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October 7, 2022

Director General
Financial Services Division
Financial Sector Policy Branch
Department of Finance Canada
James Michael Flaherty Building
90 Elgin St
Ottawa ON K1A 0G5

RE: Consultation on Fighting Predatory Lending

Dear Director General:

Please accept the following submission on behalf of Vancity Community Foundation to inform your consultation on fighting predatory lending by lowering the criminal rate of interest in the Criminal Code of Canada applicable to, among other things, installment loans offered by payday lenders.

Vancity Community Foundation is a public charity established by Canada's largest credit union, Vancity Credit Union. We help communities thrive and prosper by using and leveraging financial tools and providing direct support to community organizations in innovative ways to address systemic poverty and to support financial resilience and affordability, while working to embed principles of anti-racism and Reconciliation. As a charitable institution connected to a financial institution, we have unique, direct experience with this topic developed through building up a provincial network of local in-community rent banks (BC Rent Bank), administering the Reaching Home strategy in our region (with Luma Native Housing Society), microcredit and direct lending for self-employment, and matched savings and financial literacy programing.

We strongly support fighting predatory lending by lowering the criminal rate of interest in the Criminal Code of Canada applicable to, among other things, installment loans offered by payday lenders. We recognize that reducing the criminal rate of interest is but one measure among many needed across the country and by all levels of government to address affordability and indebtedness. Canada's usury (criminal) interest rate ceiling is one of the highest internationally. There is considerable room for it to be lowered to the Bank of Canada's overnight rate (currently 3.25%) plus a risk premium of 20% with a cap at 30% (including all fees, insurance, etc.). Specific responses to consultation questions are provided below.

Should the criminal rate of interest be set at a fixed level or linked to prevailing market conditions? Please provide your rationale.

Linking the rate to prevailing market conditions would not allow the rate to become disconnected from market rates, which has been the case since 1981 for the current rate. An alternative that could connect the criminal interest rate to market conditions but have the benefits of a fixed rate would be to establish a schedule to review the rate periodically. The benefits of a fixed rate would be improved ease of calculation, transparency and enforceability. The interest rate cap should be calculated to include all fees and charges that are faced by the financial consumer. A precise formula should also be specified for calculating the criminal interest rate.

To what extent is the interest rate charged by alternative lenders on high-cost installment loans a reflection of the creditworthiness of the borrower?

Studies that evaluate the cost structure of payday lenders suggest that while a primary characteristic of the market is the inherent risk of non-repayment, the risk of unrecoverable debt does not necessarily justify the high interest rates that are currently charged by the industry. A Deloitte survey of payday lenders surveyed in British Columbia, found that 10.6% of all loans went into default, with 80.2% collected after the due date. The remaining defaults were written off (2.6% of all loans) after being deemed unrecovered.[1] Dr. Robinson, in comparing Dollar Financial (the parent company of Money Mart, a multi-national operating in Canada), to other jurisdictions elsewhere found evidence of excess profits in Canada. Based on this analysis he determined that lenders can profitably operate at fee rate limits as low as 15%.[2] While this research looked at payday lending rather than high-cost installment loans (which is not covered in studies in Canada yet), the experience of high-cost installment loans and vehicle title loans in the United States suggests that these forms of credit are associated with better repayment because of direct access to the borrower's chequing accounts or collateral (in the case of auto title loans or pawn shops).

Data increasingly show a picture of high-interest installment loans being used to cover basic expenses due to a crisis in affordability in Canada (see question below). From a moral and ethical standpoint, <u>no</u> Canadian should be borrowing money continually, at any rate, to pay for basic expenses such as rent, food, utilities or child care. This issue should not reflect the creditworthiness of the borrower, but that borrower's human right.

What are the reasons financial consumers access high-cost installment loans?

