Written Submission for the Standing Senate Committee on Banking, Commerce and the Economy's Study on Bill C-69

By Canadian Consumer Finance Association

Summary of Recommendations

Recommendation 1: That the government does not lower the maximum interest rate and payday loan rate below 35 per cent and $14 per hundred.

Recommendation 2: That the government develop a robust identification and enforcement strategy to pursue illegal, unlicensed online lenders to better protect Canadians seeking credit.

Recommendation 3: That the government respect provincial jurisdiction and the robust regulatory framework established by the provinces and territories to protect consumers as it relates to payday loans.

Recommendation 4: That the government implement an appropriate transition period for the implementation of the proposed regulatory changes to Section 347.1 of the Criminal Code, so it allows lenders sufficient time to modify their operations, systems, and credit risk models to align with new requirements.

Introduction

For decades, banks have gradually shifted their market focus towards wealthier Canadians, rendering access to credit and banking services less appealing for those with lower credit scores. This shift resulted in the birth of the cheque cashing industry in the 1990s, propelled by consumer demand in an era devoid of electronic banking and direct deposit.

During this period the cheque cashing industry developed in response to consumer demand. Electronic banking and direct deposit did not exist. People were paid on payday by cheque and cheques were the only alternative to cash used in commerce however if a person did not have funds in their account or a good banking record their bank would put a hold on the cheque being deposited for 8 to 10 days. Many Canadians needed to pay for everyday expenses and could not afford to go without access to their funds for the hold period and this drove demand for cheque cashing services. The customer would endorse the cheque over to the business in exchange for proceeds less a discount (currently around 3 per cent of the face value of the cheque).

Many Canadians have unexpected expenses or fluctuating income from unstable working hours with various jobs. Customers with regular employment then began asking for an advance or credit until their next payday to address short term cash needs. A substantial portion of all borrowers is comprised of nurses, teachers, firefighters, police, and government workers. In response, companies began to provide these cash advances or loans to payday. The industry grew rapidly across the country in response to a pent-up demand by Canadians who needed access to credit.

Payday loans play a critical role in Canada's financial ecosystem, providing a much-needed credit solution for individuals underserved by traditional banking structures. Notwithstanding the characterization of payday loans as “predatory lending,” these loans serve a legitimate need for short-term credit in a responsible manner. When a shortfall occurs in the finances of those Canadians who cannot access credit from traditional lenders, they need quick access to an unsecured small, short-term loan to bridge the gap. A payday loan is a better choice when for example a borrower is faced with failure to pay a bill.

A payday loan does not accrue interest but rather the lender charges a fee (although the APR of each specific loan must be calculated and disclosed on the Loan Agreement). The fee does not vary with the term of the loan. It is consistent whether the term is 10 days or 30 days. That is because the major costs to provide the loan do not vary whether the term is 10 days or 30 days. Generally, to qualify for a payday loan you need a job or other steady source of income and a residence. The Applicant must provide identification proving they are 18 or over, a current bank statement, and proof of residence.

Recent regulatory changes, such as the cap on provincial payday loan rates and the reduction of the maximum federal interest rate, could unintentionally exacerbate financial challenges for the very individuals they aim to protect. Such changes will force many legal, regulated lenders to exit the market or diversify their product offerings, thereby creating opportunities for illegal, unlicensed lenders to fill the void. These unregulated entities could exploit borrowers, exposing them to predatory practices, higher rates, and potential data security risks.

The government needs to take time to study the impact of these changes once they come into effect. While the impact will be immediate it will take at least two or three years to assess and document the unintended impacts. It is far too early to even consider further changes at this time. Yet in the 2023 Budget the federal government indicated they would investigate further reductions in the maximum lending rate and further restrictions to the maximum payday loan cap.

Recommendation 1: That the government does not lower the maximum interest rate below 35% and payday loan rate below $14 per hundred.

At this point, no one including the government knows what all the impacts will be resulting from the reduction of the maximum interest rate to 35 per cent and reduction of the payday loan cap to $14. To force legitimate licensed high-cost credit lenders out of the market will not help borrowers improve their financial position. A certain outcome will be many Canadians being denied access to credit, at least from licensed legal lenders.

Legal licensed lenders serve those who cannot access convential banking structures. We encourage regulators to not further lower lending caps which would further exclude Canadians. Lowering the interest rate from 60 per cent EAR to 35 per cent APR was not a measured careful reduction. It was drastic and done without analysis or research as to what its impact might be. While this change has yet to go into effect, when it does, it will result in denial of access to credit for many Canadians. It is impossible to rely on theoretical financial modelling to assess the impact to the industry, borrowers, and the illegal lending market by a further reduction of the interest rate from an unknown environment (of 35 per cent APR) that is yet to exist. As such, the full impact and unintended consequences flowing from the reduction will not be known for at least two years after the regulations come into force.

