

Chapter 1

Introduction and main conclusions

1.1 A new market for consumer loans

The instant cash loan market is growing, but the statistical coverage of the market is limited. This means that the debate is often based on opinions and individual accounts from companies, debt counsellors, interest groups or consumers themselves. On that basis, the Competition and Consumer Agency, as the secretariat of the Competition Council, has prepared this analysis. The conclusions and recommendations of the analysis are those of the Competition and Consumer Authority - as the secretariat of the Competition Council. The analysis has been conducted as an industry survey under the Danish Competition Act, cf. section 15 d.

Among other things, the analysis shows that the market for instant cash loans is concentrated with a few providers. The vast majority of small consumer loans are used for general spending on e.g. electronics, clothing, furniture or pleasure. Over half of consumers who have tried to take out small consumer loans did not consider any alternatives, and more than 40 percent subsequently regretted taking out the loan.

The Competition and Consumer Authority estimates that in 2014 consumers paid approximately DKK 140 million to borrow a total of approximately DKK 436 million as instant cash loans for an average of 30 days.

This new market for consumer loans, in the form of instant cash loans, emerged with the spread of the mobile network after the turn of the millennium. Providers emerged offering small loans with relatively short loan periods, but the great innovation has been the opportunity for consumer to take out these loans by filling out a simple form on the internet or on their mobile phone. Now, borrowed money is just 'a click on the mobile' away. In the report, the loan period instant cash loan market refers to this segment of consumer loans. The report's formal definition of an instant cash loan is a consumer loan with no security which is not conditional on the purchase of a product and where the loan period is no longer than three months.

For the purpose of the analysis, the Authority carried out a major collection of data from companies as well as a comprehensive survey of consumers. These data are the platform for this first mapping of the instant cash loan market in Denmark. The analysis was published on 20 May 2015. On the basis of new reports made to the Danish Consumer Ombudsman's reporting scheme, the individual figures for 2014 were updated on 1 July 2015. This has not affected the conclusions and recommendations of the analysis.

