Research impact summary

Financial protection: reforming the “villains of recession Britain”

The practices of many payday loan companies came under scrutiny in the wake of the global financial crisis. Research by the Nottingham School of Economics proved pivotal in shaping major reforms that forced the industry to change its ways or face annihilation.

The nightmare of small loans escalating into huge debts became increasingly commonplace during the recession that followed the global economic crisis. In many instances it was payday lenders that left borrowers under intense pressure from ever-increasing charges and default fees.

“These companies grew accustomed to a very lightly regulated market in which they had substantial freedoms,” says Dr John Gathergood, an Associate Professor of Economics affiliated with both the Centre for Finance, Credit and Macroeconomics and the Granger Centre for Time Series Econometrics. “They took advantage of a weak regulatory regime by consistently exploiting their customers’ lack of financial sophistication. They were the villains of recession Britain, and their behaviour was allowed to go on for too long.”

As a leading researcher in the field of household behaviour in financial markets, Dr Gathergood was asked to produce a major study for the Financial Conduct Authority to help design stricter regulations and end the misery of massive debt spirals. The resulting research, which evaluated the impact of payday loans on consumers, was crucial to the introduction of an interest-rate ceiling – a “price cap” – restricting interest and charges to a maximum of 0.8% of the loan principal per day.

This and other measures were introduced in January 2015. They represented a “reform or die” proposition for the industry. Six months later fewer than 250 of the 400 lenders with a payday licence reapplied to the FCA, whose officials suggested only a handful would ultimately be granted authorisation. The number of payday-loan-related problems reported to Citizens Advice halved within three months.

“The new regulations gave these companies a simple choice,” says Dr Gathergood. “Those willing to provide products and services for the good of their customers would be allowed to do so. Those incapable of meeting that basic demand would go out of business. The hope now is that payday loans become the first rung on the ladder to better forms of credit rather than the last step on the descent into financial distress.”

Click here to read a Q&A in which Dr Gathergood discusses his research in more detail.