Additionally, there seems to be a governmental assumption that borrowers seeking installment loans will turn to payday loans if denied access. Unfortunately, this is an incorrect assumption and a decision that seems to have been made without consultation with key stakeholders. Lower interest rates will not necessarily channel borrowers towards payday loans. Installment loans and payday loans are fundamentally different products, serving different purposes. Installment loans typically offer larger amounts repayable over extended periods.

The result of lowering the maximum interest rate from 47 per cent to 35 per cent APR will not cause a wholesale shift to payday loans for those Canadians that are denied installment loans and the government does not seem to appreciate or recognize that payday loans are an important and necessary product. Borrowers will be hurt by the actions that have been taken to cap the rate provinces can set for the loan product at a level that is not viable for most lenders.

The reduction of the maximum federal interest rate will lead to credit denial and loss of access to installment loans for individuals with lower credit scores, causing them to fall off the lower rungs of the credit ladder. There is no silver bullet to providing low-cost credit to high-risk borrowers on a financially viable basis. A lender must be able to recover their costs of operation including bad debt plus a reasonable profit in order to stay in business.

Regulatory shifts in several provinces have led to lower maximum permissible fees for payday loans. This has resulted in an environment of extremely thin margins, pushing many payday lenders out of the market. Even established lenders have had to diversify into other lending products to remain profitable. The viability of the payday loan sector was a concern even before the rate changes. Now, with further reductions on the horizon, the industry's survival is increasingly uncertain. Our members who plan to continue offering the product warn that a $14 rate will necessitate the introduction of credit scoring – a practice not previously required – potentially excluding and denying a segment of borrowers.

Recommendation 2: That the government develop robust identification and enforcement strategy to pursue illegal, unlicensed online lenders and better protect consumers seeking credit.

The reduction of the maximum payday lending rate to $14 will deny more Canadians assess to payday loans from legal licensed lenders. Licensed payday lenders' profits will likely drop 50 per cent from a profit margin that is currently very thin. This will transition borrowers not to friends and family but to easy and convenient higher cost lenders.

Loss of access to credit does not mean the need disappears and many Canadians will have no choice but to turn to illegal online lenders. It is crucial for the government to develop a robust strategy for identifying unlicensed lenders and enforcing the laws they violate by operating illegally.

In the area of unsecured installment lending and payday lending, the biggest issue is the growth of the illegal online sector who provide credit more than the current maximum rate of 60 per cent EAR and payday loans at rates far in excess of the provincial maximum rates. When the reduction in the criminal interest rate comes into effect many more Canadians with low credit scores will lose access to credit from licensed credible lenders.

There is the assumption that with restriction of access a large contingent of borrowers will choose not to borrow or will borrow from family and friends. We believe this is incorrect. Borrowing is intentional and for a specific need. It is rarely discretionary. Over the past it has often been suggested that if denied access from a licensed lender, a borrower will go to family or friends to borrow instead. There is no evidence of this. The experience is clear that if denied access to a local payday loan outlet or platform a borrower will seek credit elsewhere.

There are many unlicensed lenders, both sophisticated and unsophisticated, that operate online in the same market as licensed lenders (perhaps analogous to licensed and unlicensed cannabis retailers). Unlicensed lenders outnumber licensed lenders and because regulators have no ability to sanction them, governments ignore their existence when analyzing the market.

For those seeking a loan, it is just as easy and convenient to get a loan from an unlicensed lender. Their websites and lending platforms are slick and as professional as licensed lenders. Government is often unable to stop these unlicensed lenders and their presence in the market remains significant. It is profitable at the rates they charge (i.e. $25 per hundred rather than $15) and the government is unable to stop them. The government must focus efforts on developing a robust enforcement arm to pursue illegal online lending as that is where the abuse will occur.

Recommendation 3: That the government respect provincial jurisdiction and the robust regulatory framework established by the provinces and territories to protect consumers.

Being primarily a consumer protection issue, the Federal government enacted Section 347.1 of the Criminal Code to allow provinces to regulate and license lenders instead of enforcing the criminal code that would eliminate credible lenders and push the industry underground. As a result, all provinces except Quebec have now introduced respective legislation.

In the context of federal regulations, it is crucial to recognize the existing provincial regulations and ensure that any additional regulations align with these existing frameworks, promoting consistency and minimizing confusion for lenders and borrowers.

