Filling the gap

Can banks step into the gap left by payday loans --- and if so, how?

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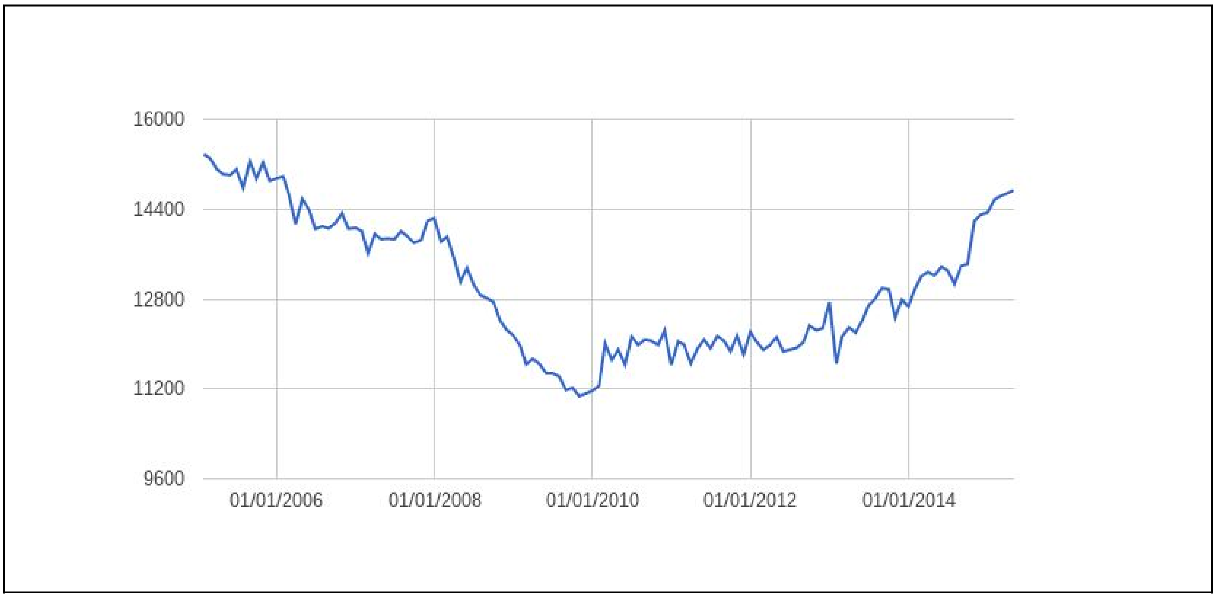
citizens advice

Introduction

The financial crisis of 2008 and subsequent recession led to an explosion in the payday loan market in the UK. The conditions at the time provided fertile ground for the burgeoning payday loan industry. Lower income consumers, already hit hard by the downturn, were less able to turn to mainstream financial credit due to more stringent lending criteria imposed by banks. This resulted in many, who would have previously dipped into their overdraft or increased their credit card spending, looking elsewhere for access to quick cash.

Chart 1: Monthly amount of monetary financial institutions sterling unsecured gross lending to individuals (in sterling millions) seasonally adjusted 2005-2015.



Source: Bank of England

Under these conditions, the payday loan market experienced rapid growth, with a particular increase in online providers entering the market. Research estimates suggest that in 2009 1.2 million adults in the UK took out 4.1 million payday loans totalling £1.2 billion.[1] The Financial Conduct Authority (FCA) found that in 2013, 1.6 million customers took out 10 million loans with a total value of £2.5 billion.[2]

The impact of this growing market on consumers was significant. Citizens Advice saw a ten-fold increase in the proportion of clients seeking advice about payday loan debt

