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MEMORANDUM

TO: Department of Finance, Government of Canada

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DATE: November 30, 2023

SUBJECT: Department of Finance Consultation on Cracking Down on Predatory Lending Faster by Further Lowering the Criminal Rate of Interest and Increasing Access to Low-Cost Credit

ISSUE

The Department of Finance is consulting on predatory lending, including considerations on lowering the criminal rate of interest, increasing access to low-cost, small-value credit, and on additional revisions to the payday lending exemption. Below are responses to the key questions in this consultation.

RESPONSES TO KEY QUESTIONS

1. What are the features of credit products that can help Canadians improve their financial positions?

Credit products should be safe, affordable, and accessible. They should state clearly and simply the terms of the loan and the cost of borrowing, which should reflect fairly the risk incurred by the lender. We believe governments of various levels have been vigilant about maintaining and improving consumer protection legislation for high-cost credit products in recent years. These measures—which include things like disclosure requirements, cooling-off periods, caps on NSF charges, etc.—have made the alternative lending market safer and cheaper for Canadians. However, we would like to stress that high-cost credit products from alternative lenders are not an optimal way for Canadians to improve their financial positions. They may be (and often are) the least bad of a series of worse options,[1] but Canadians in dire straits don't need a better-regulated high-cost loan—they need a better option than a high-cost loan. As we have written in previous submissions to government on high-cost credit regulation,

> Creating an alternative regulatory regime for AFS [alternative financial services] further distinguishes AFS businesses from mainstream financial institutions, contributing to the creation of two separate banking systems: a low-risk, low-cost system for the wealthy, and a high-risk, high-cost system for the poor and marginalized. **Trying to improve the second-tier system with borrower-protection regulations will not address the fundamental inequality of a two-tiered arrangement. Government should instead work to integrate vulnerable borrowers into the first-tier financial system by supporting mainstream financial institutions seeking to meet the needs of lower-income borrowers.**[2]

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[1] Dijkema, Brian and Rhys McKendry, "Banking on the Margins," Cardus, 2016, https://www.cardus.ca/research/work-economics/research-report/banking-on-the-margins/.

[2] Dijkema, Brian and Johanna Lewis, "Protections for Users of High-Cost Credit," Cardus, 2021, https://www.cardus.ca/research/work-economics/research-report/protections-for-users-of-high-cost-credit/.

2. **What protections from unreasonable fees for credit products, including payday lenders, could help Canadian consumers?**

A maximum interest rate established and enforced by government legislation will help protect Canadian customers from predatory lenders. All mandatory costs and add-on charges should be included in the maximum legal interest rate. Mandatory insurance and loan fees, for example, can significantly inflate the cost of lending and benefit the lender at the expense of the borrower.[3]

However, governments should approach changes to the maximum interest rate with caution. The maximum legal interest rate should be set based on evidence on consumer behaviour. Simply lowering interest rates is an easy and popular policy move. However, the primary force driving high-interest loan usage is demand: vulnerable consumers take out these loans because they are in desperate need of credit and have no other options. Since 2016, provincial governments across the country have slashed interest rates, leading to savings that were undoubtedly appreciated by customers but did not turn payday loans into an affordable credit product. In Alberta, for instance, someone who took out a $500 payday loan in 2016 would have to pay back $615 ten days later. The same loan in 2023 would cost them $575. For someone facing a severe cash crunch, the extra $40 is certainly helpful. But they didn't take out a payday loan because they were short $40. They took out a payday loan because they were short $500.[4] Thus, these reforms have likely had little effect on demand.

On the supplier side, however, the interest rate caps turned payday loans into a less profitable product, which may have unintended consequences for consumers. Payday loans are still offered in most provinces, which shows there was room for governments to push regulated rate caps lower—as they did—without rendering the product unprofitable and forcing all payday lenders out of business. Still, as we predicted, it appears that the reduced rates were no longer enough for payday loan firms to provide these loans given their current business structure.[5] Some lenders did close: data on licensed payday lenders from Ontario, Alberta, and British Columbia show that the number of payday loan outlets in all three provinces is on the decline.[6] Ontario has lost nearly 30 percent of its shops over the last seven years; the lion's share of the losses have been borne by independent operators, leading to a significant concentration of the market for the three largest

