming to have been “maxed out” on cards and more than four out of ten (42%) having made minimum payments on credit cards for a year or more and 15% for three years or more. Relatively few of the “Payday Mainstream” segment share this experience, however, with less than one in ten (8%) having maxed out on credit cards and only one in twenty having made minimum payments for an extended period. Very few of the “Mainstream Excluded” segment appear to have a history of problematic mainstream revolving credit use.

Core payday users have few problems with revolving credit while segments with heavy mainstream credit use appear more likely to struggle

Chart 55. Repayment behaviour on credit cards by segment



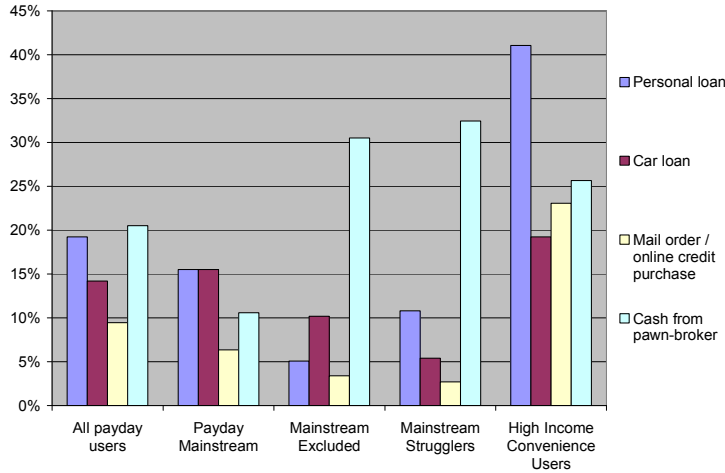
Source: Synovate Research for Policis 2008

Patterns of term loan use reflect both access to credit and the propensity of the different segments to be more or less heavy credit users

Patterns of term loan use among The “Payday Mainstream” segment again reflect the relatively modest use of credit among the group, with some 15% having taking out both personal loans from the bank and car loans over the last twelve months. Only one on in twenty (5%) of the “Mainstream Excluded” segment had taken out a bank loan while one in ten had had a car loan in the last twelve months. Three in ten had used a pawn-broker. By comparison term loans and credit agreements of all kinds, mainstream and fringe, were relatively heavily used by the “High Income Convenience User” segment, four in ten of whom had taken out a personal loan from a bank in the previous twelve months and one in five of whom had done the same with a car loan. Around a quarter of the segment had also used mail order with the same proportion using pawn-brokers. The “Mainstream Strugglers” segment had much lower levels of mainstream term credit use, not least because, on the basis of the background difficulties and the extent to which borrowers were at the limit of existing credit lines, access would likely be increasingly constrained for this group. This may explain the relatively high use of pawnbrokers, used by a third (32%) of the segment within the last twelve months.

Segments have distinctive patterns of term loan use with segments with constrained options using pawn and “Convenience Users” using bank finance

Chart 56. Use of fixed term credit (non payday) by segment



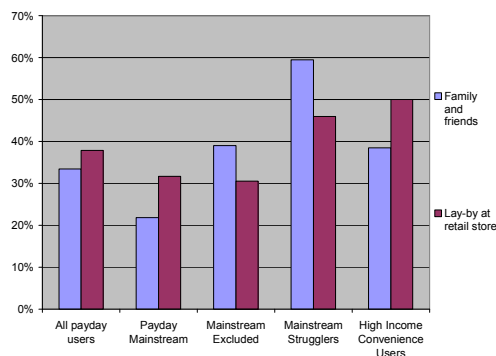
Source: Synovate Research for Policis 2008

Segments that are heavy credit users also make greater use of informal borrowing with the “Mainstream Excluded” more likely to use Social lending

The role of access to credit is reflected in patterns of informal and social credit use. Six out of ten of the “Mainstream Struggler” segment - whose access to credit is constrained by adverse credit history - have borrowed informally from family and friends while almost half have used lay-by at a retail store in the last twelve months. Almost a third have had a Centre-link loan. Four in ten of the “Mainstream Excluded” segment - whose access to credit is constrained by eligibility issues primarily because of insecure and / or low incomes - have borrowed informally, three in ten have used lay-by and a little over a half (51%) have had a Centre-Link loan. By contrast only one in five of the “Payday Mainstream” segment have borrowed informally, while three in ten have used lay-by or obtained a Centre-Link loan. The “High Income Convenience User” segment are much less likely than other segments to have taken on a Centre Link loan (19%) but use of informal borrowing reflects their generally high patterns of credit use, with four in ten borrowing from family and friends and half having used lay-by in the last twelve months.

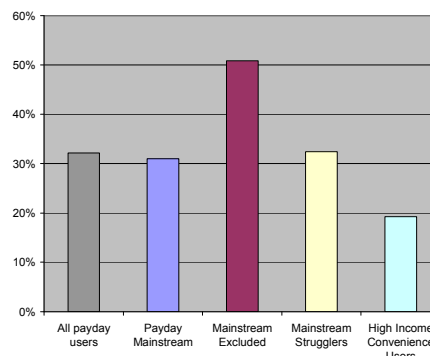
Heavy credit users also borrow more heavily informally. Use of social lending peaks in the disadvantaged “Mainstream Excluded” segment

**Chart 57a. Informal borrowing by segment
% Borrowing from family and friends in last 12 months**



Source: Synovate Research for Policis 2008

**Chart 57b. Social lending by segment
% with Centre-Link loan in last 12 months**



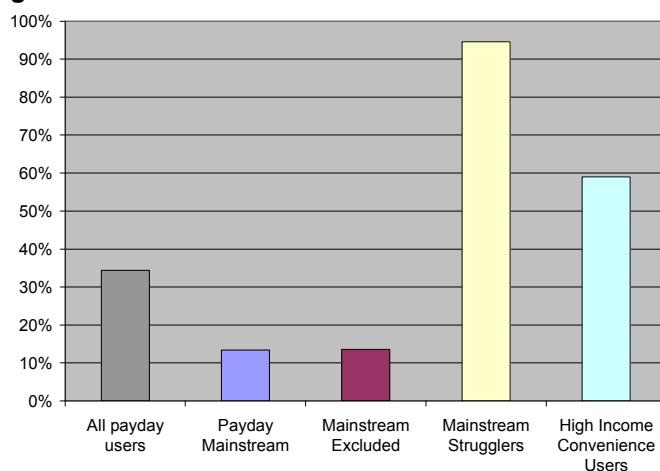
Source: Synovate Research for Policis 2008

Dramatic differences between segments in patterns of delinquency on mainstream loan and credit agreements

As has been discussed in previous chapters, missing and making late payments on credit and loan agreements is endemic among low income borrowers, not just in Australia but also in other credit markets. Missed payments arise usually because individuals run short of cash or because there are insufficient funds to accommodate both credit payments and more urgent competing priorities. The penalty charges that are associated with these missed and late payments are one of the principal mechanisms by which lenders adapt the cost of credit for higher risk borrowers using low APR credit models. There are very significant differences between the segments in the incidence and extent of such payment “delinquency” on mainstream credit models. Both the segments with modest use of mainstream credit have much lower levels of mainstream payment delinquency than the better off segments of heavy credit users. Only 13% of “Payday Mainstream” and “Mainstream Excluded” borrowers admit to having made late or missed payments on mainstream loan or credit agreements, compared to 95% of “Mainstream Strugglers” and 59% of “High Income Convenience Users”.

Core payday users exhibit little payment irregularity on mainstream credit while heavy credit using segment have high levels of delinquency

Chart 58. Whether have missed or late payments on mainstream loans or credit agreements



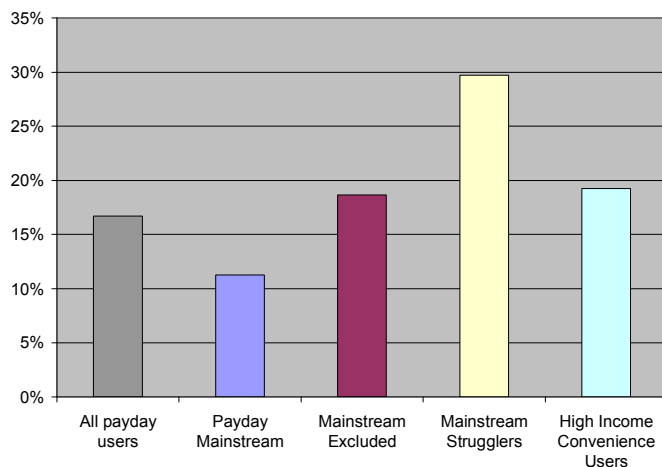
Source: Synovate Research for Policis 2008

The incidence of payment irregularity on payday loans is much lower than on mainstream credit reflecting the short term nature of contracts

The incidence of payment problems on payday loans is much lower than on mainstream credit, reflecting the short term nature of the contract, but also varies by segment. Only a little over one in ten “Payday Mainstream” borrowers have missed or made late payments on a payday loan, while close to one in five of both the “Mainstream Excluded” and “High Income Convenience Users” have done so. The highest incidence of payment problems on payday loans arise in the group that also exhibits greatest delinquency in the credit mainstream, i.e. the “Mainstream Strugglers”, three in ten of whom have made late or missed payments on a payday loan.

Segments most reliant on payday because of constrained credit options also those most likely to reschedule or miss payday payments

Chart 59. Ever had problems with repaying payday loan on time and contract term



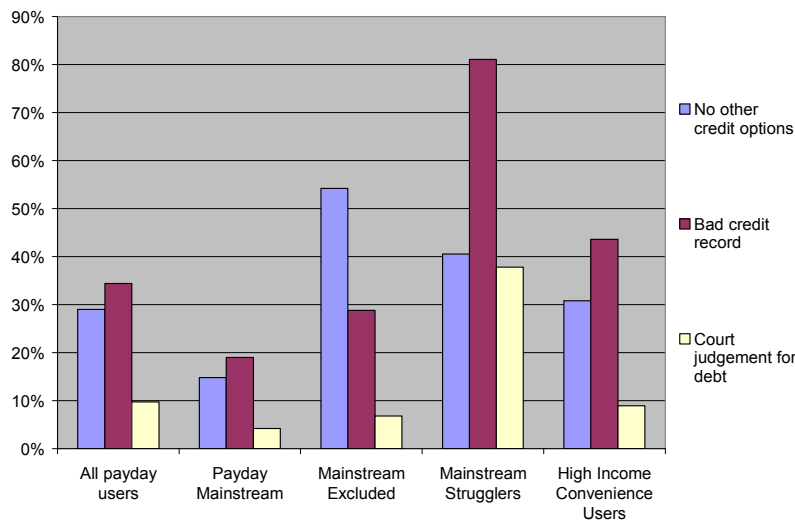
Source: Synovate Research for Policis 2008

The core payday user base appears to be less likely than other low income credit users to run into serious financial difficulties

The patterns of credit use just described are reflected in the outcomes of credit use and in patterns of the experience – and avoidance - of financial difficulties. As was discussed in section 5.0, a significant minority of payday borrowers have experienced financial difficulties and have an adverse credit history, with some borrowers having no other credit options as a result. Serious financial difficulties are, however, concentrated in particular sub-sets of the payday user base. It would appear that in fact the “core” payday user - i.e. the largest “Payday Mainstream” segment are in fact less likely than other low income credit users to run into serious difficulties with credit and so they generally tend to have credit options other than payday. Some 4% of these borrowers have a court judgement for debt compared to 8.5% of all low income credit users with household income of less than \$35,000 p.a. and 6.7% of credit users with household incomes of less than \$50,000 p.a. Some one in five admit to having a poor credit record. The “Mainstream Excluded” segment, more than half of whom have no other options for cash credit, have an average incidence of serious difficulty with credit, with some 7% admitting to a court judgement for debt. Three in ten admit to having a poor credit record, slightly fewer than for all low income households.