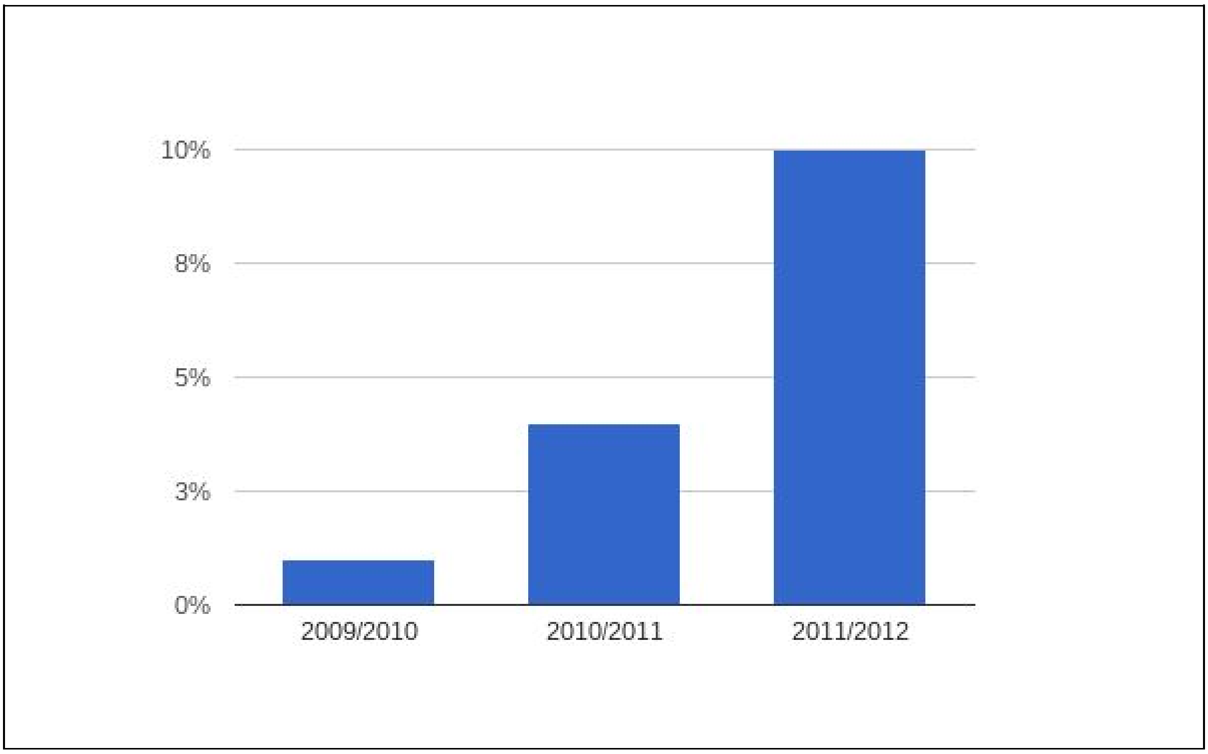
[1] *Keeping the Plates Spinning*, Consumer Focus, 2010
[2] *Proposals for a price cap on high-cost short-term credit*, FCA, 2014

problems from 2009 to 2012. Typically, clients experienced high charges and successive defaults leading to spiralling debt. For example:

> My initial loan was £240 with interest of £180 making the total £420. As I couldn't afford to pay I rolled it over 2 or 3 times. With the interest they charge they now say I owe them £1700 and possibly more now.

This irresponsible lending, and poor debt collection practices, led Citizens Advice to work with the government and regulators to establish stronger protections for borrowers.

Chart 2: Percentage of those seeking advice from Citizens Advice who had taken out at least one payday loan.