[3] Carter, Carolyn, "Predatory Installment Lending in the States," National Consumer Law Center, 2022, https://www.nclc.org/resources/predatory-installment-lending-in-the-states-2022/.
[4] Dijkema, Brian, "Payday Loan Regulations: A Horse Race Between Red Tape and Innovation," Cardus, 2018. https://www.cardus.ca/research/work-economics/research-report/payday-loan-regulations/.
[5] Dijkema, "Payday Loan Regulations: A Horse Race between Red Tape and Innovation"; Dijkema, Brian, "The Changing Face of Payday Lending in Canada," Cardus, 2019, https://cardus.ca/research/work-economics/research-report/the-changing-face-of-payday-lending-in-canada/.
[6] Ontario, "Search for a business licence, registration or appointment," accessed June 2023, https://www.ontario.ca/page/search-business-licence-registration-or-appointment#section-0; Consumer Protection BC, "BC Aggregated Payday Loan Data 2022," https://www.consumerprotectionbc.ca/wordpress/wp-content/uploads/2023/06/2021-22-PDL-Agg-Data-Summary-Table.pdf; Consumer Protection BC, "BC Aggregated Payday Loan Data 2020," https://www.consumerprotectionbc.ca/wordpress/wp-content/uploads/2021/04/2020-Aggregate-Payday-Lender-Licensee-Loan-Data-Summary-Table.pdf.

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lenders.[7] Similarly, the number of licensed lenders in Alberta has shrunk by 29 percent since 2017.[8] While some may hail this trend as a positive development, the problem is that it has left consumers with fewer options. As market concentration increases, consumer choice decreases, leaving borrowers worse off.[9]

Other alternative lenders, however, responded by adapting their products to the new regulatory conditions. Emerging data support what industry observers (including us[10]) have been calling attention to for the last few years: alternative lenders are changing their focus from small-dollar, short-term payday loans to larger, longer-term loans.[11] Considered on an APR basis, these loans are cheaper than payday loans. But as we detail in our forthcoming paper, the extended terms of high-cost instalment loans and lines of credit mean customers usually pay far more in interest overall than they would on a payday loan. Alberta has published data on both types of loans, which can provide a rough sense of the respective costs. In 2021, the average customer had just over $3,000 in principal to repay over the course of 12 months for both high-cost loans (average principal value of $7,137 for a 27-month term) and payday loans (average principal value of $767, with the average borrower taking out 4 loans in a year). But while the payday-loan customer would pay $328 to borrow their $3,000, the high-cost credit customer would be on the hook for over $1,600 in interest payments for almost the same amount.[12] Over the long term, this new high-cost lending landscape appears to be one in which consumers will be worse off, paying far more for credit than they would have for payday loans.

In short, further reductions to the maximum interest rate may be helpful but governments must justify their need with robust data, lest reductions yield unintended consequences for consumers.

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[7] Dijkema, "The Changing Face of Payday Lending in Canada."

[8] Government of Alberta annual aggregated payday loan data reports (2017–2021), available at https://open.alberta.ca/dataset?pubtype=Report&tags=payday+loans&dataset_type=publications.

[9] Market concentration is one of the key indicators used to measure competition. See Canada, "Competition Bureau report finds Canada's competitive intensity in decline," October 19, 2023, https://www.canada.ca/en/competition-bureau/news/2023/10/competition-bureau-report-finds-canadas-competitive-intensity-in-decline.html.

[10] Dijkema, "The Changing Face of Payday Lending in Canada," 13–14.

[11] See, e.g., J. Stiglic, J. Cowley, and C. Agro, "'Canadians deserve better': Experts decry 'outrageous' interest rates by alternative lenders," *CBC News*, January 30, 2021, https://www.cbc.ca/news/canada/alternative-lenders-marketplace-1.5891676; E. Alini, "Forget payday loans, this is Canada's new generation of high-interest loans," *Global News*, October 23, 2021, https://globalnews.ca/news/8286483/canada-personal-loan-payday-bad-credit/; D. Buckner, "Payday lender lines of credit and instalment loans at 47% create debt traps, critics say," *CBC News*, March 5, 2021, https://www.cbc.ca/news/business/instalment-loans-payday-lenders-criticism-1.5936331; Hoyes Michalos, "Rapid Payday and Installment Loans & Insolvency," https://www.hoyes.com/press/joe-debtor/how-insolvent-borrowers-use-payday-loans/; Momentum, "Creating Change," https://files.momentum.org/wp-content/uploads/2022/02/Creating-Change-Momentums-Contribution-to-High-Cost-Credit-Reform-in-Alberta-web.pdf, 12.