A significant minority of all segments have constrained credit options but lack of other credit options highest among most disadvantaged group

Chart 60. Access to alternative credit options by segment



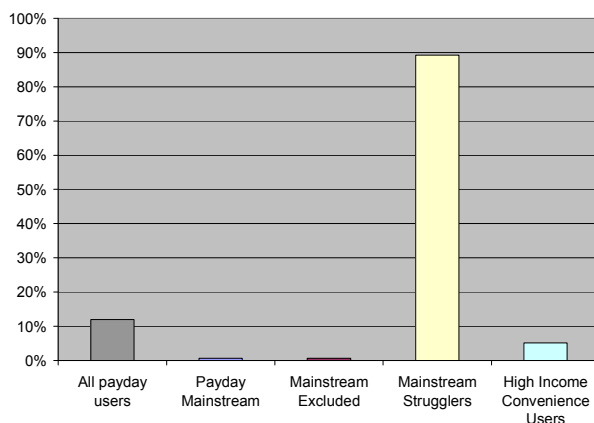
Source: Synovate Research for Policis 2008

Serious financial difficulties are concentrated primarily in those sub-sets of the payday user base who are heavy mainstream credit users

Serious problem debt appears to be heavily concentrated in the “Mainstream Strugglers” segment and to a lesser extent the “High Income Convenience Users”. Four in ten of the former and a little less than a third of the latter claim to have had no other credit options the last time they borrowed from a payday lender. Eight out of ten of the “Mainstream Strugglers” and a little over four out of ten of the “High Income Convenience Users” admit to having a poor credit record. However, really serious problem debt appears most concentrated in the “Mainstream Strugglers” segment. Four out of ten of this segment have had a county court judgement for debt, 95% admit to having been late or missed payments on credit and loan agreements and nine out of ten (89%) that they been three months or more behind on payments on such agreements.

Serious payment difficulties on mainstream loans concentrated in small “Mainstream Struggler” segment

Chart 61. Three months or more behind on loans and credit agreements by segment



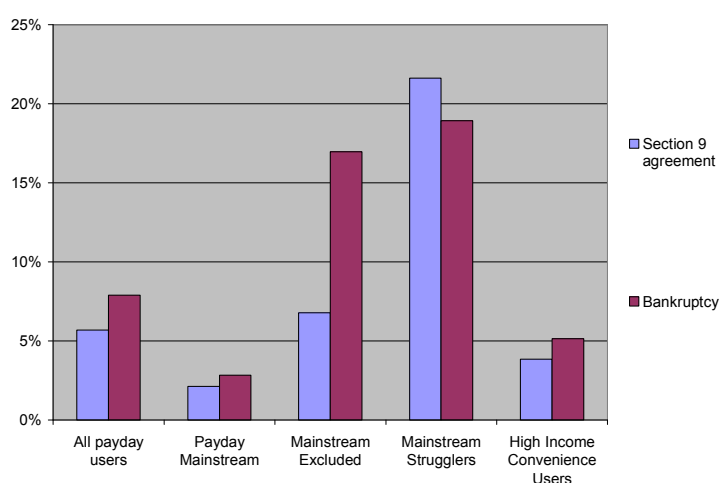
Source: Synovate Research for Policis 2008

High levels of financial breakdown among both the “Mainstream Excluded” and “Mainstream Strugglers” segments

Against this background a little over one in five (22%) of the “Mainstream Strugglers” admit to having experienced Section 9 insolvency and a not dissimilar proportion (19%) to have gone bankrupt. Levels of financial break-down are much lower for the “Payday Mainstream” and “High Income Convenience Users” segments, at 5% of the former and 9% of the latter having experienced some form of insolvency. The most disadvantaged payday user segment, the “Mainstream Excluded” segment also exhibit a relatively high level of insolvency, however, with 7% having experienced Section 9 insolvency and 17% having been made bankrupt.

Both the “Mainstream Struggler” segment with problems in the mainstream sector and “Mainstream Excluded” segment at high risk of financial breakdown

Chart 62. Financial breakdown by segment



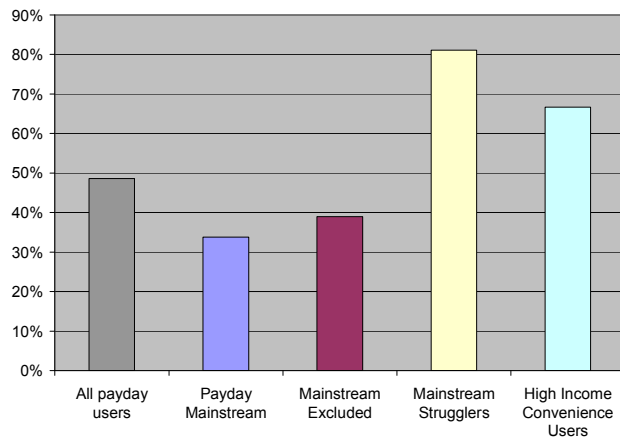
Source: Synovate Research for Policis 2008

Arrears on household bills, rent and mortgage payments are also concentrated in those segments characterised by heavy mainstream credit use

Moving on from credit related difficulties to the experience of arrears arising on household bills, it would appear that problems with arrears arise primarily in the two segments characterised by heavy mainstream credit use and by heavy use of revolving credit in particular. Around a third of the core “Payday Mainstream” segment have experienced arrears on household bills - in fact a significantly smaller proportion than for all low income credit users - as have almost four in ten (38%) of the more disadvantaged “Mainstream Excluded” segment. By contrast, two thirds of the “High Income Convenience Users” and eight out of ten of the “Mainstream Strugglers” had been in arrears on household bills.

Segments relying heavily on mainstream credit those which most likely to have arrears on rent and utilities

Chart 63. Arrears on household bills, rent or mortgage payments by segment



Source: Synovate Research for Policis 2008

It is clear that the segments have very different needs and issues and could be differently impacted by policy moves on payday

Taken together, a segmented perspective on payday users adds significant insight into the dynamic and effects described in section 5.0. Payday users are clearly not a homogenous group, and include both relatively disadvantaged users with little access to mainstream credit, those choosing to use short term low value credit in preference to other credit types, high income users employing payday in parallel to mainstream lending and those struggling or failing in the credit mainstream.

These various groups of users bring different motivations and needs to their use of payday, have different risk profiles and thus have different, or no, alternative credit options. As a result different groups would be differently impacted by policy moves which influenced the cost or availability of payday lending. This is explored in more detail in section 7.0 following which looks at the likely impact of a restriction of credit supply.

7.0 The impact of a restriction of payday supply

The impact of restriction of payday supply

- The most likely impact of any restriction of payday supply will be to create credit exclusion for some, while diverting others to revolving credit or pawn
- An increase in use of revolving credit will likely result in greater indebtedness, extended payment terms on revolving credit and increased delinquency and default.
- The real cost of credit will not necessarily reduce and may increase for some.
- Increased default and financial breakdown will result in more individuals becoming excluded from the credit mainstream.
- In the absence of credit options for high risk borrowers, the evidence from other markets suggests a part of the credit vacuum may be filled by unregulated lenders.
- Restriction of payday supply would impact the various segments differently.
- The impact would be most deeply felt and most negatively experienced by those segments who are credit excluded and by those now struggling with mainstream credit
 - Payday Mainstream will see a modest increase in mainstream credit use with similarly modest upswing in delinquency from low levels
 - Mainstream Excluded segment will suffer hardship in cash crises. More distress driven use of pawn likely to pose greater risk to pledged assets.
 - Without lubrication of payday funds financial difficulties may rapidly become financial break-down for Mainstream Strugglers
 - For High Income Convenience Users the fine balance between coping and struggling may be compromised, creating an increase in serious financial difficulty.
- A minority of payday users may experience a net financial gain from the restriction of payday supply. These are however not vulnerable low income borrowers but rather high income users with ready access to the credit mainstream and high levels of credit use

Those concerned about the high cost of credit for vulnerable borrowers - who not only need credit more than the more affluent but pay significantly more for it than the better off - frequently advocate price controls as a perceived solution to what is seen as a pressing social and moral issue. These typically take the form of interest rate ceilings. Economic theory suggests - and indeed the experience of rate capped credit markets around the world indicate²² - that where price controls are introduced, lenders will withdraw from the market and the supply of credit to high risk borrowers will shrink.

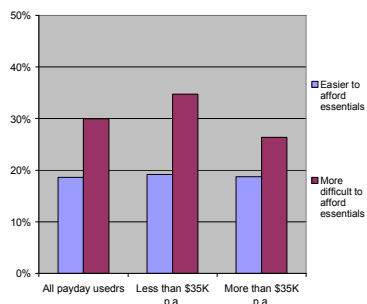
We turn now therefore to examine the likely impact of a restriction of payday supply on borrowers' ability to manage their finances. We also explore the potential

²² The evidence for and the dynamics of this effect are discussed in great detail in our study "The Impact of Interest Rate Controls", Policis (2008), which reviews the evidence from major credit markets around the world and discusses the implications and likely outcomes for Australian consumers of the introduction of a rate ceiling.

displacement effects if payday were not available and the likely consequences of these, for payday users, for different segments of the market and for the credit market as a whole.

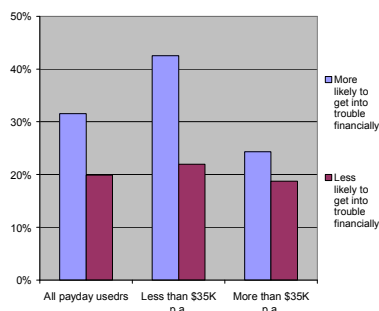
Payday borrowers believe that without payday it would be more difficult to afford essentials and to avoid getting into financial difficulties

Chart 64a. Ability to afford essentials without payday



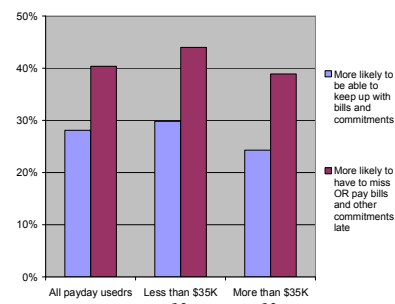
Source: Synovate Research for Policis 2008

Chart 64b. Likelihood of getting into financial trouble without payday



Source: Synovate Research for Policis 2008

Chart 64c. Ability to keep up with bills and commitments without payday



Source: Synovate Research for Policis 2008

In the US an increase in judgements for debt and an upswing in bankruptcy has followed restrictions on payday supply

Some support for this view is provided by evidence from a recent US study, undertaken by researchers from the New York Federal Reserve²³ which concluded that payday bans had resulted in an increase in indicators of problem debt and financial breakdown. This study looked at the impact of payday lending on the occurrence of financial difficulty, as measured by the incidence of bounced cheques, complaints about lenders, court judgements for debt and filings for bankruptcy protection before and after payday loans were banned in Georgia and North Carolina in May 2004 and December 2005. This found that the incidence of all of these phenomena increased following the payday credit ban and that the reduced supply of payday credit correlated with increased credit problems and financial difficulties in both states. A similar effect has followed the restriction in the supply of consumer credit to high risk borrowers in Japan following the introduction of a sharply reduced interest rate ceiling in 2006. Bankruptcies, which had been falling, have risen rapidly as the supply of credit to high risk borrowers has dried up.²⁴

The lowest income and most vulnerable payday borrowers are more likely to believe that they will be adversely impacted by the withdrawal of payday

It would appear that it is the most vulnerable households who would be most adversely impacted by losing access to readily accessible small sum credit. The lowest income households are most likely to take the view that they would find it more difficult to afford essentials or to keep up with bills and commitments and would be more likely to get into trouble financially without payday. Households with income of less than \$20,000 a year are 2.6 times more likely to believe that they would find it

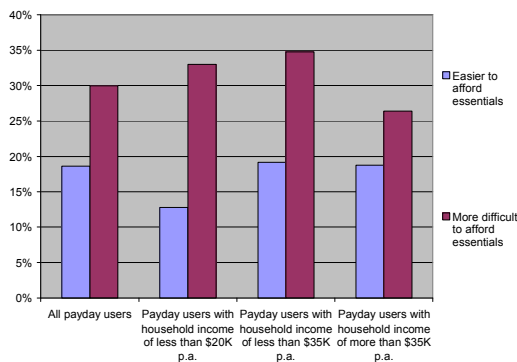
²³ Payday Holiday: How households fare after payday credit bans, Donald P. Morgan and Michael R. Strain, Federal Reserve Bank of New York Staff Reports No 309, November 2007, Revised February 2008.

²⁴ For detailed discussion and further evidence on these effects see our study "The impact of interest rate ceilings" Policis, 2008.

more difficult to afford essentials without payday than to take the view that they would find it easier to afford essentials. The equivalent ratios for payday borrowers with less than \$35,000 p.a. and for payday borrowers with more than \$35,000 p.a. are 1.8 times and 1.4 times. A similar pattern applies also to perceptions that borrowers are more likely to get into trouble financially without payday, with the lowest income payday users more likely to feel that payday has a positive impact on their ability to avoid financial difficulties. Households with income of less than \$20,000 were 2.2 times more likely to take the view that without payday they were more likely to get into trouble financially than to feel they would be less likely to get into trouble. Households with incomes of less than \$35,000 were 1.9 times more likely to take a positive view.