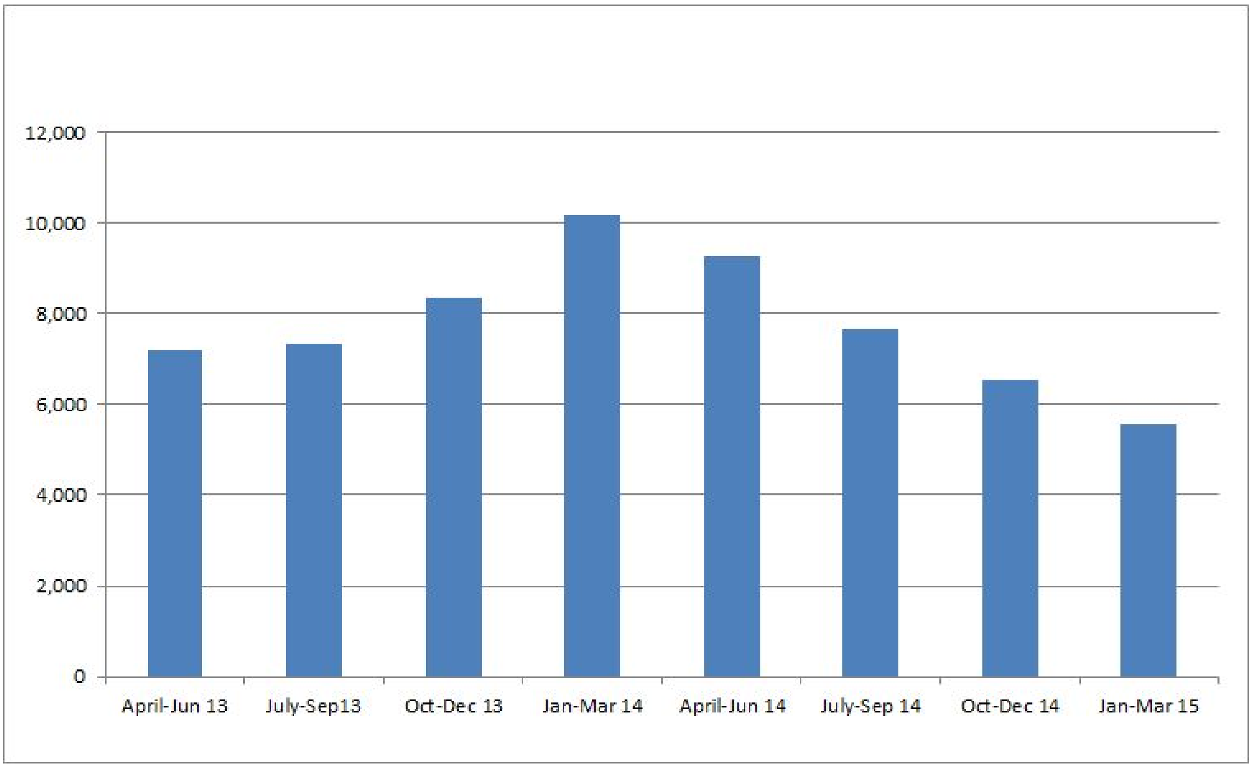


Source: Citizens Advice

The newly created FCA took over regulation of consumer credit from the OFT and acted by introducing stricter rules on payday loans in 2014. These new rules included strengthened affordability checks, compulsory signposting to debt advice and limiting how many times a loan could be 'rolled over'. In January 2015 a daily interest cap of 0.8% and a total cost cap came into force meaning that a consumer could never pay back more than double what they borrowed, including interest, fees and charges.

Our evidence suggests these changes have worked. Problems with payday loans have roughly halved following the introduction of this regulation. In the first quarter of 2014, there were 9,243 problems with payday loans seen by Citizens Advice, this fell to 5,554 in the first quarter of 2015. As the FCA expected, in response to the new rules and the cap, many payday lending firms are exiting the market and a significant proportion of individuals will no longer be lent to by payday lenders.

Chart 3: Number of payday loans problems seen by local Citizens Advice 2013-2015



Source: CItizens Advice

The question now is: where will the demand for short-term credit go, given the contraction of the payday lending market? In answer to this question we are producing a series of briefings on forms of lending that could absorb past demand for payday loans. Other briefings look at other forms of high cost credit. This briefing focuses on the role of mainstream banks. The growth of payday lending corresponds closely with the contraction of mainstream lending and these providers have the reach and scale to provide greater access to affordable credit. This report investigates the extent of this role, what that might look like and what barriers banks face to playing this role.

This report is based on in-depth interviews with senior representatives with responsibility for unsecured lending from six major high street banks. The interviews gave us a private insight into research undertaken by banks about their customers who had used payday loans, the appetite of banks to lend to customers who have used payday loans and what, if any, action banks had taken to modify or improve their existing credit products to better serve these customers.

In addition, in-depth interviews were carried out with eight consumers who had taken out a payday loan at least once in the previous twelve months and were in employment (as a proxy for eligibility for bank credit). Our focus in these interviews was on the attitudes and behaviours that made payday attractive. These consumers were recruited through the Citizens Advice network across England and Wales and the interviews lasted approximately 1 hour. These interviews explored clients' credit histories and short-term lending preferences.

We find that banks could have lent to anywhere from 10 to 40 per cent of payday loan borrowers, depending on the bank's appetite for risk. Banks do not want to enter this market but they will countenance products with some similar characteristics. Borrowers, meanwhile, liked payday loans because they were online, anonymous and clear about their fees. They chose payday products because they felt *less* risky than credit cards, which they see as open-ended borrowing with unclear costs. When we consider the overlap between what banks will consider, and what borrowers want, the product that has most potential is flexible overdrafts with clear and fair fees. Products in this space could fill some of the gap left by payday loans.

We look first at the findings from our interviews with banks. We then discuss the views of payday loan users on mainstream credit products. Finally, we compare what borrowers want and the products banks are willing to develop, showing how mainstream credit could fill the gap left by payday loans.