Financial consumers who access payday loans also access high-cost installment loans for the same reasons. Recent survey research by Acorn Canada found that the majority of respondents who took out any type of high-interest loan (pay day or high cost installment loan) used them to meet every day expenses (such as rent, groceries, hydro), while a minority took loans out for unexpected expenses (critical illness, a medical expense, a car repair expense). Financial consumers turn to this credit because they do not have other options available to them such as credit cards, friends or family, or standard loans. [3] Compared with the conventional lump-sum model, installment loans give customers more

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[1] Deloitte & Touche LPP (2008). Cost of Providing Payday Loans in British Columbia, p. 11. Cited in Sean Magee-Teitelbaum "Short term Loans with Long term Consequences: An analysis of payday loan policy for British Columbia" Project Submitted in Partial Fulfillment of the Requirements for the Degree of Master of Public Policy, Simon Fraser University, Spring 2017.

[2] Robinson, Chris (2016). An Economic Analysis of the Payday Loan Industry and Recommendations for Regulation in Manitoba. *A Report to the Manitoba Public Utilities Board.* Retrieved from PUB website: http://www.pub.gov.mb.ca/payday_loan_review2016/cac_5_tab_3_economic_analysis_c_robinson.pdf

[3] Acorn Canada. Study on High Interest Loans. February 2021. https://acorncanada.org/wp-content/uploads/2021/02/National-Report-on-High-Interest-Loans_Eng.pdf

time to repay loans in smaller amounts that fit into monthly budgets. Nevertheless, features and structures of these loans can still be very problematic and still lead into a debt spiral for many. For a detailed analysis based on the experience in the United States where these loans are more common see *From Payday to Small Installment Loans: Risks, opportunities, and policy proposals for successful markets* (PEW Charitable Trust, August 2016).

What are the impacts of high-cost installment loans on the financial well-being and financial resilience of Canadians?

U.S. research is useful to look at for insight about high-cost installment loans because these loans have been studied there more widely. A review of research relates these loans to a risk of prolonged indebtedness, increased financial fragility and borrower delinquency, inability to pay important bills and prioritize other liabilities (e.g., child support payments), and the loss of transportation due to vehicle repossession.[4] It is also important to note that there are some features of high-cost installment loans that make them particularly risky to those who are most vulnerable to financial challenges. For instance, they can be collected more easily because of more ready access to borrowers' checking accounts. Similarly, in the auto title loan market, lenders' ability to repossess borrowers' vehicles can pressure customers to make loan payments they cannot afford, which in turn can leave consumers without enough money to meet their basic needs.[5] Momentum, a community development organization in Calgary also describes these impacts, describing these loans as capable of trapping a vulnerable borrower in a cycle of debt. Financial exclusion perpetuates cycles of poverty, in which individuals are unable to secure neither the income nor the assets necessary to thrive in the long-term.[6]

We consider the following related questions together:

> **What impact would lowering the criminal rate of interest have on the availability of credit for financial consumers who use high-cost installment loans?**
>
> **Would lowering this rate have any negative implications for financial consumers, including lost or reduced access to credit?**
>
> **What impact would lowering the criminal rate of interest have on credit products other than high-cost installment loans?**

It is unlikely that reducing the criminal rate of interest to the Bank of Canada's overnight rate (currently 3.25%) plus a risk premium of 20% with a cap at 30% (including all fees, insurance, etc.). would have a significant impact on the availability of credit. Some considerations:

- While some empirical research in the United States based on considering credit access in states with different interest rate regulations suggest that tighter interest rate restrictions

[4] S. Ilan Guedj, *Report Reviewing Research on Payday, Vehicle Title, And High-Cost Installment Loans.* Bates White Economic Consulting, May 14, 2019. https://lawyerscommittee.org/wp-content/uploads/2019/05/Report-reviewing-research-on-payday-vehicle-title-and-high-cost-installment-loans.pdf

[5] PEW Charitable Trust (2016).