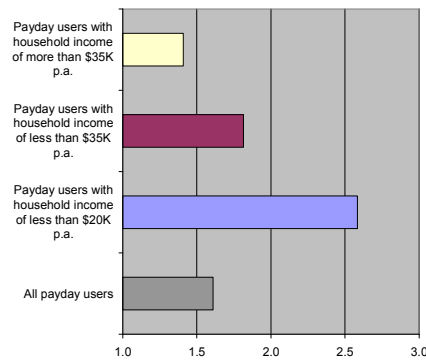
Lowest income households are most likely to believe that without payday it would be more difficult to afford essentials

Chart 65a. Payday users perceptions of ability to manage finances without payday Whether easier or more difficult to afford essentials by income range



Source: Synovate Research for Policis 2008

Chart 65b. Balance by which payday users believe that without payday it would be more difficult to afford essentials by income range

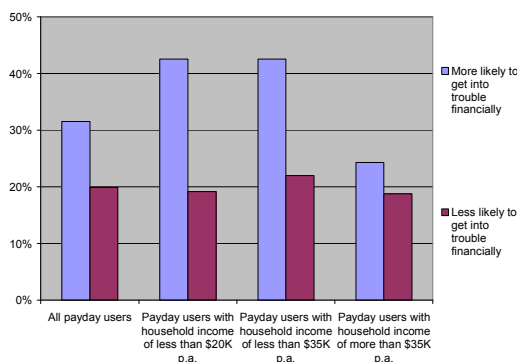


1.0 = equal balance between view that easier / more difficult to afford essentials

Source: Synovate Research for Policis 2008

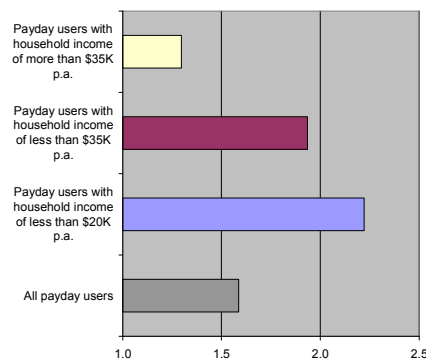
Low income households also those that feel that without payday they will be more likely to run into financial difficulties

Chart 66a. Payday users perceptions of ability to manage finances without payday Whether more / less likely to get into financial trouble by income range



Source: Synovate Research for Policis 2008

Chart 66b. Balance by which payday users believe that without payday they would be more likely to get into trouble financially by income range



1.0 = equal balance between view that more / less likely to get into financial trouble

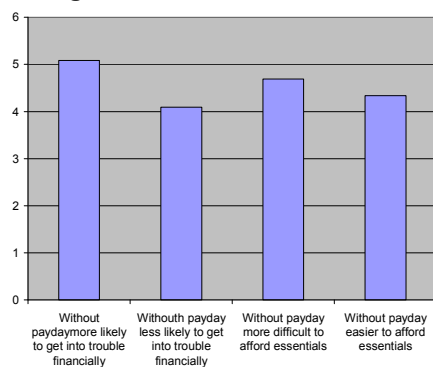
Source: Synovate Research for Policis 2008

Borrowers who felt that their ability to afford essentials or avoid financial difficulty would be compromised are those who are most dependent on payday

Borrowers who felt that their ability to afford essentials or avoid financial difficulty would be compromised if they were to lose access to payday borrowing tended to be those borrowers most dependent on it and to be more likely to be distress borrowers. They also appear to be more frequent borrowers than those who feel that they could cope better if they did not use payday and to borrow smaller sums. A third of those believing that payday make it easier to afford essentials had taken out their most recent payday loan to make ends meet when they ran out of cash.

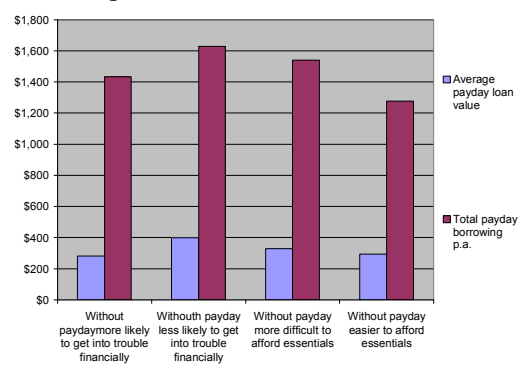
Borrowers who feel that payday supports their ability to manage their finances the most frequent users but also those taking out smallest loans

Chart 67a. Average number of payday loans p.a. by view on impact of payday on ability to manage finances



Source: Synovate Research for Policis 2008

Chart 67b. Payday loan values by perceptions of impact of payday on ability to manage finances



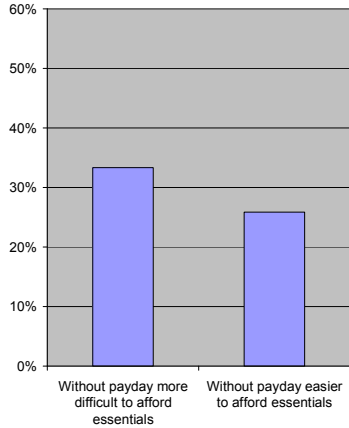
Source: Synovate Research for Policis 2008

Those at most risk to detriment believe most strongly that without payday it will be more difficult to afford essentials and avoid difficulties

It would seem that it is those borrowers most at risk to various forms of detriment who believe most strongly that they would be adversely impacted by not having access to payday lending. Thus a higher proportion of those borrowers who believe that they are more likely to find it difficult to afford essentials used their most recent loan to sustain cash flow when they ran out of cash to make ends meet (33%) than is the case among those who feel that they will find it easier to afford essentials without payday (25%). Similarly a higher proportion of those who think it more likely that they will miss payments on bills and commitments have experienced arrears on rent and household bills (56%) than among those who think they will find it easier to meet bills and other commitments without payday (49%). In the same way, a higher proportion of those who believe that they are more likely to get into trouble financially without payday have missed loan or credit repayments (47 %) or been three months or more behind on payments (18%) than is the case with their counterparts who believe they are less likely to get into trouble financially without payday (37% and 5% respectively).

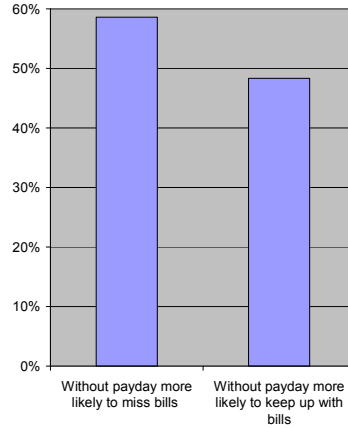
Those who feel payday supportive of their ability to manage their finances those most likely to face a range of pressure points and payment difficulties

Chart 68a. Last payday loan used for making ends meet when ran out of cash



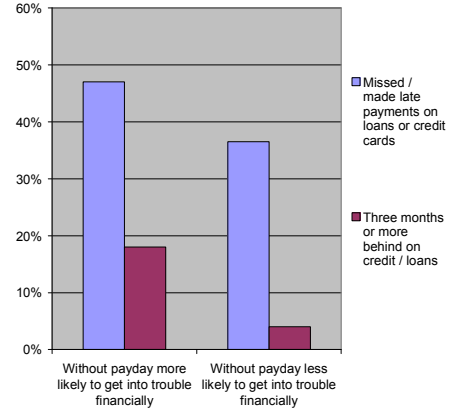
Source: Synovate Research for Policis 2008

Chart 68b. Arrears on household bills, rent or phone payments



Source: Synovate Research for Policis 2008

Chart 68c. Payment difficulties on loans and credit agreements



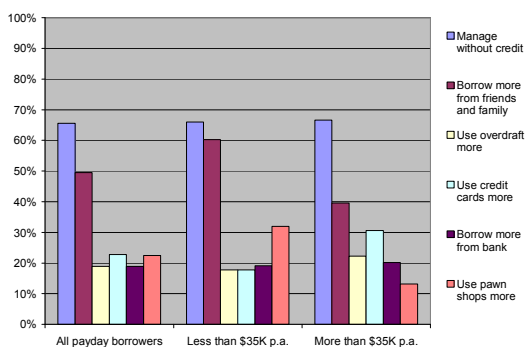
Source: Synovate Research for Policis 2008

In the absence of payday some borrowers would turn to the informal sector with more affluent users diverted to credit cards and less affluent to pawn

When payday borrowers in the qualitative research were asked about their likely strategies in the event that payday loans were no longer available, most payday borrowers took the view that they would either do without credit or borrow more from family and friends. The higher income payday users tended to see themselves using more mainstream credit, particularly credit cards, while lower income borrowers and those no longer able to borrow in the credit mainstream saw themselves as more likely to turn to pawn-brokers.

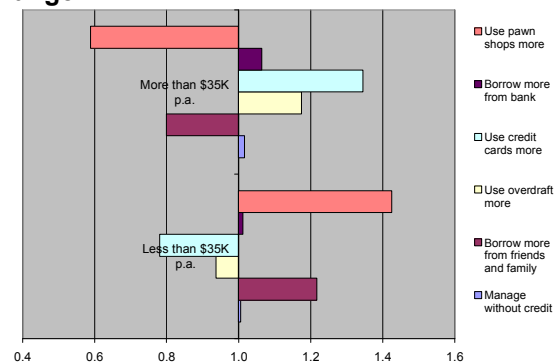
Those with constrained credit options would make greater use of pawn while those with options would switch from very short term loans to revolving credit

Chart 69a. Payday users response to withdrawal of payday lending by income range



Source: Synovate Research for Policis 2008

Chart 69b. Payday users response to withdrawal of payday lending by income range



Source: Synovate Research for Policis 2008

Those without mainstream options regarded pawn as inconvenient while those with options felt they would have to borrow more than they needed

Borrowers' response to the prospect of payday not being available varied depending on their options. Those without access to the credit mainstream clearly valued payday as a facility and were dismayed by the idea that they might not be able to borrow in this way in future. Those whose only option would be pawn tended to take the view that pawn would be much less convenient and more disruptive. Those who did have access to the credit mainstream took the view that they were more likely to run up greater and potentially less manageable debt, either because they would tend to use credit cards more and build up bigger outstanding balances or because they would need to borrow larger sums than typically obtained from payday lenders.

The major concern was how borrowers would cope with cash emergencies if payday borrowing were not an option

The greatest concern, particularly for lower income borrowers, was that without payday borrowing, individuals would have no resource to fall back on when faced with a cash shortfall or unexpected crisis. Payday borrowers tended to take the view that payday represented something of a safety net in the event of an emergency.

"The hardest thing would be having fuel in an emergency, having food in an emergency"

"I think that would leave people a lot worse off, generally speaking than they are now, with having access to a short term loan... Sometimes you really don't have anywhere else to go."

"But at least knowing it's (payday) there as a stop valve. Yeah. I say I hope not to go there, but you know at least you can when you really need it... to put food on the table or whatever."

"Even though I'm budgeting and as we said, we don't have access to those accounts, because we don't have any cards and if you have to really wait for your monthly pay and you've got so many days to go, then you're really gone crazy because I don't see how you're going to get by. Because everything will get affected – budgeting, work, personal."

Many payday users disliked borrowing from friends and family or felt that informal borrowing would either not be available or not adequate to needs.

As was discussed in section 4.0, one of the drivers for use of payday lending is a desire avoid borrowing from family and friends. The prospect of having to rely further on informal borrowing was not one welcomed by payday users, who tended to see informal borrowing as humiliating and as compromising social and family relationships. Some did not have ready sources of informal borrowing. Others were already borrowing as much as they could from friends and family alongside their use of commercial credit and did not necessarily believe that it would be possible to increase their existing level of informal borrowing.

"Well I'm grateful I suppose that it (payday) is available. I don't know how I'd feel if it wasn't available. There's always the option of borrowing from friends, but I find that far more humiliating, so I do prefer to use (named lender)".

"It (not having payday) would definitely be a little bit crazy. More frustration because there's no access to something. The easy method has gone away."

Friends and other people would be in the same situation because realistically they have their own stuff to pay as well."

"Not everyone has family. I don't have family I could ask."

Those who would likely use more mainstream credit feared getting into deeper and less manageable debt

Borrowers with access to the credit mainstream felt that banks were unlikely to offer the small sum credit or instant access that payday users valued in payday lending. Against this background, borrowers feared either that they might not qualify for credit, that they would end up taking on larger loans than they would like or that they would find themselves borrowing on credit cards, with credit card debt seen as much more difficult to pay down.

"A bank you would be borrowing, I reckon I'd be borrowing just a lot more money."

"People use pay day lenders, they tend, they're looking at small, relative small advances over a short period of time. And if that gets taken away, then you're only other choice is to approach something like a bank, who, realistically are not going to lend you a small amount of money over a short period of time."