1. The views of banks on short-term credit

Most banks we spoke to had undertaken extensive research to understand their customers who use payday loans. This included understanding the demographics of these customers, the degree to which they were eligible for (more) credit from the bank and in some cases, tracking the outcomes for these customers and comparing these with customers with a similar profile who did not use payday loans. Three main lessons emerged from these conversations.

First, banks could have lent to a significant minority of payday loan borrowers. The proportion of payday loans users that banks were willing to lend to ranged from 10 to 40 per cent. This range is in line with previous research from the Department for Business, Innovation and Skills, which found that a quarter of online payday loan users were eligible for mainstream credit.[3] It also chimes with wider research. For example, one study found that 35 per cent of payday loan customers who have used some form of mainstream credit (overdrafts/credit cards) are eligible for further mainstream credit.[4]

In our interviews, we found that the variance in willingness to lend was attributed primarily to the risk appetite of the bank, and also in some cases the nature of the customer base of the bank.

Customers who banks were unwilling to lend to had credit problems such as missed payments or County Court Judgements (CCJ), and/or would fail an affordability check for

[3] *The impact on business and consumers of a cap on the total cost of credit*, Department for Business, Innovation and Skills, 2013.
[4] *The Payday Way*, GFK 2012

further lending. Banks reported that many of their customers using payday loans were in acute financial difficulty.

> I think overall looking at should we be lending to people that are taking payday loans? I think in a vast majority of cases the answer is probably not. (High Street Bank B)

> Three quarters of our payday loan users are in financial difficulty - giving them more money might not be the best solution for them in the long term. (High Street Bank C)

One bank reported that even in cases where customers met lending criteria at the point in time they took out a payday loan, paired tracking of these customers showed that they were more likely to end in financial difficulty than similar customers who did not use payday loans.

> Of customers that use payday loans there are 10 per cent that would pass our normal credit assessment. But even that 10 per cent are performing three times worse than others with a similar profile. (High Street Bank B)

This finding is in line with research from the Competition and Markets Authority (CMA), which found that payday loan customers represented a higher credit risk than average customers and, indeed, that some lenders were using payday loan use itself as a factor in credit scoring, given its association with financial difficulty.[5]

These findings also accord with previous research which has found that many payday lenders failed to carry out affordability checks prior to lending. In 2013, the Office of Fair Trading found widespread non-compliance with the Consumer Credit Act and that "the majority of [payday] lenders are not conducting adequate affordability assessments and their revenue streams rely heavily on rolling over or refinancing loans."[6] Many of these payday lenders worked with credit brokers using 'pingtree' technology to source business.[7] These brokers matched individuals and lenders on the basis of the highest bid from lenders, not based on the most suitable loan for the customer. Even when customers applied directly, some payday lenders failed to conduct any affordability checks.[8] It is unsurprising that many payday loans customers would fail banks' affordability checks: much payday lending has been irresponsible.

Second, banks reported that many of the payday loans customers eligible for credit had not applied to the bank for (further) credit. For example:

> Certainly there's a proportion of the people that we see have some interaction with payday lenders, that we have overdraft services with, and would be happy to do overdraft business with, but they don't seem to be asking us. (High Street Bank D)

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[5] *Payday lending market investigation: provisional findings report*, CMA, 2014
[6] *Payday lending: compliance review, final report*, Office of Fair Trading, 2013
[7] *Ibid.* Note: FCA regulations in force from January 2015 have curtailed the actions of credit brokers in the high cost credit market.
[8] *Ibid.*

Some banks had done their own in house research with payday loans customers who were eligible for bank credit which confirmed this finding. This research found both push factors from the bank and pull factors towards payday lenders similar to the demand side barriers discussed in the next section of this report. In essence, all of the banks interviewed reported both that some of their customers who used payday loans could be responsibly lent to with the bank's existing suite of products, and that some of these customers had simply not approached the bank, turning instead to payday lenders as a first point of call

Third, mainstream banks have little interest in developing a payday loan product of their own. Some banks with a higher risk appetite had modelled the interest rates needed to lend to their customers who had taken out payday loans. One bank that had done so, questioned whether there was a commercially viable rate within the daily interest and total cost cap. They felt the economics of the proposition did not stack up.

The banks that had investigated more aggressively competing with payday lenders emphasised that even if a commercially viable interest rate was set, reputational and brand issues prevented banks from offering products with the necessarily high APRs. Creation of new banking products requires a large amount of bank resource and agreement from a range of internal stakeholders. Even the bank that had most fully investigated the credit needs of its payday loans customers was not considering launching a new product for this market.