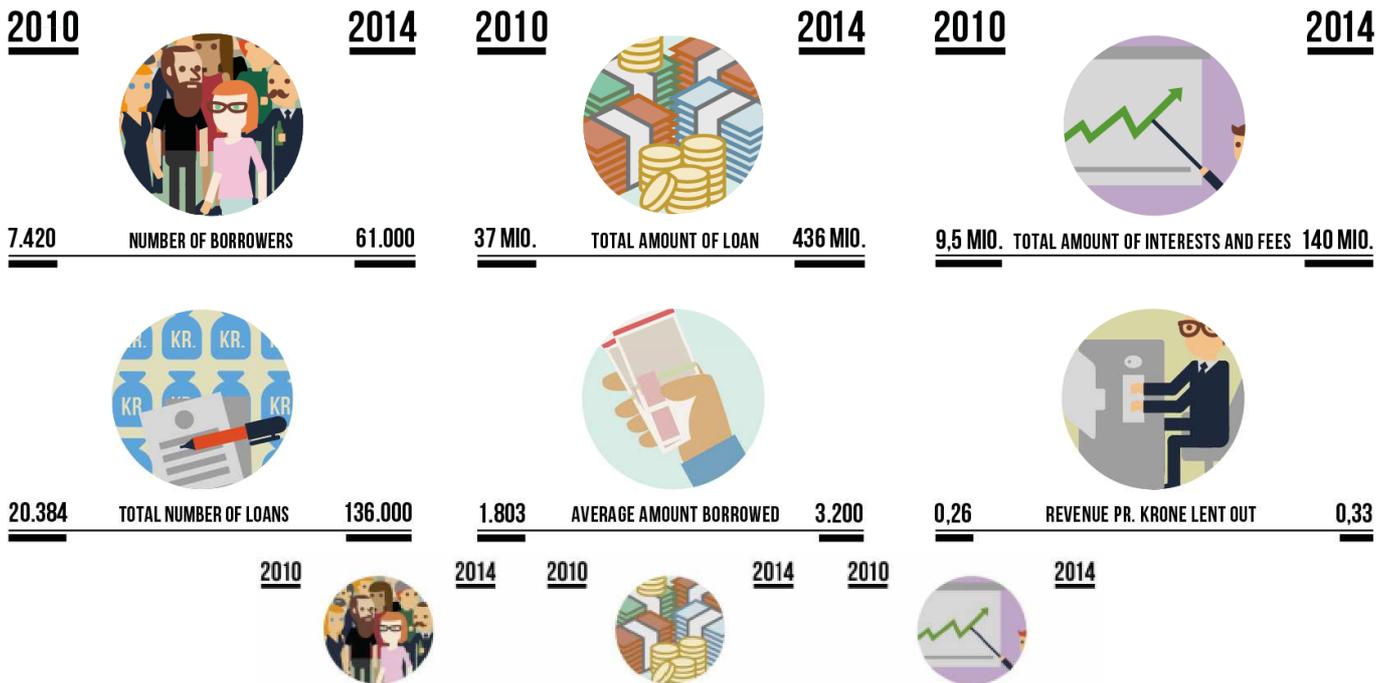
A growing market

In early 2015, there were six providers in the market, exclusively selling instant cash loans. The demand for instant cash loans has increased significantly. In 2010, 7,420 consumers took out 20,384 instant cash loans totalling DKK 37 million. In 2013, 53,741 consumers took out 118,469 instant cash loans totalling DKK 302 million.

The Competition and Consumer Authority estimates that in 2014 approx. 61,000 consumers will have taken out around 136,000 instant cash loans, and that the total borrowing will be approximately DKK 436 million.

The vast majority of instant cash loans have a loan period of one month, and no instant cash loans in today's market have a loan period of over 45 days. In 2010, the total cost of credit, i.e. interest and fees, was DKK 9 million. In 2013, it was just over DKK 90 million. The Competition and Consumer Authority estimates that in 2014 the total cost of credit will be approximately DKK 140 million. This is the total price that consumers are going to pay to spend approx. DKK 430 million an average of 30 days before the money is earned.

Figur 1.1 The instant cash loan market and its development since 2010



Note.: Figures for 2014 are estimated figures for the whole year based on data collected from providers and information from the Consumer Ombudsman's reporting scheme. See the methodological annex for details. Note that the figures for the number of borrowers, total loan amount, number of loans and average loan amount were updated on 1 July 2015.

Source: Data collected from providers by the Competition and Consumer Authority

The instant cash loan market is a concentrated market. This is due to the small number of providers, but also to significant differences in the providers market shares, with the two biggest providers, measured by borrowing, making up around 80 percent of the market. In 2013, the average profit margin was 22-39 percent, albeit the profit margin shows signs of fluctuation from year to year. This is consistent with this young market being still in a maturing phase.

In preparing this analysis of the market for instant cash loans, the Competition and Consumer Authority found indications of issues in relation to competition law. Credit costs in the instant cash loan market.

A comparison of prices on providers' websites shows relatively large differences in credit costs for otherwise comparable loans. For example, it costs DKK 190 to borrow DKK 1,000 for a month from the cheapest provider, while it costs DKK 375 from the most expensive provider. This is a difference of DKK 185.

The public debate often highlights the annual percentage rate (APR), which can be several thousand percent. Among other things, a loan's APR depends on the loan period. If two loans are compared, where the loan amount and total costs are equal, the loan with the shortest loan period will have the higher APR. It is therefore important that consumers are aware that the APR should only be used as a basis for comparison when the loans are of the same size and have the same loan period. For an instant cash loan, the APR will be considerably higher than the APR of long-term consumer loans, but the total credit cost may still be greater for the long-term loan.

There is ongoing debate about introducing a cap on the borrowing costs for instant cash loans to protect consumers. Such price regulation is a major intervention in a market - both in relation to competition and in relation to the principle of contractual freedom - but it can be a necessary tool if it is introduced in markets where there is no basis for effective competition, e.g. due to high entry barriers. Generally speaking, the instant cash loan market is a normal consumer market where the entry barriers for new players are relatively low. Mainly, these relate to certain capital requirements, particularly in the first year during which new providers have difficulty recouping their initial costs.

Responsible lending

There is a basic principle of freedom of contract in Denmark. This means that, unless the law makes exceptions, individuals are free to enter into agreements as they wish. On the one hand, consumers in the instant cash loan market are responsible for exploring markets, comparing alternatives and making a considered choice in connection with taking out instant cash loans. On the other hand, providers are responsible for exercising responsible lending to their customers. This responsibility lies with providers because the Danish Credit Agreements Act requires them, before a credit agreement is entered into, to assess whether a potential borrower, based on their financial situation, will be able to make the expected repayments.

The loan period for instant cash loans is short, and many consumers miss the repayment deadline. In 2013, the repayment deadline was missed by 30 days or more for more than 25 percent of the contracted loans. Many borrowers therefore have to extend their loans when the repayment deadline is reached or accept instalment plans to get out of the debt. In the end, 18 percent of contracted loans in 2013 were referred for debt collection.

A large proportion of instant cash loans are extended when the repayment period expires. The analysis estimates that in 2013 the providers had combined turnover of DKK 30 million on extensions and instalment plans, representing more than 30 percent of their turnover. There are a number of administrative costs associated with generating this extra turnover, but at the time where a loan agreement is extended, there are, for example, no marketing or set-up costs.