"So, if you don't have the pay day advance option, but you need money for whatever, then you're, you're going to end up in a situation where you have to take a, a much more significant loan. Maybe five, ten times more than what you want....But there's no guarantee you're going to get it, though"

"Get it from the credit card. You need a lot of discipline to pay that back. That's not good. It's never done."

"I would have to get a credit card. I cut my last one up. I couldn't handle it. I know myself. I'd get into trouble."

Payday users saw pawn as a cumbersome alternative source of cash credit but also as poor value and high risk

Those more likely to be thrown back on pawn-broking had a number of reservations. Principle among these was the feeling that pawn was inconvenient and slightly disreputable. Others felt that they would be reluctant to risk pledging goods that they might not be able to redeem while others simply took the view that prices obtained at pawn were poor value.

"I feel that it (payday) gives everybody a chance to get a loan, cash advance, whatever. 'Cause many people have got bad credit ratings. So you go to a bank and you apply for a loan or a credit card and you get knocked back...Hock shop, will be the only way I guess...It's (payday) a lot easier than pawning stuff. You know, carting stuff around the place. It's ridiculous. I'd rather take their payday loan."

"I actually found the pawn broking section the most uncomfortable. I don't know why. I've always found it dodgy. It's humiliating actually. But if that's my only option, I wouldn't be happy about it"

"And they (pawn-brokers) give you nothing for it. Nothing. Honestly. And you go in there and you see the price of things they're selling things for."

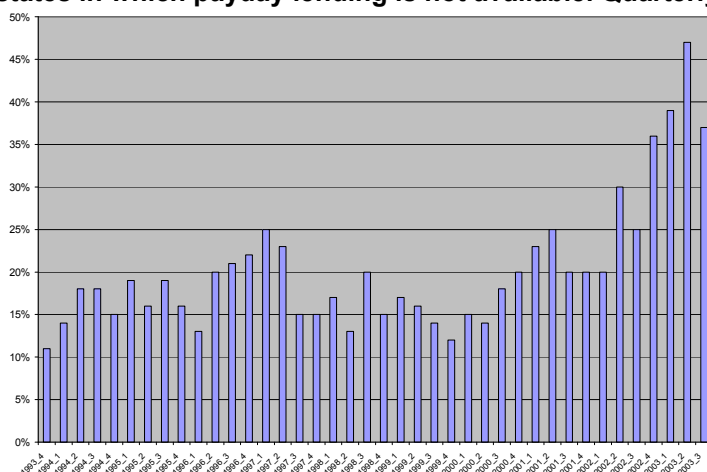
"I'd be worried about losing my stuff if I had to go there more often."

The likelihood is that the delinquency and indebtedness profile of payday users would move closer to that of those taking cash advances on credit cards

As we have seen earlier, a shift to greater use of revolving credit would likely result in payday users' delinquency and indebtedness profile moving closer to that of other credit card revolvers and those taking cash advances on credit cards in similar income ranges. The result would likely be an increase in overall indebtedness, an increase in account delinquency on credit cards and loan agreements and an extension of the time that is taken to pay down credit card balances. Powerful support for the likelihood of these effects occurring can be seen in the difference between states in the US with and without legislation enabling payday lending. In those states where high cost credit is not available, borrowers are diverted primarily to revolving credit. In these states, over a ten year period, delinquency on credit cards has been consistently an average of 17% higher than in states where payday lending is available, rising in recent years as behaviour driven charging has become more prevalent and peaking in periods of economic strain.²⁵

Late payment – and thus behaviour driven charging – on revolving credit is consistently higher in US states which do not allow payday lending

Chart 70. Ratio by which late payments on non bank revolving credit is higher in US states in which payday lending is not available. Quarterly over 10 years to 2003



Source: TransUnion

Base: transactional records of 340,00 US credit users

Source: Department of Trade and Industry UK, The Effect Of Interest Rate Controls in Other Countries, 2004

Increased delinquency, higher card balances and longer repayment terms may mean that the cost of credit is not reduced and may even rise for some

As was discussed in section 5.2, use of revolving credit products under uneven payment conditions does not necessarily result in credit that is any lower cost than payday loans lenders and has the effect also of creating greater indebtedness. The combined effect of increasing the incidence of account delinquency - and thus exposure to penalty charging - increasing the value of outstanding balances and the time over which they are paid down is likely to run counter to any reduction in the cost of credit implied by the lower headline interest rate on revolving credit products. There is the possibility indeed that, under certain behavioural conditions - such as occasional missed payments combined with taking occasional cash advances and making only partial payments of outstanding balances - that such credit could even

²⁵ For detailed discussion and further evidence on these effects see our study "The impact of interest rate ceilings" Policis, 2008.

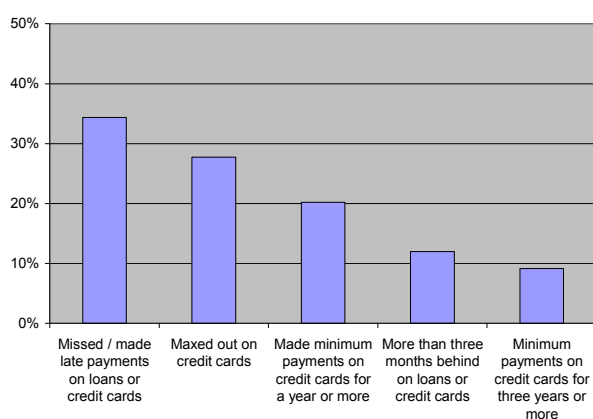
be more expensive than payday borrowing for some borrower types. Under these circumstances cost would in any case become less transparent and less predictable.

The greater risk of a shift to revolving credit may be that of increased default - a significant proportion of payday users are barely coping with revolving credit

Perhaps the greater risk of any shift from payday to revolving credit would lie not with the likely cost impacts but with the potential for an increase in default and serious financial difficulty. Payday borrowing does appear to be acting to minimise delinquency charges and to prevent difficulties in repaying mainstream credit from becoming default crises. Nonetheless it is clear that a significant minority of payday users using mainstream credit, particularly revolving credit, are already barely coping. Among the quarter of payday users who have also used credit cards in the last twelve months, a significant proportion are servicing maxed out card balances with many of these making minimum payments. Any shift from short term borrowing to revolving credit would seem likely to increase the risk of default, and of pushing at least some of those now barely coping into break-down.

A quarter of payday users have struggled with maxed out credit cards often serviced with minimum payments

Chart 71. Payday users - incidence of payment problems on mainstream credit



Source: Synovate Research for Policis 2008

Three quarters of payday users with credit cards are revolvers

Six out of ten credit card users in households with income of less than \$50,000 p.a. pay off their card balance each month. Users of small sum credit, whether payday users or those taking cash advances on credit cards, are much less likely to be able to pay down outstanding balances in this way. Almost three quarters of payday users with credit cards (74%) are “revolvers” (i.e. making partial or minimum payments) as are almost two thirds of (63%) of those taking cash advances on credit cards.

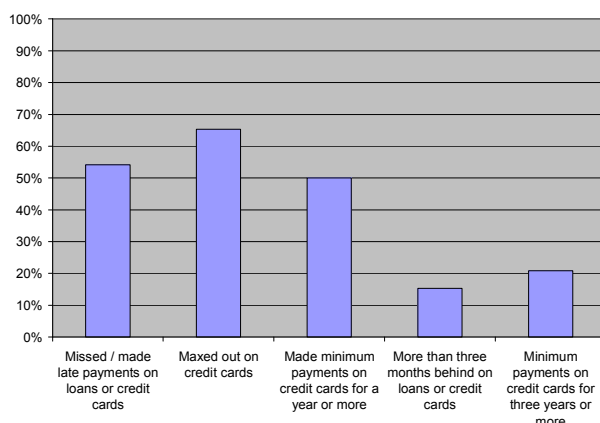
Payday users are much more likely than those raising cash advances on credit cards to be making minimum payments on often maxed out balances

Payday users appear much more likely than other borrowers to be making minimum payments with almost a third of payday users (32%) doing so compared to a little less than one in five (18%) of revolvers and 12% of those raising cash advances on credit cards. Almost two thirds (64%) of payday users with credit cards admit to having struggled with “maxed out” credit cards, rising to seven out of ten for payday users also “revolving” on their credit cards. Half of payday users with credit cards

admit to having been making minimum payments on credit cards for a year or more and one in five (21%) to having made minimum payments for three years or more. Clearly this will have cost implications in that paying down balances over a greatly extended period is an extremely high cost way to borrow. As significantly, however, these borrowers are also exposed to the risk of sanctions and financial break-down in the event of income shocks for all of the time that it takes to pay down the debt.

Two thirds of payday users with credit cards have maxed out their cards

Chart 72. Payday users using credit cards in parallel to payday - incidence of payment problems on mainstream credit



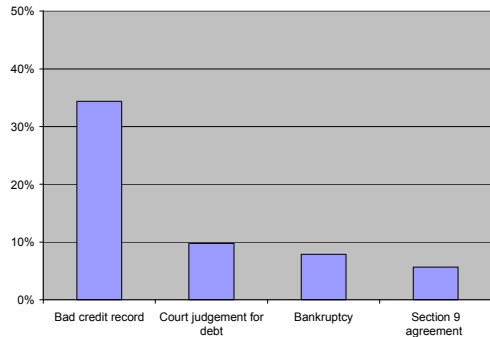
Source: Synovate Research for Policis 2008

A significant minority of payday borrowers have failed in the credit mainstream

Payday borrowers, and particularly payday borrowers who also use credit cards, are more likely than other credit users to have suffered serious financial difficulties. This appears less to be a function of the impact of payday itself, but rather reflects the fact that the universe of payday users includes a group who have turned to payday because they have struggled with mainstream credit, either reaching the end of a mainstream credit line or no longer able to borrow in the credit mainstream on account of a history of more or less serious delinquency. Those taking cash advances on credit cards are also more likely than other borrowers to have faced serious financial difficulties but to a lesser extent than payday borrowers. Slightly fewer than one in ten payday users have a history of insolvency (9%), more than twice the incidence among all credit users with household incomes of less than \$50,000 p.a. A similar proportion have a court judgement for debt against their name while a third admit to having an adverse credit record.

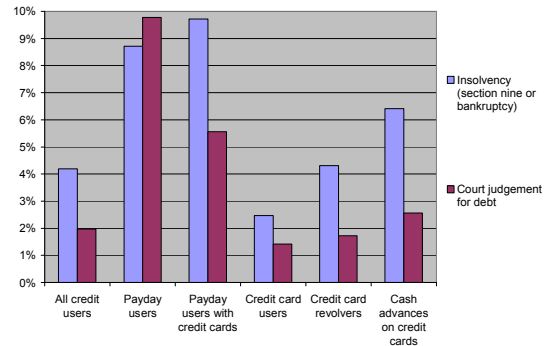
There is a high incidence of insolvency among payday users but this arises from historic problems with mainstream credit rather than use of payday

Chart 73a. Incidence of serious financial difficulties. All payday users



Source: Synovate Research for Policis 2008

Chart 73b. Experience of serious financial difficulties by credit user type



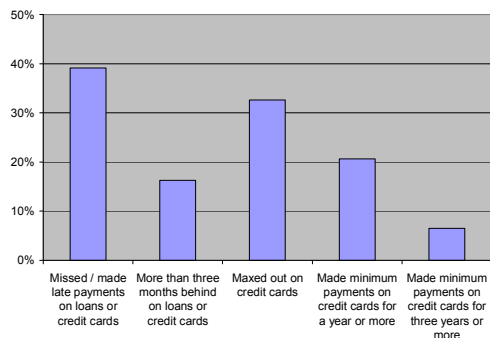
Source: Synovate Research for Policis 2008

Among payday borrowers with no other credit options, almost half have an adverse mainstream credit record while almost a quarter have been insolvent

As is discussed in some detail in the previous chapter on segmentation, the universe of payday users is not homogenous and includes borrowers using both payday lending and mainstream credit in a modest way and with few payment difficulties, those without sufficient resource to be of interest to mainstream lending institutions and those who are barely coping or have failed in the credit mainstream. Among the three in ten (29%) of payday borrowers who have no other credit options, a significant minority have a history of payment difficulties on mainstream credit, with a high incidence also of financial break-down having followed such difficulties. Almost half have an adverse credit record, a little short of one in five (16%) have a court judgement for credit related debt with almost a quarter (23%) having been through some form of insolvency.