> We understand what that product would look like: a small sum, short term loan with a set repayment date. But I think we are a million miles away from being able to say that it's something we can launch. (High Street Bank A)

The key supply side barrier to banks competing with payday lenders was the inability to lend to most payday loans customers due to responsible lending criteria. In addition were the reputational or brand issues related to the very high interest rates needed to lend in this market.

Overall, then, our interviews suggest that as the high cost short term credit market contracts, there is a possibility for mainstream banks to responsibly absorb some demand from payday loans customers. There are also possibilities for improving bank services for this group of borrowers, some of which are underway or already being discussed within banks. Our consumer interviews, presented in the next section, focused on what these products would need to look like in order to meet borrowers' demands.

2. The view of consumers

Our consumer interviews also revealed both barriers and opportunities to improving bank lending for some payday loan users. We asked consumers about credit cards, overdrafts and personal loans, including their experience of using them, and which features they found helpful or unhelpful. We found that in many ways existing bank products were not meeting the needs of these consumers. We start by talking through consumers' views on mainstream products and in the subsequent section we turn to the opportunities for banks to develop products more in line with consumer demands.

Personal loans

There is long-standing evidence that low income consumers need to borrow relatively small sums for short periods to help with day-to-day expenses or cover larger unexpected costs.[9] Bank personal loans are not suited to meeting these needs, as a standard minimum personal loan is £1,000 borrowed over a year. In comparison, payday loans can be as small as £50. The FCA found the average payday loan was £260 lent over 30 days.[10]

This research was reinforced by our interviews. There was little experience of using personal loans among the consumers we interviewed. Those who had not used personal loans assumed that they would not qualify for them due to a poor credit history. In some cases participants had been rejected for a personal loan in the past. Personal loans were seen as inflexible, long-term and inappropriate and, in any case, the structure of the product did not meet the needs of payday borrowers.

Credit cards

Credit cards were more widely used by the consumers interviewed. Negative attitudes towards credit cards were sometimes shaped by past experiences of problem debt, including that of family members or friends. For example:

> I just didn't like the idea of credit cards [when I was younger], I always saw them as something where they can get you in a lot of debt. (Male consumer)
>
> I am not with the credit card thing ... some of my mates and certain other people they used to have loads of them and like ah mate, you very like, very dependant on them. (Male consumer)
>
> My mum always warned me [to] never take out credit cards. (Female consumer)

In line with other research,[11] there were concerns about the revolving nature of credit from credit cards (i.e. credit without fixed repayments). Some consumers also felt that credit cards were too tempting as they did not feel like 'real' money:

> I will never take out a credit card because it is like you never finish paying. (Female consumer)
>
> It feels like it is free money so you are just spending and you realise afterwards, hold on a minute now I've got to pay back this £300, this £500 or whatever it is. (Female consumer)

These attitudes help to explain why payday products are appealing to vulnerable borrowers; their clear and simple repayment terms means they are seen, despite far higher interest rates, as *less* dangerous to borrowers than mainstream revolving credit.

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[9] Sharon Collard and Elaine Kempson, *Affordable credit for low-income households*, Joseph Rowntree Foundation, 2005.
[10] *Proposals for a price cap on high-cost short-term credit*, Financial Conduct Authority (FCA), 2014
[11] Sharon Collard and Elaine Kempson, *Developing a vision for financial inclusion*, 2012.

Overdrafts

Concerns about revolving credit and associations with problem debt were also raised regarding overdrafts. For example:

> Bills come out of my account I am back in my overdraft so I live in my overdraft (Female consumer)

> I got into a lot of debt with them [overdrafts] … it just started to spiral (Female consumer)

> You'd go and put your card in and [have] this disheartening feeling because every time you did check your balance it was a reminder: you owe us. (Male consumer)

In addition, some participants raised concerns about unauthorised overdraft charges:

> If you go over your overdraft you then get charged. (Female consumer)

However, experiences of overdrafts were broadly less negative than for credit cards and attitudes towards overdraft borrowing were more mixed. For example:

> I prefer the overdraft you know, it is hard to get out of it that's the only thing, I don't know how I am going to get out of it but it's okay, I am not having problems with it. (Female consumer)

Again, the discrete nature of the payday product was attractive, separating out the borrowing into a clear, time-limited repayment.

Overall, then, our interviews help to explain why the payday product was preferred by some borrowers. Credit cards, and to some extent, overdrafts were mistrusted by consumers we interviewed due to the revolving nature of the credit and an association with getting into unmanageable debt. Other research also indicates a standalone fixed term loan product is preferred to revolving credit by low income consumers.[12] Yet personal loans were rarely used and not suited to these consumers due to the long loan terms and high minimum levels. This suggests that there are barriers to mainstream bank lending from a demand perspective and helps to explain precisely how payday loans have met this gap in the market.