[6] Momentum (2017) *High-Cost Alternative Financial Services: Issues and Impact,* Calgary, AB. https://momentum.org/wp-content/uploads/2018/02/Part-1-High-Cost-Alternative-Financial-Services_1.pdf

lower credit access for low-income customers as well as total consumer credit, these studies consider interest rate caps that are relatively low (eg. 12%). The results are not necessarily transferable to the interest rate cap considered in our submission (25-30%).[7]

- Reduced access to high-interest credit is not per se negative (especially in the long run) for low-income, vulnerable customers, if their needs are not actually met by this high-interest credit.
- Credit alternatives to high-interest installment loans have become available in some regions.[8] The reach of these credit products is still relatively small in scope but can be significantly strengthened, particularly with federal government support and action, for instance, as ACORN Canada suggests through the Post Office and through Federal government's legislative powers through the Bank Act.

How could the Government of Canada, including the FCAC, improve financial education and awareness regarding high-cost installment loans to further empower and protect Canadians as they make informed financial decisions?

While improving financial education and awareness is important, we would argue that other measures are more critical to fighting predatory lending. These are summarized in our concluding remarks.

A suggestion for improving financial education and awareness would be to mandate a standardized Financial Facts Label on all credit agreements and advertising for federally regulated financial products.[9] High-interest installment loans are complex for the borrower to understand, particularly in understanding credit insurance premiums, refinancing renewal and payout options and the implications of the decisions. It would also be good to have a Canada-wide assistance mechanism to assist potential lenders to navigate the complexity of applying for a loan and to have a means of reporting concerns and complaint.

In closing, we strongly support efforts to lower the criminal rate of interest in the Criminal Code of Canada as discussed in the responses above. These relate to the scope of this consultation. To be effective in addressing predatory lending and its harmful impact, we strongly urge the Government of Canada to lower the criminal rate of interest in conjunction with the other following measures:

- Ensure access to safe and affordable credit for all Canadians by creating viable alternatives to predatory lending. This can be through banks and other financial institutions, postal banking and expansion of networks such as the BC Rent Bank to other jurisdictions and for other purposes.

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[7] Based on research summarized in U Reifner (2009) *Study on interest rate restrictions in the EU Final Report* https://www.academia.edu/79756287/Study_on_interest_rate_restrictions_in_the_EU_Final_Report_for_the_EU_Commission_DG_Internal_Market_and_Services Project No. ETD/2009/IM/H3/87 Publications Office of the European Union.

[8] Credit unions like Vancity have developed installment loan products with significantly lower interest rates for individuals who would have turned to unconventional (high interest) lenders. For example, Vancity Credit Union's Fair and Fast loan product, Desjardins' Mutual Aid Fund, Causeway Work Centre's Micro-loan Product, Momentum & First Calgary Financials' Micro-Loan Product.

[9] Momentum (2017). High Cost Alternative Financial Services: Policy Options. Part-3-High-Cost-Alternative-Financial-Services-Policy-Options_0.pdf (momentum.org)

- Repeal section 347.1 which provides an exemption for payday lending by transferring responsibility to the provinces.
- Lead a Pan-Canadian consumer protection strategy with solutions to address the three other key problems with installment loans as defined in PEW Charitable Trust[10]:
    1. Require loans to have reasonable repayment terms to address unreasonably long repayment terms that extend indebtedness and drive up the cost of borrowing.
    2. Allow only interest charges or monthly fees on the loan, with no other fees. Front-loaded fees create an incentive for lenders to encourage refinancing.
    3. Establish clear ability-to-repay standards, limiting loan payments to an affordable percentage of a borrower's periodic income. This would address large monthly payments that often exceed borrowers' ability to repay, creating a risk of frequent refinancing or inability to pay other bills.

Beyond the measures noted here, action on predatory lending must be tied to Canada's continued commitment to address deeper issues of affordability that are driving people to these loans.

Should you require any further information or be interested in speaking with us, do not hesitate to contact me.

Sincerely,

Genesa Greening
Chief Executive Officer

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[10] PEW Charitable Trust (2016), *From Payday to Small Installment Loans: Risks, opportunities, and policy proposals for successful markets.* The 4th problem is the high rate of interest that would be addressed by lowering the criminal rate of interest.