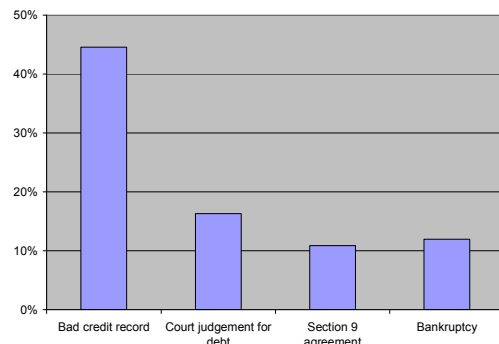
A significant minority of payday users excluded from the mainstream have a history of serious credit problems, primarily with revolving credit

Chart 74a. Incidence of payment problems on mainstream credit.



Base: Payday users with no alternative credit options
Source: Synovate Research for Policis 2008

Chart 74b. Incidence of serious financial difficulties.



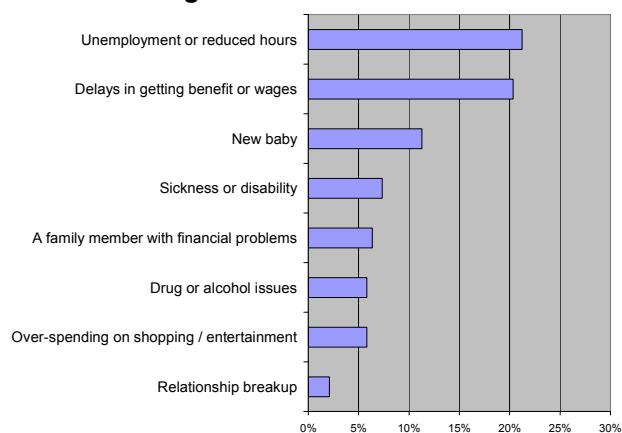
Base: Payday users with no alternative credit options
Source: Synovate Research for Policis 2008

The major driver of serious financial difficulty appears to be reduced income occasioned by changes in circumstances

In some of these cases financial difficulties may have arisen through over-borrowing, poor financial management and a lack of financial capability, most typical of younger borrowers. More frequently, however, credit difficulties and financial breakdown tend to arise in the wake of a change in life-style or circumstances. Even allowing for the fact that borrowers who have got into serious financial difficulty will tend to under-play financial capability issues and point instead to circumstances, the key drivers of financial difficulty – albeit self reported by those experiencing difficulty - appear to be income shortfalls caused by unemployment, reduced hours, delays in receiving wages or benefits due, the arrival of a new baby or the onset of sickness or disability. Where borrowers do not have savings safety nets or are unable to make good income shortfalls from other sources, the resulting cash flow difficulties result in indebtedness escalating towards credit limits where a credit line remains open and / or missed payments on outstanding bills and agreements.

Income shocks which leave borrowers unable to service ongoing debt rather than fecklessness appear to be the primary cause of serious credit problems

Chart 75. Background to credit difficulties



Base: Credit users with serious financial difficulties with household income of less than \$50,000

Source: Synovate survey of 500 low income Australians for Policis, 2008

Diversion of payday borrowers to revolving credit would seem likely both to increase the numbers barely coping and the risk of financial breakdown

Payday users do, however, appear to be significantly more likely than other borrowers to have a background of repayment difficulties with mainstream credit and to be trapped servicing “maxed-out” revolving credit balances over a greatly extended period. This scenario is itself likely to result in a cost of credit that is not dissimilar to that of payday loans. It also carries greater risk to financial security, in that borrowers remain at risk of default, lender sanctions and, ultimately, even insolvency throughout the time the balance is outstanding. The diversion of borrowers now using payday to revolving credit, likely to occur in the wake of any restriction of payday supply, would seem likely both to increase the number of mainstream credit users barely coping with revolving credit and the risk that those already in this position slip into default and financial breakdown. Less affluent payday borrowers unable to access mainstream credit would seem likely to suffer real hardship in the event of cash shortfalls. The diversion to pawn that would likely result from any restriction of payday supply would not only be unpopular but itself carry risks in that hard-pressed borrowers without options could be driven to pledge goods that they may not be able reliably to redeem.

There is a risk not only of increased financial breakdown and credit exclusion but also that a credit vacuum will be filled in part by unregulated lenders

Against this background, it would seem entirely possible that greater use of revolving credit by those currently using payday lenders will result in both increased financial breakdown but also to an increase in those excluded from the credit mainstream by virtue of credit delinquency. In the absence of payday such borrowers will have no credit options. The evidence from credit markets around the world is that unregulated lending tends to fill part of such credit vacuums, with such lending being concentrated in individuals who have been rejected by legitimate lenders or barred from the credit mainstream because of adverse credit history. Such lenders are invariably very high cost. They are however also frequently deeply exploitative.

In the event of restriction of credit supply the segments would be impacted differently but all would face difficulties in managing through cash shortfalls

The various patterns described thus far suggest that policy moves in relation to payday borrowing would impact on the various segments in rather different ways. In particular exclusion and displacement effects would operate very differently. To try and understand the demand dimensions of these effects, payday users were asked how they would respond if payday borrowing were no longer available to them. Overwhelmingly, the biggest single effect for all segments would be that they would have to manage through cash flow difficulties or financial pressure points without the low value short term payday loans on which they currently relied. The most significant displacement effect would appear to be a diversion to informal borrowing, with all payday segments claiming that they would need to borrow more from friends and family.

Some will face credit exclusion. Those with constrained options will be diverted to pawn while those with options divert primarily to revolving credit

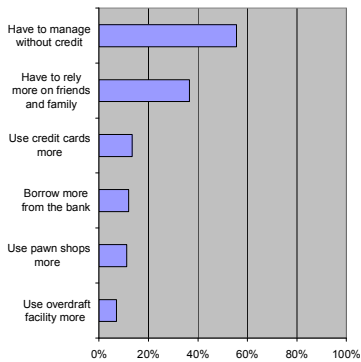
Thereafter displacement effects depended on the nature and extent of alternative credit options. The “Payday Mainstream” segment would make relatively low level use of a range of mainstream credit options, including credit cards and bank borrowing, with a little over one in ten in each case claiming that they would use these types of finance more. The “Mainstream Excluded” with fewer options and a greater need for short term credit to bridge cash flow difficulties would make greater use of pawn-brokers – with three in ten (29%) saying that they would do so, slightly less than quarter (24%) saying that they would need to use their overdraft facility more and one in five saying that they would need to use credit cards more. The “Mainstream Strugglers” would be primarily diverted to pawn, with more than four in ten (43%) saying they would need to use pawn-brokers more. One in five would turn to overdraft finance while some 16% claim that they would use credit cards more. The segment with the heaviest mainstream credit use, the “High Income Convenience Users” would likely be diverted in relatively large numbers to the revolving credit which is already a significant feature of both their credit use overall and their use of small sum cash credit. A little under half (45%) claim that they would use their credit cards more, around four in ten that would borrow more from the bank (37%) and around a third (34%) that they would make more use of their overdraft facility.

The most disadvantaged segments would face greatest difficulty but segments with mainstream options would also face cash flow issues

As discussed in Section 5.0, not having access to payday was thought primarily likely to impact on cash flow. There are also significant variations between segments in terms of the severity and manageability of these impacts. Within the core “Payday Mainstream” segment, four out of ten say that without payday they would have difficult managing when they ran short of cash or needed extra money while a third would find it difficult to manage an unanticipated bill or repair. All three of the other segments appeared more likely to suffer cash flow issues as a result of the withdrawal of payday. Some three quarters of the most disadvantaged segment would find it difficult to manage cash flow shortfalls or unanticipated expenses. However, likely difficulties with cash flow are not confined to the lowest income segments. Approximately seven out of ten of both the “High Income Convenience Users” (71%) and two thirds of the “Mainstream Strugglers” (69%) would also find it difficult to manage through a cash shortfall and two thirds of both group would have difficulty funding an unexpected bill or repair without payday.

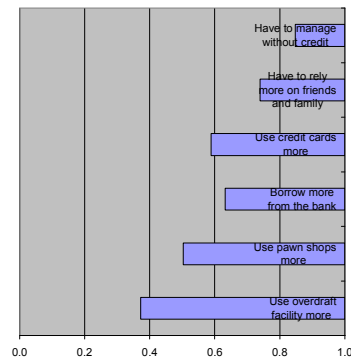
Likely response to withdrawal of payday lending - exclusion and displacement effects by segment

**Chart 76a. Payday Mainstream
% claiming likely response in event of
payday lending no longer being available**



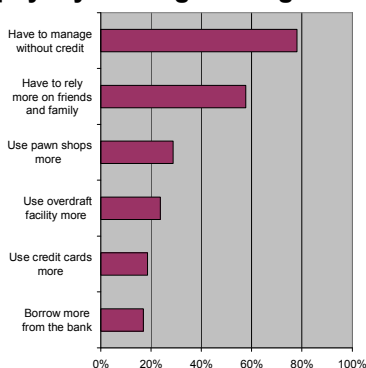
Source: Synovate Research for Policis 2008

**Chart 76b. Payday Mainstream
Likely segment response relative to
average for all payday users**



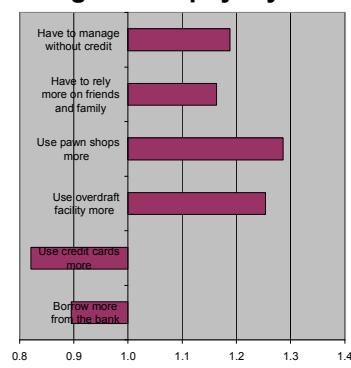
1.0 = average for all payday users.
Source: Synovate Research for Policis 2008

**Chart 77a. Mainstream Excluded
% claiming likely response in event of
payday lending no longer being available**



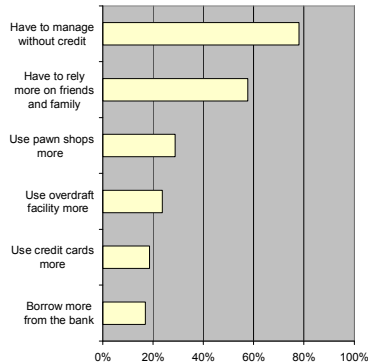
Source: Synovate Research for Policis 2008

**Chart 77b. Mainstream Excluded
Likely segment response relative to
average for all payday users**



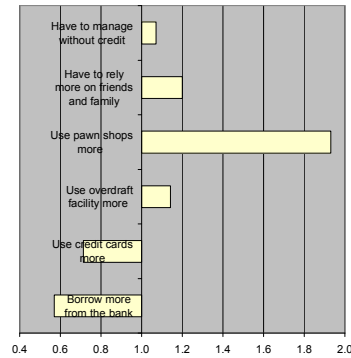
1.0 = average for all payday users.
Source: Synovate Research for Policis 2008

**Chart 78a. Mainstream Strugglers
% claiming likely response in event of
payday lending no longer being available**



Source: Synovate Research for Policis 2008

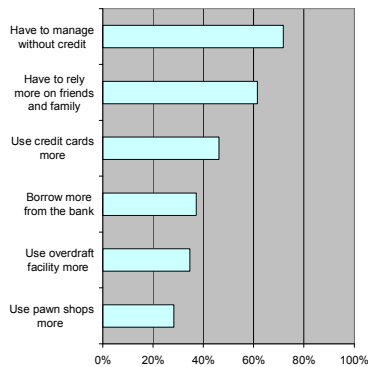
**Chart 78b. Mainstream Strugglers
Likely segment response relative to
average for all payday users**



1.0 = average for all payday users.

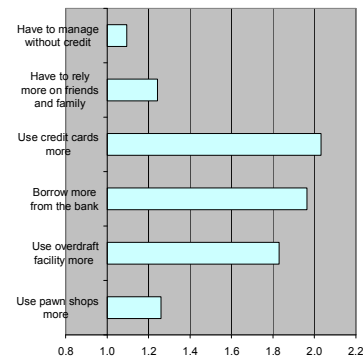
Source: Synovate Research for Policis 2008

**Chart 79a. High Income Convenience Users
% claiming likely response in event of
payday lending no longer being available**



Source: Synovate Research for Policis 2008

**Chart 79b. High Income Convenience Users
Likely segment response relative to
average for all payday users**



1.0 = average for all payday users.