In respect of payday lending, the provinces have established a regulatory framework that sets out strict guidelines on fees and interest rates for payday loans. The mechanisms in place have been designed to protect consumers from exploitative practices, ensuring that fees are transparent and capped at reasonable levels. This regulatory environment has been shaped through rigorous consultations, assessments, and based on substantial empirical evidence over the past 15 years.

Regulations at the provincial level already fix maximum dishonoured payment ("NSF") fees and limit the rate charged for post default interest for payday loans and high-cost credit. These limits (which are listed by province in our Prior Submission) are substantially lower than fees currently charged by banks and credit unions for their credit products.

Even though this consultation is still underway, the draft Regulation issued by the Government of Canada on December 23, 2023, has set a cap on the NSF fee that can be charged by a payday lender in Canada to $20.00. These fees are not a penalty to the borrower but reflect the cost to the lender resulting from a default in payment. These charges are approximately one half of what is charged by banks and credit unions.

Payday loans are far more regulated than any other credit product. It is important to note that provinces have already undertaken significant efforts to regulate these fees and charges, ensuring consumer protection while allowing payday lenders to recover legitimate costs.

Recommendation 4: That the government implement an appropriate transition period for the implementation of the proposed regulatory changes to Section 347.1 of the Criminal Code, so it allows lenders sufficient time to modify their operations, systems, and credit risk models to align with new requirements.

The implementation of the legislation and associated regulations marks a significant transformation for the payday lending industry, impacting both lenders and borrowers. To ensure a smooth and well-prepared adaptation, it is crucial to allow for an appropriate transition period.

To mitigate adverse effects and facilitate an orderly transition, the CCFA strongly recommends a 24-month implementation timeline from the date of enactment for the regulations to come into force. This timeframe allows lenders the necessary time to modify their operations, systems, and credit risk models to align with the new requirements, minimizing disruption for borrowers and industry stakeholders.

The necessary adjustments encompass reprogramming and redesigning IT and human resource systems to accommodate the new regulations. The most demanding task lies in developing and testing revised credit risk models to accurately assess high-risk borrowers. Each lender relies on a credit facility to fund its loans, necessitating the demonstration of the viability of new credit models to satisfy their lenders. Additionally, lenders must evaluate potential downsizing, store closures, and employee layoffs, requiring careful planning and consideration. These complex processes pose challenges, especially for industry members offering both payday and installment loans.

A longer transition period is essential to enable lenders to adjust their practices effectively and ensure continued access to legal credit options for borrowers. It also offers an opportunity for comprehensive consultation and collaboration among the government, industry stakeholders, and consumer advocacy groups to address potential unintended consequences and develop effective strategies for the future.

By affording an adequate transition period, the government demonstrates its commitment to responsible and well-informed policymaking, upholding the long-term sustainability of the industry and safeguarding consumer interests. This approach fosters an environment where lenders can adapt to the regulatory changes seamlessly, ensuring a smooth transition for borrowers and promoting overall stability in the payday lending sector.

Conclusion

We emphasize the importance of ongoing dialogue and collaboration between the government, industry stakeholders, and consumer advocacy groups. By engaging in informed discussions and drawing from successful examples of collaboration in other jurisdictions, we can develop effective strategies that balance consumer protection with access to credit. This collaborative approach will enable us to address potential unintended consequences and ensure that policies reflect the best interests of Canadians.

Ultimately, our goal is to achieve a balanced approach that supports responsible lending practices, safeguards consumer interests, and enables individuals to manage their financial obligations effectively. By considering the specific concerns regarding timing and coming into force, we demonstrate our commitment to responsible and well-informed policymaking. Together, we can foster an environment that promotes financial stability for individuals across the country while ensuring access to safe and regulated short-term credit options.

We invite policymakers to carefully consider the insights presented in this submission and to engage in constructive dialogue with industry stakeholders, consumer advocacy groups, and experts. Through collaborative efforts, we can develop evidence-based policies that protect consumers, maintain access to credit, and support the financial well-being of all Canadians.

About the Canadian Consumer Finance Association

The Canadian Consumer Finance Association ("CCFA") was created in 2004 and represents consumer financial service businesses that provide a range of financial products to Canadians including installment loans, cheque cashing, cash wire services, bill payment services, payday loans and currency exchange. The CCFA is the leading voice representing cheque cashers and payday lenders in Canada.

The CCFA member companies hold provincial payday lending licenses and high cost credit licenses for their stores and online lending platforms. Our members represent by far the majority of the payday loan and cheque cashing industry in Canada.

Contact

Norm Bishop, Secretary
Canadian Consumer Finance Association
E. nbishop@bmllp.ca