3. Opportunities to improve existing bank products

Despite the identified product shortfalls, exploring consumer preferences for short-term credit also highlighted some opportunities for improvements to bank lending to meet low income consumer needs. In this section we draw out these opportunities, looking at the overlap between what low income consumers want and the kinds of products that banks are willing to consider developing. We found three key areas of opportunity.

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[12] *Ibid.*

1. Banks are seen by many borrowers as a preferred lender

FIrst, banks were preferred to payday lenders in some respects. Some consumers who use payday loans, do not do so out of preference. Previous research indicated that nearly a third of the 21 million people in financial difficulty in Britain would prefer to apply for low interest loans via their high street bank.[13] In line with this, among the consumers interviewed for this study, there was a preference for borrowing from a bank rather than from a payday lender. For example:

> It is much more easier to deal with a bank [than a payday lender]. (Female consumer)

> If I had the opportunity ... if like someone said look you can go definitely for the bank or a payday, I'd go to the bank. (Male consumer)

What exactly is it about banks that consumers liked? Participants were presented with a set of words (see Appendix I) and asked which, if any, they associated with banks and payday lenders. The words most associated with banks were: safe, respectable and formal but unwelcoming and unapproachable were also common. The words most associated with payday loans were: risky and dodgy but approachable and informal were also commonly chosen.

Some of this was a reflection of the negative experience of payday loans among those consumers interviewed, suggesting there may now be new new opportunities as public perceptions of payday lenders deteriorate. These experiences included not being clear on terms of the loan when taking it out, difficulty in making repayments, aggressive collection practices and being harassed with promotion for further loans. For example:

> The interest are really high, you are paying back more than a quarter of your wages, and then you have to borrow from them again. (Female consumer)

> They make it sound glamorous, yes take £200 off us no worries but you end up paying back probably about £600 or £700, man it's ridiculous! (Male consumer)

> [I missed a payment] then they got all funny with me, started sending me letters, starting texting, constant calls and I just thought, I changed my number in the end because I couldn't be doing with the grief off it. (Female consumer)

Banks were seen as more supportive and safer than payday lenders, as there was someone to discuss your options with. In some cases banks were thought to be fairer and more flexible about repayments.

> With banks they will tell you, well you are going to take this but just remember you have this to pay and that is going to be the interest on it. (Female consumer)

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[13] *An Action Plan on Problem Debt*, Stepchange, 2015

This suggests that there is an opportunity for high street banks to build on the positive relationships with their current account customers by improving access to their existing credit products.

2. Some mainstream products share characteristics with payday loans

Second, some bank products come closer than others to fitting the requirements of payday borrowers. Consumers were asked a range of questions about how they would like to access funds if they needed to borrow £250 at short notice.

Among existing bank products, arranged overdrafts were perceived the least negatively by the consumers interviewed for this study. This suggests that, with improvements, arranged overdrafts could meet some of the credit needs and preferences of payday loan users. For some consumers interviewed, overdrafts were found to be easy to access and use:

> It's only £100, it's not a big overdraft and just stay within it if I need to so, I don't really use it that often. I've had it for years and not changed. Well it's just if you run out of money for a couple of days, it just sees you through until you get paid. (Female consumer)

Consumers were also asked whether they preferred a one-off loan or revolving credit. As discussed earlier, there were clear concerns about revolving credit in some cases with a belief that this type of credit could lead to unmanageable debts. However, it was not completely ruled out by all consumers interviewed.

There will always be consumers who prefer the standalone nature of payday loans to revolving credit offered by overdrafts and credit cards. However, for those who have less a strong preference, making arranged overdrafts feel more separate from the money in a current account and made to feel more like a standalone loan could make a difference. This could be achieved by ensuring the overdraft is clearly marked as borrowing not just as part of the available balance in the account. Banks could also describe an arranged overdraft as an 'emergency borrowing facility'.

Their priorities reflected the three elements of payday loans that consumers found attractive: online access, speed and (perceived) clarity about fees. Similarly FCA research has found that most consumers of payday loans like the speed, ease and anonymity of borrowing from payday lenders.[14] Interviews with banks also revealed that some work is underway to enhance these elements of arranged overdrafts.