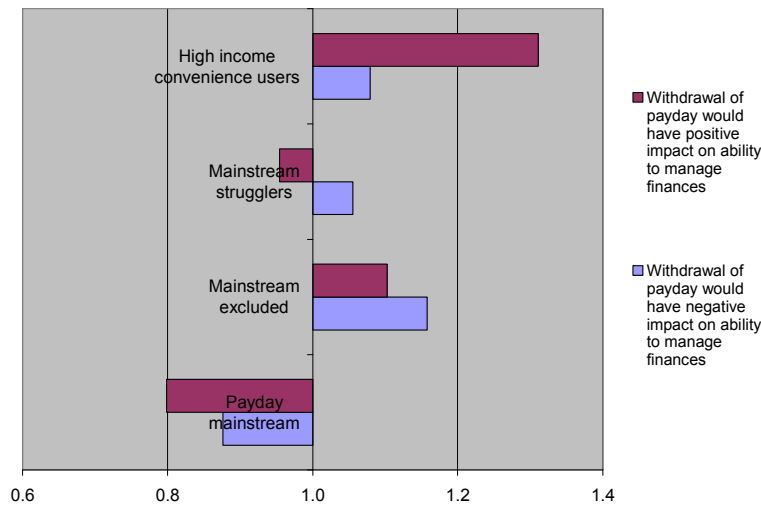
Source: Synovate Research for Policis 2008

The segments most likely to feel that financial management would be compromised without payday are the least affluent and most pressured

As was discussed earlier in section 5.0, borrowers who feel that their ability to manage their finances effectively will be compromised without access to payday borrowing tend to be the least affluent borrowers and those with fewest credit options. These are also the most frequent users of payday loans, though borrowing lower than the average on each occasion. Payday users who feel that they are likely to be better off without payday, on the other hand, tend to be higher income, to be heavy mainstream credit users and to be more drawn to the convenience aspects of the payday offer. This pattern is reflected in the way that the different segments would be impacted by any restriction of payday supply. The segment most likely to feel that their ability to manage their finances would be compromised (i.e. the ability to afford essentials, keep up with commitments and avoid getting into financial difficulties) is the most disadvantaged “Mainstream Excluded” segment while that most likely to feel that their ability to manage their finances would be enhanced is the “High Income Convenience Users” segment.

Those taking positive view of impact of withdrawal of payday the most upmarket segment using on discretionary basis

Chart 80. View that withdrawal of payday would have a positive / negative impact on finances relative to all payday users by segment²⁷



1.0 = average for all payday users
 Source: Synovate Research for Policis 2008

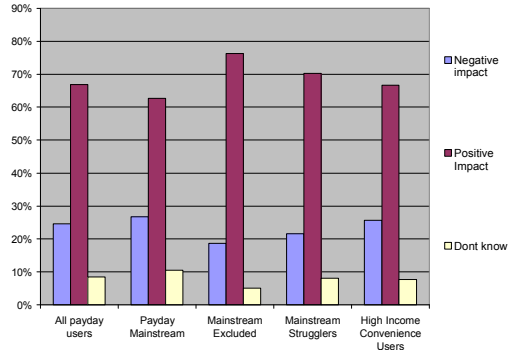
More than 7 in 10 the disadvantaged “Mainstream Excluded” and a quarter of the pressured “Mainstream Strugglers” see payday as having a positive role

Understanding how the different segments might be impacted by a restriction of payday can be best seen in an examination of how each segments thinks the management of both day to day finances and various financial pressure points would be effected. A good majority of all segments believe that use of payday lending has a positive impact on their finances and quality of life, “bearing in mind both the high cost of credit and the convenience of quick access to credit”. Two thirds of all payday users (67%) take this view. The segments under greatest financial pressure, albeit for different reasons, are those most likely to feel that payday has a positive impact overall, with more than three quarters of the most disadvantaged “Mainstream Excluded” segment taking this view as did seven out of ten of the “Mainstream Struggler” segment, facing the most serious financial difficulties.

²⁷ *As measured by agreement with various statements. Positive = any of "On balance, payday has positive impact on finances", "without payday would be more difficult to afford essentials ", "without payday would be more difficult to keep up with commitments", "without payday would be more likely to get into trouble financially". Negative impact = any of the obverse of all of the above.

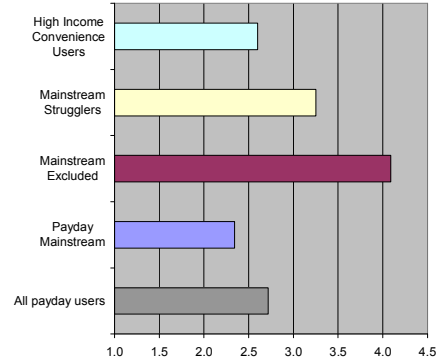
All segments have a positive view of impact of payday on finances with most hard pressed Mainstream Excluded feeling this most strongly

Chart 81a. Overall impact of payday on finances bearing in mind high cost as well as convenience



Source: Synovate Research for Policis 2008

Chart 81b. Positive balance on impact of payday on finances overall



1.0 = equal balance between those taking view that payday has positive impact and those believing that it has negative impact on their finances overall

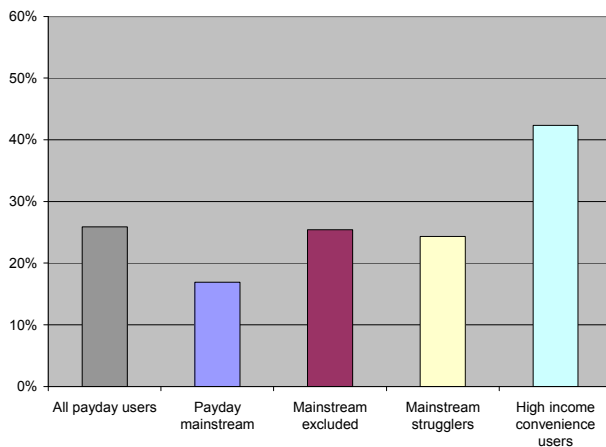
Source: Synovate Research for Policis 2008

“High Income Convenience Users” for whom payday is one component of a credit portfolio who most likely to think would be better off without payday

A significant minority however do see payday as having a negative impact on their finances, with these users being concentrated in the two segments with greatest control of their finances. Around a quarter of the two segments under less financial pressure, the “Payday Mainstream” and “High Income Convenience Users” segments feel that on balance that payday has a negative impact on their finances. It is the most affluent who are most likely to feel that they would be better off if they didn’t use payday, a view espoused by 45% of the “High Income Convenience Users” but shared by only 17% of the core “Payday Mainstream” segment.

Not far from half of High Income Convenience users believe better off without payday compared to less than one in five of core Payday Mainstream segment

Chart 82. % agreeing that “better off when not borrowing from payday lenders”



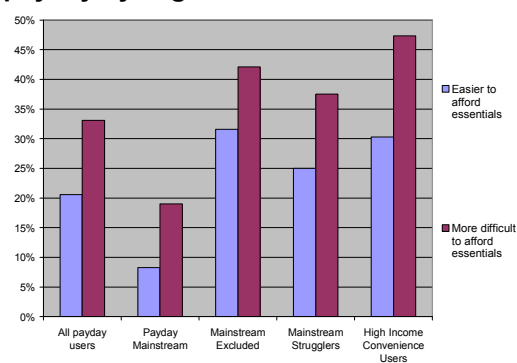
Source: Synovate Research for Policis 2008

A balance of all segments believe that without payday it will be more difficult to afford essentials, “Payday Mainstream” significantly less so than others

This phenomenon, in which the most affluent and least pressured are most likely to think they would be better off without payday while the most vulnerable believe payday has a positive impact is best understood by looking at the detail of how the various segments believe they will be impacted by a restriction of payday supply. Although a majority of all segments took the view that payday had a positive impact on their ability to afford essentials, the balance varies significantly between segments as did the extent to which negative or positive views were more or less strongly felt. The largest “Payday Mainstream” segment with the most disciplined and careful approach to financial management were least likely to feel that without payday it would be more difficult to afford essentials, believed to be the case, however by one in five (2.3 times more than took the opposite view that it would be easier to afford essentials without payday). All the other segments were much more likely to take the view that it would be more difficult to manage essentials, believed to be the case by 42%, 38% and 47% of the “Mainstream Excluded”, “Mainstream Strugglers” and “High Income Convenience Users” respectively. In each case the balance of those taking a positive view of the role of payday lending in affording essentials was greater than those taking a negative view.

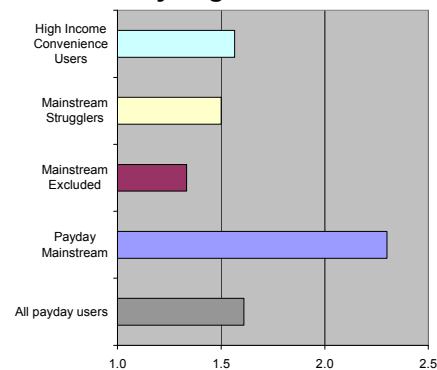
Most hard-pressed segments most likely to have difficulty in affording essentials if payday withdrawn

Chart 83a. Whether think will be easier or more difficult to afford essentials without payday by segment



Source: Synovate Research for Policis 2008

Chart 83b. Ratio by which payday users believe likely to be more difficult to afford essentials by segment



Source: Synovate Research for Policis 2008

A significant minority of all segments other than the core Payday Mainstream group believe they would be better able to afford essentials without payday

Clearly however, a significant minority – three in ten – of all the segments other than the large Payday Mainstream segment - felt that without payday it would be easier to afford essentials, a view shared by only 7% of the Payday Mainstream borrowers. This reflects the essential ambiguity of the payday experience and the ambivalence borrowers feel about this type of credit. Using payday lending is a fully rational decision based on fit with need and the utility of the product for the customer but customers are also painfully aware of its high cost.

This rests in part in the ambivalence users feel about the high cost of payday and in part reflects attitudinal and behavioural differences between segments

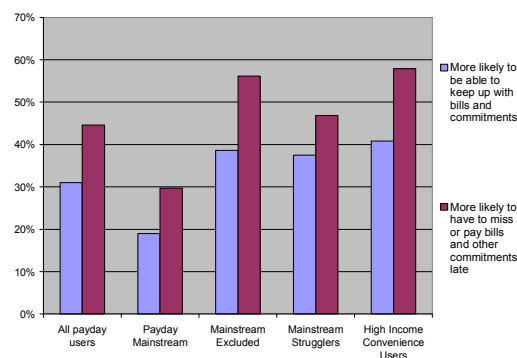
It also illustrates the influence of both behavioural factors and relative disadvantage in the use and impact of payday and how these come together for different segments. The “Payday Mainstream” segment are less likely to have their ability to afford essentials influenced by payday borrowing because of their generally modest and disciplined use of credit and careful budgeting. The Mainstream Excluded, on the other hand, are both those for whom repayments are most painful and the most likely to face cash emergencies and thus are also the most frequent but also the most likely distress borrowers. They are thus more likely than other payday users to feel ambivalent about the role of payday. The small “Mainstream Strugglers” segment have a similar income and demographic profile to the core “Payday Mainstream” segment but are set apart by their heavy use of credit and the financial pressures arising from their relatively chaotic finances. For these borrowers payday lending will all too often be a lender of last resort, used either because the borrower has run out of cash or to avert financial difficulties becoming crises. Finally the “High Income Convenience Users” tend to have alternative sources of credit available. For this group use of payday is more finely balanced in that it is more discretionary and convenience-oriented and part of a wider pattern of heavy credit use. For these borrowers, particularly where they are able to keep up repayments on mainstream credit, avoiding the temptation to use payday or better organising their finances so as not to run short of cash could indeed likely result in more money being available both for essentials and life-style spending.

Six out of ten of both “Mainstream Excluded” and “High Income Convenience Users” believe more likely to miss bills and other commitments without payday

A similar pattern pertains in relation to being able to keep on top of bills and commitments. Three out of ten of the “Payday Mainstream” users felt that they would be more likely to have to miss bills or credit commitments without payday borrowing, a view shared by almost six out of ten of the most disadvantaged “Mainstream Excluded”, by close to half of the “Mainstream Strugglers”(47%) and by 58% of the “High Income Convenience Users”.