[12] See Government of Alberta, "Payday Loans Aggregate Data," https://open.alberta.ca/publications/payday-loans-aggregate-data; Government of Alberta, "High-Cost Credit Aggregate Data," https://open.alberta.ca/publications/high-cost-credit-aggregate-data.

3. **What marketing techniques target vulnerable Canadians into taking on high-cost debt, and what measures would protect Canadians from deceptive advertising?**

Institutions who have frontline experience working with Canadians who have taken on high-cost debt will be better suited to answer this question. We will only note, as we have in the past,[13] that most consumers are aware of the high cost of such agreements and are taking them out because they have no other options. Most provinces already have strong regulations around disclosure and advertising. Some borrowers take on high-cost debt because they have been deceived by lender advertising, but most are choosing the best option they can given their constrained choices. Given the robust consumer protections around advertising that already exist at various levels of government, marketing reform should be a low priority in high-cost credit policy.

4. **How could all types of credit lenders better provide Canadians with information on the costs of credit products, including associated fees and interest?**

See comments on #3 above.

5. **What barriers do Canadian consumers face in accessing low-cost, small-value credit?**

This is a question that needs further research to answer adequately. See comments on #8 below.

6. **What barriers do financial institutions, banks, and credit unions in particular, face in increasing their offerings for low-cost, small-value credit to a broader consumer base?**

Research has shown that removing regulatory barriers at the credit union level has had limited impact on the availability and usage of payday loan alternatives (see #8 below).[14] Low-cost, small-value credit products are by definition not very profitable to financial institutions, especially credit unions which lack the scale of the big banks. While financial institutions would be best situated to answer the specifics of this question, governments, in collaboration with the banking sector, should consider removing barriers that discourage big banks from offering these kinds of products and creating incentives that would make it viable for them to offer small-dollar credit products.

7. **What could various levels of government, including provincial governments, do to improve, promote, and support access to low-cost, small-value credit?**

Governments have the power and responsibility to regulate the small-dollar credit market. However, this is a tool that we urge policymakers to use carefully and on the basis of solid evidence so as to prevent unintended consequences (on which see #10 below). And this is not the only tool available to various levels of government. Governments have the capital to support the development of new credit products until they become financially viable; this could include typical loans offered by banks and credit unions as well as

[13] Dijkema and McKendry, "Banking on the Margins"; Dijkema and Lewis, "Protections for Users of High-Cost Credit"; Dijkema, Brian, "Testimony to Standing Committee on Social Policy on Putting Consumers First Act (Bill 59)," Cardus, February 2017, https://www.cardus.ca/research/work-economics/reports/testimony-to-standing-committee-on-social-policy-on-putting-consumers-first-act-bill-59.

[14] Dijkema, "The Changing Face of Payday Lending in Canada."

creative alternatives such as rent banks.[15] High-cost credit users are diverse and may need a variety of products to meet their financial needs.

In keeping with the importance of evidence-based policy, governments should collect and publish aggregate data on consumers' use of payday loans and other high-cost credit products. British Columbia, Alberta, and Nova Scotia already collect and publish such data; Ontario and New Brunswick collect some data but have not made it available to the public. Information such as the number and value of loans, the total cost of credit charged, the number of licensed lenders and locations, the number of borrowers, multiple and repeat loan usage, the number of loans defaulted and written off, and the type of loans used would allow governments to monitor the alternative lending industry and evaluate the impact of policy changes.

However, it is crucial that the government collect data on *consumers*, not just on lenders. British Columbia and Alberta, for example, publish the number of individual borrowers in their payday lending data, but this total is based on the number of customers reported by each lender. Since some borrowers use multiple lenders, the true number of borrowers is almost certainly lower: if one person borrows from three different lenders, he or she will be counted three times. This is a significant blind spot in the data, not least because borrowers who take out payday loans from multiple lenders are among the most at risk of negative financial outcomes.[16] Lender-based data is important, but it is no substitute for solid information on the vulnerable consumers that government legislation is designed to protect.