(a) Online access

Consumers in this study reported that online access was preferred to other access methods as it was perceived as easier and avoided the embarrassment of potentially being rejected for credit in person. Nonetheless, the support and ability to interact with a person and ask questions was highlighted as a benefit of face-to-face lending.

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[14] *Consumer Credit Research: Payday Loans, Logbook Loans and Debt Management Services*, FCA, 2014

> You're not face to face with anyone and embarrassingly asking them for money, you're asking, you know, an app for some money. (Female consumer)

> [I prefer the] quickest route [of access] … I work so I have no time trying to take time off running to places. (Female consumer)

One bank acknowledged that payday lenders had outcompeted banks with their online and app-based lending platforms but that banks were catching up.

> We have been playing catch up in last 12 months - there has been a technology lag … [consumers] can now arrange overdrafts on our mobile banking app - just the same as using a payday lender, just as slick and just as easy. (High Street Bank A)

All of the banks we interviewed were investing heavily in their online and mobile banking platforms. Improving online and mobile access to arranged overdrafts could help banks absorb some of the demand for payday loans.

(b) Speed of access

In line with other research,[15] the customers we interviewed had a clear preference for having access to the loan either instantly or within 24 hours.

> Instantly it's good … I think the world we live in and technology, I think people expect things now. If they say a week or two weeks you probably say, oh god why is it taking so long? (Male consumer)

> Payday took about 5, 10 minutes to go through. Money is in the account within 15 minutes. There wasn't a lot of messing around - it was sort of quick and done. (Male consumer)

Here too, arranged overdrafts offer similar features to a payday loan. Due to the fact that banks hold very detailed information about customers based on their current account transactions, arranged overdrafts are pre-approved at certain levels and can be set up almost instantaneously. As one bank explained:

> I think the other piece around sort of ease of access and the process, our processes are extremely quick. … you can get your mobile phone out, yes you have to read through all the T&Cs but the credit assessment is purely answering questions whether anything has changed or whether you expect anything to change because we've done all the hard work already by having the banking relationship. And at the end of the process you can hit go and the money goes straight into your account. And literally by the time you get back to your home page the money is there. (High Street Bank B)

(c) Clarity over fees

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[15] *Ibid.*

Some consumers were wary of the expense of incurring high unarranged overdraft fees. Some banks also believed that consumers had low awareness about arranged overdrafts as a product and how they could meet short-term credit needs. In the consumer interviews there was a strong preference for complete transparency around fees and a full explanation of repayment costs upfront. A breakdown of the full costs of repayment and the timeframe was also important. For example:

> I think that they need to focus more on how much the overall fee is going to be. (Female consumer)

> Rather someone tell you black and white, look you have £100 and you pay £300 back. (Female consumer)

> I'd like to know the APR and if I was to miss a payment what the costs would be, default charges, late payment fees. And also for taking out a flexible, a loan, I'd also like to know if there's any costs to repay it early. I'd want to know what I am paying back, total cost, what the penalties are if I do. (Male consumer)

Other research has also found that the clarity of payday loan fees is a major reason that they are preferred over other forms of finance.[16] One consumer interviewed for this study preferred using payday lenders to banks because of the way that payday lenders displayed costs:

> [I'd prefer a payday lender] because they're upfront. They tell you how much you're going to have to pay back, how much you're borrowing. (Female consumer)

There has been considerable discussion about the complexity and opacity of both authorised and unauthorised overdraft charges.[17] A combination of complicated fee structures and unclear or difficult to find information can make calculating and comparing overdraft fees next to impossible for consumers.[18] A number of banks have replicated the slider approach used by some payday lenders to help consumers calculate the cost of an arranged overdraft. Such developments will help better meet consumer needs.

Arranged overdrafts must also be affordable. The representative rates and fees found on bank websites reveal that the cost of arranging an overdraft of £100 to be used for 30 days ranges from more than £20 to less than £2. The more expensive arranged overdrafts in this scenario are not much cheaper than using a payday lender. Unarranged overdraft fees are expensive - consumers are typically charged fees in the range of £5 to £20 per day. These can be far more expensive than payday loans. Some of the consumers interviewed for this study were wary of using arranged overdrafts, having incurred high unarranged overdraft fees in the past. Treating customers fairly regarding unarranged overdrafts may be key to regaining trust and encouraging more use of arranged overdrafts as an alternative to payday loans in the future.