All providers carry out some sort of credit assessment of their customers, albeit the credit assessment is not rigorous compared to the practice of banks. All providers check whether the applicant for the loan is registered in one of the two debtor registers, RKI or the Debtor Register, and all providers have a minimum age limit to avoid lending to consumers under e.g. 21 or 23 years of age. Similarly, the borrower's credit history with the provider in question is checked. In addition, procedures vary from provider to provider.

Additional credit assessment may involve investigating other matters via other registers, e.g. residence via e.g. the OIS or BBR register, or asking about income and monthly expenses. It is uncertain when the individual parameters in the credit assessment lead to a rejection of the loan.

The high proportion of extensions, defaults and collection cases indicates that many borrowers are granted a loan they cannot repay within the loan period. To monitor the trend going forward, in 2009 the Consumer Ombudsman established a reporting scheme for companies primarily marketing instant cash loans. The scheme works by providers voluntarily undertaking to provide quarterly reports on a number of factors. Among other things, the reports include loans entered into broken down by age and number of defaults.

The Danish Appeals Board for Lending Institutions, established on January 1, 2015, will serve as an appeals board for consumers who have wrongfully got into difficulty in the instant cash loan market or other areas of the consumer lending market that issue consumer loans not conditional on the purchase of a product. The appeals board can thus provide a certain amount of consumer protection. In order to ensure that consumer awareness of the board is increased so that relevant cases are brought before it, the Competition and Consumer Authority has taken steps for the board to be marketed on the public consumer portal forbrug.dk. On forbrug.dk, the Competition and Consumer Authority has also published a topic with advice on what consumers should consider before taking out instant cash loans.

Since the establishment of the Danish Appeal Board for Lending Institutions, the providers of instant cash loans, pursuant to the Danish Credit Agreement Act, have been obliged to inform consumers about this complaint option, and they are also obliged to inform consumers how to make use of this option. The Competition and Consumer Authority recommends regular follow-up on whether providers are meeting these obligations.

1.2 Consumers in the market

There are only very limited statistics on consumers taking out instant cash loans. On that basis, the Competition and Consumer Authority has therefore conducted a comprehensive survey of 20-59-year-old consumers. In the survey, it has not been possible to use the loan period as a demarcation. Instead, the survey has been limited to consumers who have tried to take out small consumer loans of maximum DKK 12,000 unconditional on making a purchase where the loan taken out using an online form. The term small consumer loans is therefore used in connection with the description of the consumers.

Small consumer loans are used by all age groups, but they are most popular among 20-29-year-olds and least popular among 50-59-year-olds. Small consumer loans are taken out by students, employed people and the unemployed, but consumers outside the labour market are most likely to have taken out a small consumer loan. Moreover, the tendency to take out small consumer loans is greater among consumers with worse private finances, where e.g. they have had trouble paying bills on time.

For almost 40 percent of consumers of small consumer loans, their loans turned out to be more expensive than they expected when they took out the loan. The reason for this may be that a large proportion of the loans are extended, defaulted on or referred for debt collection, all of which increases the cost of credit.

It could also be due to the fact that many consumers find it difficult to comprehend the information about the cost of the loan, which providers are required by law to present them with. This concerns, for example, the loan's borrowing rate, the total cost of credit and the loan's APR.

The survey shows that consumers find it difficult to understand the concept of APR and use it in practice. Moreover, cases from the Consumer Ombudsman show that several providers are not providing the information which they are obliged to by law when issuing instant cash loans.

1.3 There are indications that instant cash loans are largely used for impulse buying

The survey shows that the vast majority of small consumer loans are used to purchase general consumer goods, such as electronics, clothing, furniture or entertainment. Only a small proportion of consumers spend money on services such as food or bills.

The study also shows that more than 50 percent of consumers did not consider alternatives to the consumer loan they ended up taking out and that more than 40 percent of borrowers subsequently regretted taking out a small consumer loan. This indicates that instant cash loans are largely used for impulse purchases where the purchase is based on limited consideration of cost and consequence. In addition, reports from the companies show that most instant cash loans are taken out early in the month and that borrowing falls rather steadily as the month wears on. The majority of instant cash loans have 30-day loan periods and no instant cash loans in today's market have a loan period of more than 45 days. When an instant cash loan is taken out, it is thus with the expectation of repayment when the borrower is next paid.

Wages are typically paid at the end of the month, which is why the beginning of the month is the time when the consumer has more money available because incidental expenditure and minor spending which occurs over the course of the month have not taken place yet. So, if there is insufficient money for a given product at the beginning of the month, this is when a consumer may be most optimistic about their ability to repay an instant cash loan on time, albeit this optimism may be unrealistic. When disposable income is highest, at the beginning of the month, it may seem more likely that it is possible to save during the rest of the month and thus repay the loan within the next income cycle. Later in the month, when less money is available, the assessment may be more pessimistic, so consumers may be less likely to take out instant cash loans at the end of the month.