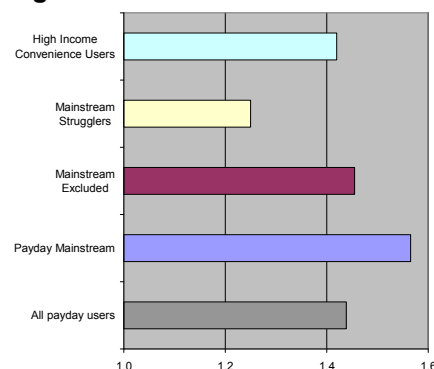
View that without payday would be more likely to fall behind on bills strongly felt among both most disadvantaged and affluent convenience users

Chart 84a. Impact on household finances if payday not available – ability to keep up with household bills



Source: Synovate Research for Policis 2008

Chart 84b. Positive balance on impact of payday on ability to keep up with bills by segment



1.0 = equal balance between those taking view that payday has positive impact and those believing that it has negative impact on ability to keep up with bills
Source: Synovate Research for Policis 2008

Few of core “Payday Mainstream” borrowers believe better able to meet bills without payday but significant minority of other segments take this view

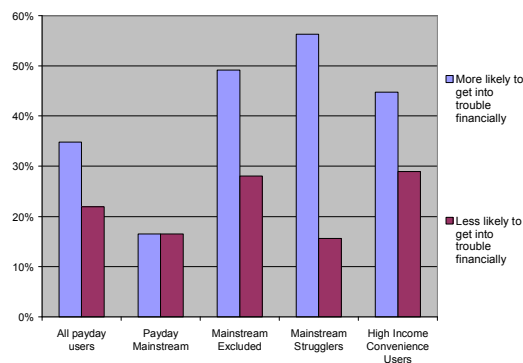
A significant minority of users, however, about three in ten overall, felt that they would be more likely to be able to keep up with bills and commitments without payday. Again this varied significantly by segments. The core payday users in the “Payday Mainstream” segment were much less likely to take this view (16%) than other segments. As discussed previously, the relative lack of impact likely reflects their careful budgeting and use of credit. The perspective peaked among the “High Income Convenience Users”, four in ten of whom (40%) felt they would be better able to keep up with bills and commitments if they did not use payday.

Payday most clearly playing a role in preventing financial difficulties becoming financial breakdown among the segments experiencing greatest pressure

Payday users as a whole took the view that, on balance, without payday they would be more likely to run into trouble financially. Perhaps unsurprisingly, those most likely to take this view were either those most exposed to the risk of financial breakdown and / or with the greatest spread of commitments or those with the tightest budgets. The proportion of the “Payday Mainstream” segment - least likely to be facing financial difficulties in any case - believing that they were more or less likely to get into financial trouble without payday were evenly balanced, with some 17% of the segment espousing each perspective. Both viewpoints were felt to much less an extent than was the case with the other segments, however, where the balance was heavily biased towards the view that use of payday worked to prevent getting into trouble financially . Almost six out of ten of the “Mainstream Strugglers” - the group most likely to be at risk of financial breakdown and often using payday to prevent themselves slipping over the edge - felt they would be more likely to get into trouble financially. This view was shared by a half (49%) of the “Mainstream Excluded” segment and 45% of the “High Income Convenience Users”.

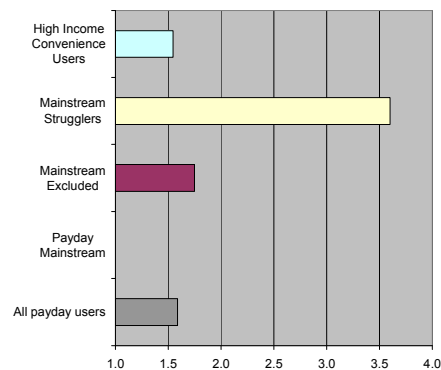
The segments most at risk of financial break-down those that believe that without payday more likely to get into trouble financially

Chart 85a. Impact of withdrawal of payday on likelihood that will get into financial difficulties



Source: Synovate Research for Policis 2008

Chart 85b. Positive balance on impact of payday on ability to ward off financial difficulties



1.0 = equal balance between those taking view that payday has positive impact and those believing that it has negative impact on their ability to ward off financial difficulties
Source: Synovate Research for Policis 2008

All segments likely to restrict use of credit to some extent, making greater use of both informal borrowing and social lending to avert short term cash crises

Overall therefore the evidence suggests that the various segments would be impacted in different ways by policy moves that resulted in a restriction of the supply of payday lending. The most immediate impact of any such moves would be a sharp contraction of the availability of short term credit, a development that would impact those with fewest credit options most quickly. Many payday users would likely do without credit, thereby turning cash shortfalls into more serious crises, potentially resulting in the diversion of funds from items such as utility or rental payments to cover essentials.

“Payday Mainstream” likely to be diverted in limited way to credit mainstream, occasioning modest increases in indebtedness and financial difficulty

The core “Payday Mainstream” segment, who appear to use payday in a relatively considered and cautious manner would likely be diverted in a modest way to mainstream banking and revolving credit vehicles, with the most likely source of small sum credit being cash advances on credit cards and overdraft finance. As was discussed in section 5.0, this will not necessarily be a net benefit for at least some of these consumers nor will it necessarily result in a reduced cost of credit for those unable to keep to regular repayments. The attitudes and expectations of payday users described above is borne out by evidence which suggests that those using cash advances on credit cards are more likely than their counterparts in similar income ranges using payday loans to be in arrears on household bills and to be exposed to penalty charges for breaching overdraft limits or the terms of credit agreements. Those raising cash on advances on credit cards also pay down revolving credit debt more slowly than do payday users with credit cards. Payday users taking out cash advances also have greater overall indebtedness than other payday users with credit cards²⁸. There is a real possibility therefore that an increase in the use of revolving credit vehicles and overdraft finance will result in a rise in the incidence of credit payment problems and financial difficulties more generally and an increase in total indebtedness. In the case of this segment, however given their behavioural signature and current exposure, this will likely be a small rise from what is currently a relatively low level of problem debt.

“Mainstream Excluded” likely to face hardship; cash crises and more frequent, distress-driven use of pawn likely to pose greater risk to pledged assets

The more disadvantaged “Mainstream Excluded” group with more constrained credit options would seem more likely to be more negatively impacted by any restriction on their access to payday borrowing. Having relatively restricted access to mainstream credit, this group will be more likely to fall back on informal borrowing to cover cash crises, potentially suffering hardship where unable to bridge cash shortfalls or find the funds for the purchase of big ticket items or the repair of essential equipment.²⁹ Where informal lending is not available, the displacement effect for this segment would most likely be in the direction of either pawn-broking or social lending, already

²⁸ For an extended discussion and evidence on the impact of use of different credit vehicles on the cost of credit and financial difficulties see Policis “The dynamics of low income credit use. A research study of low income households in Australia” (2008)

²⁹ For an extended discussion and associated evidence of the role of small sum cash credit in the financial management of those on low incomes see Policis “The dynamics of low income credit use. A research study of low income households in Australia” (2008)

key sources of small sum credit for this group. There may be some limited diversion also to overdraft finance where this is available and potentially some stimulus to use revolving credit, though any such shift would likely be muted by constraints on access. Pawn-broking will not necessarily be a cheaper form of small sum credit for this segment, and one which may have considerably less utility and convenience. If pawn is used more frequently than currently, this may expose this type of borrower to a greater risk of loss of assets which, given the constrained budgets typical of this segment, may well have been hard-won. Relatively high levels of delinquency on both payday lending and mainstream credit already evident among this group suggest that a proportion of those borrowers diverted to the mainstream are likely to struggle to keep up repayments. This will in turn have the effect of generating additional costs as a consequence of the associated penalty charges.

The impact of restriction of supply paradoxically most deeply felt among those segments who are heavy users of credit mainstream in parallel to payday

The impact of restriction of the availability of payday may be most deeply felt among the heavy credit user segments. Those among the “Mainstream Strugglers” segment who have been using payday to avoid worsening their existing financial difficulties or slipping into outright default will find their room to manoeuvre constrained to the point where some at least will face financial breakdown. Those who retain a mainstream credit line will likely take greater advantage of cash advances on credit cards while those who do not will make greater use of pawn-brokers.

As “Mainstream Strugglers” lose access to payday funding which has lubricated finances, difficulties may rapidly become financial breakdown

In the case of the former, greater use of revolving credit will likely both increase indebtedness and exposure to the risk of financial breakdown, while not necessarily reducing the cost of credit (see detailed discussion in section 5.0). Increased use of pawn-broking may not carry the same risks, but it is difficult to see how it will represent any benefit to the consumer over use of payday, either in terms of cost of credit or more general utility. The “Mainstream Strugglers” segment would seem more likely than the “Mainstream Excluded” segment to have assets of sufficient value to pledge and so may have greater access to this form of small sum credit in the event of a cash emergency than their more disadvantaged counterparts likely to be similarly diverted to pawn. The finances of the “Mainstream Strugglers” segment would seem, however, to be so under pressure, indeed for many chaotically so, that they would seem at least as much at risk of losing assets pledged.

As “High Income Convenience Users” make greater use of revolving credit, fine balance between coping and struggling likely to be compromised

The “High Income Convenience User” segment will have more options than other segments as an alternative to payday. Given their existing patterns of use of credit cards to raise small sum cash advances alongside payday loans, it would seem likely that any withdrawal of payday will lead to a corresponding shift to overdraft finance and revolving credit among this group. Again, given the already very high levels of missed and late payments, “maxed out” card balances” and minimum payments on credit cards and the high incidence of bank charges for account delinquency among this segment, an increase in use of revolving credit and overdraft facilities would seem likely to result in an increase in all of these phenomena also. In the process at least some of this segment would seem likely to be moved closer to the position of the “Mainstream Strugglers”, i.e. to make the shift from coping to failing, ultimately

increasing the risk of financial breakdown and insolvency. Some borrowers able to maintain regular payments will benefit and find themselves paying less for their credit. It is not clear, however, that for the majority of borrowers in this segment, that credit obtained from mainstream lenders will necessarily be cheaper than that obtained from the high cost fringe lenders. Increased exposure to penalty charges for missed payments and an increased propensity to make minimum payments on maxed out balances over an extended period may well be no cheaper than high cost payday lending while also creating greater risk of exacerbating wider financial difficulty.

There are significant social and economic risks attached to credit market regulation more generally and to price controls more specifically

Taken together, it would seem that policy moves that result in the restriction of the supply of high cost credit carry a number of economic and social risks, with a real possibility of significant consumer detriment and a knock on effect in the mainstream credit market. The largest group of payday borrowers, considered and careful users of both payday and mainstream credit, would be denied a facility that they appear to value, since it is used alongside, and in many cases as an alternative to, mainstream credit sources. Some of these borrowers may well find their total cost of credit reduced, although their indebtedness may increase modestly, and the downside, in terms of the numbers impacted by increasing delinquency and default on revolving credit, will be small. The evidence suggests however that this group are not suffering any significant detriment from their use of high cost credit so that it is difficult to see a compelling case for its restriction.

It is the most vulnerable borrowers who are most likely to suffer significant detriment without adequate alternative provision for low cost social lending

The most vulnerable payday borrowers, on the other hand, both those without other options and those barely coping with existing credit commitments, could suffer significant adverse effects in the event of losing ready access to small, albeit very high cost, short term loans. These will potentially take the form both of hardship, for individuals and families, and an upswing in financial breakdown, both of which are likely to result in some additional burden on, and cost to, the state in addition to the human cost. On balance, these borrowers' own assessment that payday has a positive rather than negative impact on their ability to manage their finances would seem justified by the evidence. Without provision for some alternative form of social lending, there would seem a significant risk that policy moves that result in a restriction of the supply of credit to this type of borrower will create greater detriment than benefit.

It is not clear either that the majority of payday users are suffering any detriment or that they will benefit from moves to restrict payday supply

The significant minority of high income payday users for whom payday is a convenient component of a portfolio of credit products, the benefits of a restriction of supply are also hard to call. Again, some such borrowers may find the cost of borrowing reduced. For the many credit users with an uneven payment record among these borrowers, however, it is far from certain that the overall cost of credit will be much changed, while price transparency will be more compromised and the risk of financial difficulty increased.

Regulators will wish to consider the balance of benefits and risk and the potential for unintended effects

Against this background, legislators, regulators and those concerned with consumer protection, debt and poverty issues will wish to consider carefully the balance of benefits and risks and the potential for unintended effects in formulating policies which would be likely to result in restricting the supply of high cost credit.

8.0 Policy implications

The key issue is how what would appear to be an irreducible need for small sum credit is to be met

There would appear to be an irreducible need for small sum cash credit, most deeply felt among the most disadvantaged and mainstream credit excluded but evident also among low to middle income credit users more generally. The key issue for policy makers is how this need is to be met and whether it is acceptable for it to be met by high cost payday lending.

Price controls will result in a restriction of credit supply and a displacement effect whereby borrowers are diverted to other forms of small sum credit

The evidence from markets around the world is incontrovertible³⁰ that price controls will result in a restriction of payday supply and potentially, depending on how the regulatory framework is configured, even to the withdrawal of the payday model. Lenders do not reduce their prices in line with controls but rather adapt their models and pricing structures to accommodate – i.e. to evade – the restrictions or simply withdraw from the market where they cannot achieve a price for credit commensurate with perceived risk. We here consider the policy implications of such restriction of supply.