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[16] *Keeping the plates spinning Perceptions of payday loans in Great Britain,* Consumer Focus, 2010

[17] *Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts,* FCA, 2014

[18] http://www.which.co.uk/news/2012/01/which-calls-for-action-on-bank-overdraft-charges-276899/

3. Awareness gap

Third, there is a clear gap in consumer awareness of mainstream credit products at this end of the market. Banks reported that some payday loans users that they would be prepared to arrange / extend overdrafts with did not approach the bank before taking out a payday loan. In line with this, the consumers we interviewed had not approached their bank before applying for a payday loan. Some banks reported a degree of frustration at the differing advertising and marketing budgets between themselves and payday lenders.

> I wish that my marketing guys would spend more money advertising loans but they like to spend money on mortgages and things like that. It's actually amazing taking half term off and seeing some daytime TV. You know what you get all the time, [payday loan advertising] is fairly continuous. So there's clearly still a very big promotional piece there. (High Street Bank B)

While no banks appeared to be gearing up to better advertise arranged overdrafts, many banks were investigating individualised ways of informing customers about them. These included writing to customers who had used unarranged overdrafts but were eligible for arranged overdrafts and informing them of this. Others were considering displaying the amounts that an individual would be eligible to borrow as part of statements and online platforms. Banks reported that a challenge with initiatives such as these was the degree to which such communication could be considered marketing, as many customers opt out of marketing communications. It was also a balance between informing customers who would be eligible but don't apply and encouraging them to borrow irresponsibly.

> We strike a fine balance there between running into marketing rules and also being accused of lending irresponsibly. You know, because we are almost forcing credit down people's throats. So one of the regular conversations that we have with senior data privacy people and legal people is just exactly what is our position around this and are we comfortable, are we doing the right thing? (High Street Bank B)

This is clearly a difficult balance to achieve, though the key principles should be that customers are well informed of their choices and that those in financial difficulty are offered appropriate support rather than further credit.

What does 'no' look like?

It is well established that debt advice is effective in helping people in financial difficulty to recover. However, engagement with debt and money advice is poor. Fewer than a quarter of over-indebted individuals access advice. We asked banks what support they offered to customers who it would not be responsible to lend to. Most banks we spoke to refer clients to debt advice. This occurs at different times in the debt collection process, when a customer has unmanageable debt with the bank. This does not include all customers that a bank would not lend to and no banks that we interviewed were referring clients for free debt advice at the point of decline for credit.

Some banks were changing what they were doing at the moment of decline for credit, including specifying reasons for rejection, suggesting how the customer could improve their credit score or offering a different product that the customer was eligible for. However, several banks were merely sending a letter informing the customer that they were not eligible for the credit they had applied for. We think more can be done. Many of the customers we spoke to held a strong preference for online and app based banking and banks were responding to this preference. At Citizens Advice we are also responding to client preference for online advice. Our website contains information to help people help themselves - our debt advice pages had 4.7 million views in 2014. We also offer debt advice by webchat. In the case of clients whose debt management firms have been de-authorised, we are taking these referrals directly when people are given the information about their debt management plan ending. Banks and debt advice charities should work together to build digital referrals for debt advice.

4. Conclusion

The contraction of lending by mainstream banks was one reason for the expansion of payday lending. Following regulatory action to curb the payday market, this report finds that banks could play a small but significant role in providing credit to consumers who have used payday loans. FIlling this gap will require products that both meet the expectations of credit constrained borrowers *and* that seem viable for banks.

Our in depth interviews with banks and payday borrowers show us what this overlap looks like. Payday loans users like the online application and instant access to funds that these products offer. These characteristics also apply to most arranged overdrafts. While some payday loans users use payday lenders as a preference, many would prefer to borrow from their bank. Meanwhile, banks are willing to countenance a more flexible approach to overdrafts. Arranged overdrafts therefore offer an opportunity for some consumers who have used payday loans to access credit in their preferred way from their preferred lender. Banks should ensure that overdraft fees are fair and easy to calculate and let relevant customers know that this avenue of borrowing is open to them.

Moreover, banks must improve their services to customers in financial difficulty, not necessarily through further lending but through timely referral to debt advice. The moment of rejection for credit offers an important opportunity for banks to engage with customers in financial difficulty. While some banks are beginning to make use of this communication to educate consumers, these initiatives should be built on and digital referral to free debt advice developed.

Appendix I

In the consumer interviews respondents were asked:

Please tell us which of these words you most associate with:
a: banks
b: payday lenders

Choice of words:

- Welcoming
- Unwelcoming
- Approachable
- Unapproachable
- Friendly
- Unfriendly
- For people like me
- Not for people like me
- Formal
- Informal
- Respectable
- Dodgy
- Risky
- Safe