The Competition and Consumer Authority recommends the introduction of a mandatory reflection period of 48 hours during which the borrower cannot accept an offer of an instant cash loan in order to ensure that instant cash loans are based less on impulsivity. Such a system could mean that the consumer first has to go through the normal application process in which a credit assessment is conducted. Should the provider then want to offer the loan to the consumer, a loan offer is submitted and the reflection period begins. When the reflection period is over, the consumer must contact the provider themselves and accept the provider's offer before the loan agreement can be entered into and the loan paid out. Should the consumers not contact the provider themselves and accept the loan offer after the reflection period, a loan agreement is thus not entered into. The reflection period should act as a cooling-off mechanism ensuring that consumers are better able to consider the need for borrowing and possibly explore the market for alternative sources of financing. At the same time, the mechanism ensures that consumers who want to make use of instant cash loans still have an opportunity to borrow the money.

A reflection period differs from the mandatory right of cancellation, as the exercise of the right of cancellation requires the consumer to actively contact the provider to cancel the loan and then repay the borrowed amount plus any interest which may have accrued in the meantime.

In particular since the banks' recent introduction of instant clearing, where funds are transferred between different banks at all times of the day, it is essential to ensure that instant cash loans are not taken out based on impulsivity alone.

If, subsequently, there are indications that the recommended initiatives do not have the effect of reducing the proportion or number of extensions, instalment plans, defaults and debt collection processes, further initiatives can be considered in order to improve the functioning of the market.

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Main conclusions

- » The instant cash loan market is a growing market. In 2010, 20,384 instant cash loans were taken out totalling DKK 37 million. The Competition and Consumer Authority estimates that in 2014 a total of 136,000 instant cash loans were taken out totalling approximately DKK 430 million.
- » The Competition and Consumer Authority estimates that in 2014 consumers paid approximately DKK 140 million in total to borrow this DK 436 million.
- » The instant cash loan market is a concentrated market. Today, there are six providers in the market, with the two largest providers accounting for approximately 80 percent of total lending.
- » In 2013, the repayment deadline was missed by at least 30 days for 25 percent of the contracted loans. Ultimately, approximately 18 percent of the contracted loans were referred for debt collection.
- » The analysis estimates that in 2013 the providers had combined turnover of approximately DKK 30 million from extensions and instalment plans. It is therefore estimated that around 30 percent of providers' turnover comes from borrowers having difficulty repaying their loans on time.
- » Small consumer loans of maximum DKK 12,000 are used by all age groups, but they are most popular with young consumers.
- » Small consumer loans of maximum DKK 12,000 are taken out by students, employed people and the unemployed, but consumers outside the labour market are more likely to take out small consumer loans.
- » The vast majority of instant cash loans are used to purchase general consumer goods, such as electronics, clothing, furniture or entertainment. A small proportion are spent on e.g. food or bills.
- » More than 50 percent of consumers who have tried to take out small consumer loans of maximum DKK 12,000 did not consider alternatives, e.g. overdraft facilities or approved overdrafts.
- » More than 40 percent of consumers who have tried to take out small consumer loans of maximum DKK 12,000 subsequently regretted taking out the loan.
- » The Competition and Consumer Authority has not found any indications of competition law issues in the market. However, generally speaking the Danish Competition and Consumer Authority believes that the market for instant cash loans is not as well-functioning as it could be.

The results of the analysis have given rise to a series of recommendations, set out in Box 1.2. The analysis focuses on the market for instant cash loans and the recommendations are directed at the problems addressed in the analysis. Financial products in particular, such as bridge financing in real estate deals or construction loans, are not included in the analysis.

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**Recommendations and
policy considerations**

The Competitions and Consumer Authority estimates that the Market for instant cash loans could be made to function better by:

- » Making the existing voluntary reporting scheme with the Consumer Ombudsman compulsory, which would require a legislative amendment.
- » Clarifying whether preamble 26 of the EU Consumer Credit Directive means that the Danish authorities can draft guidelines or an executive order explaining what constitutes an adequate credit assessment, including what may be regarded as satisfactory information in connection with the entering into of credit agreements.
- » Introducing a reflection period of 48 hours during which the borrower cannot accept an offer of an instant cash loan. If the consumer does not actively contact the provider to accept the loan offer after expiry of the reflection period, no loan agreement is entered into.
- » Since the establishment of the Danish Appeals Board for Lending Institutions on January 1, 2015, providers are required to inform consumers about the option to appeal contained in the loan agreement. To ensure that borrowers know their rights and options, it is recommended following up on whether providers are meeting this obligation.