Regulatory policy in relation to payday is therefore best viewed in the context of small sum cash credit use overall

Payday is not the only - and by some margin not the most important - source of small sum cash credit used by low to middle income consumers in Australia. Cash advances on credit cards are rather the leading source of small sum cash credit for those on low to middle incomes. Policy in relation to payday may be best seen in this context, with payday used by some in parallel to cash advances on credit cards, by others as a perceivedly more predictable and shorter term alternative to revolving credit and by yet others without access to the credit mainstream as their only cash credit option and a preferred alternative to pawn.

The benefits and risks of different product types are finely balanced and there can be little difference in terms of cost or impact of debt service

There are positives and negative aspects of use of the various small sum credit product types, with use of each carrying different risks and benefits for consumers and resulting in different outcomes, albeit that the total value of debt service and the proportion of income it represents appears to vary little regardless of the make up of the portfolio of credit products used³¹. The evidence suggests that for the most vulnerable consumers particularly, whether those on low incomes or those likely to struggle with credit for whatever reason, the relative benefits and risks of these various options for small sum credit are finely balanced. It also suggests that the real cost of small sum credit may differ little between credit vehicles, particularly under uneven payment conditions. That said, borrowing cash on short term contracts, as in the case of payday, appears to expose borrowers to significantly less risk of serious financial difficulty than raising similar sums on revolving credit vehicles.

³⁰ For evidence see Ellison and Forster *"The impact of interest rate controls."* Policis 2008, Policis for the Department of Trade and Industry, UK (2004) *The effect of interest rate ceilings in other countries* Staten, George Washington University (2007) *The Impact of Credit Price and Term Regulations on Credit Supply*

³¹ The exception to this latter phenomenon is those primarily dependent on pawn, where the value of debt service is much lower than for users of other credit types.

While there is some ambiguity for affluent payday users, for the majority of payday users payday appears to be playing a broadly positive role

For a large majority of payday users, payday appears to be playing a broadly positive role in the financial management of borrowers in acting to prevent cash shortfalls becoming cash crises and enabling households to keep up with commitments. This is most evident among the most disadvantaged consumers and low income households more generally.

For a significant minority of payday customers, however, some three in ten of the total, there is some ambiguity, in that borrowers feel they may be better able to manage their finances effectively and could have more money in their pockets if they avoided using payday. It is important to note however that these borrowers are not the core low income payday customers for whom payday is one element in a modest portfolio of credit products nor the more disadvantaged customer types within that customer base. They tend rather to be more affluent borrowers using payday alongside heavy mainstream credit use either on the grounds of convenience and ready access or because payday is being used to prevent a mainstream credit position or other creditor relationship deteriorating. Very few of even these borrowers would however wish to lose what they see as a safety net of last resort.

It is difficult to see a compelling case for restriction of supply when there is little evidence of a debt spiral or that users' budgets are compromised

The hypothesis that payday of itself creates consumer detriment does not appear convincingly supported by the facts. There appears to be no credible evidence of a widespread debt spiral being created by payday in the sense that the overwhelming majority of loans are paid to contract term, extensions appear relatively rare and borrowers appear to be frequently rather than quasi continually in the market – on average for a third of the year spread over four separate loan contracts.

The evidence does not support the hypothesis either that payday borrowing compromises vulnerable borrowers' ability to afford essentials or manage their finances effectively. It would appear rather that for the majority of users, the reverse is the case in that payday is used to provide essentials in times of cash shortfall and to manage through financial difficulties. That said, the pressure on household budgets during the relatively short period of time that users are in the market and making payments is significant. Payments are indubitably hard to find and borrowers clearly find the period over which repayments are being made difficult, albeit not to the point where borrowers do without essentials. Awareness of both the stress on budgets arising from making relatively high repayments over a short period of time and the high cost of payday per se is clearly dissuasive for many borrowers so that the majority of payday users do not enter into this type borrowing lightly.

This is most evident for the large group of payday users who use payday in a modest and considered manner as an alternative to revolving credit

There is clearly a large group of core payday users, a little less than half of the total, who use payday modestly in a considered way as part of a wider portfolio of credit products, also used carefully. For these borrowers payday – and specifically short term low value credit - appears to be an active preference as part of a strategy of minimising use of revolving credit and open-ended, long term debt. These consumers do not appear to be suffering any significant detriment from their use of payday – which does indeed appear to have the effect of limiting indebtedness and default in comparison to their counterparts choosing to raise small sum cash on credit cards.

Some of these borrowers may enjoy cheaper credit if diverted to revolving credit but others may pay more and all will risk greater indebtedness

It is difficult to see a compelling policy case therefore for restricting the supply of payday credit to these borrowers, for whom the likely outcome of such restriction will be a diversion to revolving credit and overdraft finance, itself likely to result in a modest increase in delinquency on mainstream credit. Some of these borrowers may enjoy cheaper credit as a result, though their overall indebtedness will likely increase. Others, if they revolve on credit cards, pay down revolving debt over significantly extended terms or who exhibit the uneven payment patterns endemic among a significant minority of mainstream credit users in the same income ranges may gain no cost benefit – and indeed for some mainstream credit may prove more expensive than payday. These borrowers will however also face a modestly increased risk of exposure to serious financial difficulties in the event of an adverse change in circumstances.

Affluent payday users with few mainstream credit problems may well enjoy a net gain without the temptation of readily accessible short term credit

For the significant minority of relatively high income payday users, circa a quarter of the total, who are using payday for convenience alongside mainstream borrowing, the balance of risks and potential benefits is rather different to those associated with the core payday user base. In the event of a restriction of payday supply, the displacement effect will be to the credit mainstream, primarily to revolving credit. Some of these users will benefit from a reduced use of credit overall, in that the temptation to take up easy access high cost credit will not arise. Some of those operating within their mainstream credit limits who simply substitute cash advances on credit cards and overdraft finance for payday loans and maintain an even payment record will enjoy cheaper credit. However, for the major sub-set of these borrowers at or close to the limit of mainstream credit lines, already exhibiting significant delinquency or barely keeping up with payments, for whom payday is acted as a safety valve and cash flow lubricant, the prospect of any savings on the cost of credit is much less certain. Indeed such borrowers may pay more for their credit, through mechanisms such as default charges and bank bounce fees and by dint of servicing minimum payments on maxed out cards over an extend period.

The most serious impacts will be felt by those excluded from the mainstream or using payday while struggling with mainstream credit

For policy makers the more difficult issues arise rather around those payday users who have no credit options and the heavy credit users using payday alongside mainstream, a significant sub-set of whom are barely coping and using payday to lubricate cash-flow and prevent the slide from delinquency to default and financial breakdown. For these consumer groups the risks and benefits are more finely balanced and the outcomes of any restriction of the supply of payday will have greater impact.

Perhaps the greatest risk is of a significant increase in serious financial difficulty and insolvency, as has occurred in the US following payday bans

The greater risk however is that as borrowers increase their use of revolving credit, they further stress what is already a fine balance between coping and struggling, resulting in increased default, serious financial difficulty and, ultimately, financial

break-down. A little more than one in ten payday borrowers would seem likely to be at significant risk of such an outcome arising.

Around a third of payday users would undoubtedly face hardship in the event that they had no readily accessible source of cash credit

There is clearly a group of payday users who have no other credit options, circa a third of the total, who would suffer hardship in the event that payday was not available in that they would have no means of managing through cash crises or peaks of expenditure or of meeting unanticipated expenses. Some of the most disadvantaged of these users simply do not qualify for mainstream credit because of low or insecure incomes. Others are already at the limit of mainstream credit lines, have already failed in the credit mainstream or have even faced insolvency, with a history of problematic mainstream credit use often a feature of such cases. It is worth noting that those no longer able to borrow in the credit mainstream will tend to be relatively high income households.

An increase in distress-driven use of pawn would likely result in increase loss of pledged assets, which difficult to replace without small sum credit

Mainstream excluded payday borrowers and those on the lowest incomes will likely respond to a restriction of payday supply by making increased use of pawn-brokers. It is not clear that the cost of small sum cash credit will be significantly reduced as a result though some will borrow less frequently than they might have done from payday lenders because the utility and appeal of the pawn model is less. A significant minority of payday transactions are distress driven, however, particularly for this kind of borrower. An increase in distress-driven use of pawn would seem likely to pose greater risk to pledged assets, some of which may have been hard won and will be difficult to replace in the absence of small sum credit.

The evidence from other market is that higher income borrowers refused credit by mainstream lenders are the primary target for black market lenders

In the absence of alternative provision and a restriction of payday supply, the evidence from other markets is that part of the resulting credit vacuum may be filled by unregulated lenders, typically very high cost, frequently exploitative and with collection often sustained by a degree of intimidation and oppressive practice which would not be contemplated by regulated lenders. In most such black credit markets around the world the prime target market for black market lenders are higher income borrowers with a strong appetite for credit who have failed in the credit mainstream, a segment now being served by the payday lenders and pawn-brokers. Use of black market lenders is not restricted to this group, however, being also used, albeit to a lesser extent, by low income borrowers unable to obtain credit from legitimate lenders.

One way forward may be to develop alternative sources of social lending, but important to acknowledge that this highly challenging and costly option

In considering how best to meeting the needs of these borrowers, policy makers may wish to examine the desirability and feasibility of creating a social lending alternative to payday, either to try and fill the credit vacuum that would arise for those left with no credit options or to act as an alternative safety net. The experience of other markets is that this is neither an easy option nor necessarily an effective solution in that social

provision tends to be perennially inadequate to need and is slow and cost and resource-intensive to create and sustain while also being difficult to build to any scale. It may be possible for some of any social provision to be delivered within the context of existing welfare related provision but this is less likely to be appropriate for the majority of payday users in work – albeit that employment can be low paid or irregular – far less for the relatively high income group who have failed in the credit mainstream.

There would appear to be significant social risks attached to a restriction of payday supply while the cost and other benefits are uncertain

The social policy case for price controls and restriction of the supply of payday lending does not appear compelling and there is a significant risk of unintended and detrimental effects attached to any such moves.

- Consumers appear to be making a rational decision in choosing payday lending as an alternative to other forms of small sum cash credit cash, to keep up with commitments and avoid penalty fees and reconnection charges and to enable the acquisition of essentials in times of cash shortfall.
- There is no strong evidence of a debt spiral or significant consumer detriment being associated with payday borrowing which appears to play a role in keeping finances on track. This does not mean that payday borrowing does not create a strain on household budgets, but rather that the stress arising is manageable and short term and is probably a more desirable outcome than the alternative - running out of cash, being unable to deal with an emergency or being unable to meet commitments.
- It is not clear that diversion of small sum cash borrowing from payday to other credit vehicles such as pawn or revolving credit will result in a net social benefit or a financial gain for consumers. The evidence is rather that the reverse will be the case,
- The sub-set of payday borrowers who may be better off in the absence of payday borrowing are not vulnerable low income payday users but higher income heavy credit users with mainstream credit options.
- Efforts to control the price of payday lending may not reduce the cost of credit to the consumer and may increase it in some cases, primarily for the most hard-pressed, while also significantly increasing the risk of exposure to serious financial difficulty.
- An increase in credit exclusion arising from a restriction of payday supply would be likely to result in hardship for the most disadvantaged.
- The most likely outcome is that restriction of the supply of high cost credit will stimulate an increase in default and financial breakdown both among the high risk borrowers diverted to revolving credit , as has occurred in the US where payday bans have been imposed, and among those denied credit, as has happened in Japan.
- There is a risk also of creating the conditions for black market lending.

Regulatory activity and consumer protection efforts may be better focused on mandating best practice and eliminate unfair or oppressive terms

Regulatory activity might be more productively focused and consumer protection most effectively enhanced by seeking to mandate best practice standards and

eliminate unfair lender practice, which appears to arise primarily among smaller lenders. This could usefully include measures designed to minimise practices, such as roll-overs, which increase cost and potentially encourage borrowers to remain continually in the market, although this does not currently appear to be a feature of more than a very small proportion of transactions.

Price reductions might be most effectively achieved through stimuli to competition and financial innovation

Price reductions might be most effectively achieved not through price controls but through greater stimulus to competition and financial innovation. More private sector provision by payday operators has brought prices down in other markets, but other types of provider, such as credit unions in the US, have also been known to launch their own payday products. Banks and other mainstream providers might also be encouraged to innovate in this area, introducing products intended to compete directly with payday, again as in the US, which in turn should lead to reduced prices and greater consumer choice.

It will be important in this regard for regulators to ensure that price transparency is not compromised through complex or opaque charging structures and that the contractual terms associated with any new product structures do not contain overly onerous conditions or unfair or oppressive charging or collection practice.