8. What could financial institutions, banks, and credit unions in particular, do to improve, promote, and support access to low-cost, small-value credit?

Offering affordable small-dollar credit products is a good first step. However, simply making these products available has so far proven to have limited effectiveness. Alberta's experience is instructive. As part of the province's 2017 payday lending reforms, the promotion of alternative short-term lending options was made a legislated mandate.[17] Yet these alternatives make up less than one percent of loan volume in the payday lending market.[18] Other provinces haven't fared much better. Some credit-union alternatives are still running, such as Windsor Family Credit Union's SmarterCash loan and Servus Credit Union's Fast Forward Small Loan.[19] Yet takeup remains stubbornly low, forcing other potential disruptors to discontinue their new products after only a few years on the market.[20]

Banks and credit unions will not be able to compete with alternative lenders without a better understanding of why vulnerable consumers use high-cost loans. The underwhelming reception of cheaper options offered by financial institutions makes clear that cost is not the only factor that matters to these consumers. High-cost

[15] BC, for example, has multiple rent banks located throughout the province. See https://bcrentbank.ca/.
[16] See, e.g., Hoyes Michalos, "Rapid Payday and Installment Loans & Insolvency."
[17] Government of Alberta, "An Act to End Predatory Lending," https://kings-printer.alberta.ca/1266.cfm?page=e09p5.cfm&leg_type=Acts&isbncln=9780779800650.
[18] Dijkema, "The Changing Face of Payday Lending in Canada," 14–15; cf. Government of Alberta, "2017 Aggregated Payday Loan Data Report," https://open.alberta.ca/publications/aggregated-payday-loan-data-report, 5.
[19] Windsor Family Credit Union, "SmarterCash – A Pay Day Alternative," https://www.wfcu.ca/Personal/ProductsAndServices/Borrowing/Loans/SmarterCash/; Servus Credit Union, "Fast Forward Small Loan," https://www.servus.ca/life/personal-loans/fast-forward-small-loan.
[20] See Momentum, "Creating Change," 10; Dijkema, "The Changing Face of Payday Lending in Canada," 15.

loan use is driven by more than lack of access to affordable credit, although this is a definite factor. Other factors driving consumers to alternative lenders may include convenience, accessibility, quick and easy application processes, financial exclusion, and negative experiences with mainstream financial services.[21] Better research on high-cost loan users would help clarify these barriers and allow financial institutions to offer low-cost credit products that are genuinely attractive to borrowers. It may be that partnership with civil-society organizations is the best way to overcome attitudinal and accessibility barriers. For example: frontline organizations may be able to leverage their relational history with vulnerable groups to promote uptake of alternative products.

9. Are there practices to improve the availability of low-cost, small-value credit within Canada or abroad that could be learned from?

Credit unions, financial empowerment organizations, rent banks, and stakeholders working directly with marginalized borrowers will be better suited to answer this question. We encourage governments to think outside the box when trying to improve access to affordable credit among vulnerable Canadians. Since borrowers use high-cost credit products to meet a variety of needs, a suite of alternatives may be better than a one-size-fits-all solution.

10. How much further beyond 35 percent annual percentage rate should the criminal rate of interest be lowered?

Any further reductions to the criminal rate of interest should be implemented on the basis of evidence regarding how this change will affect consumers, and should include provisions for measuring its impact on the same. Until the government has the evidence necessary to make an informed policy change, it should maintain the status quo to avoid unnecessary shocks to the lending market, which could have significant negative effects for vulnerable Canadians (especially the poor, who do not have the financial buffer to weather a short-term shock). See comments on #2 above.

11. How can the government improve enforcement of the criminal rate of interest to protect Canadian consumers?

As noted in our comments on #2 above, the criminal rate of interest should include all interest, fees, and add-on charges; it should be enforced accordingly.

12. Should further revisions to the Criminal Code's provincial or territorial-requested payday lending exemption be considered?

See comments on #10 above.

[21] See, e.g., Momentum, "High-Cost Alternative Financial Services: The Customer Experience," https://cdn.sanity.io/files/apj5wzzm/production/6120f679db524f83c72b22535eb66f51a309c5ea.pdf; Financial Consumer Agency of Canada, "Payday Loans: Market Trends," October 25, 2016, https://www.canada.ca/en/financial-consumer-agency/programs/research/payday-loans-market-trends.html.