momentum

Opportunities for Provincial Action on Payday Lending

EXECUTIVE SUMMARY

In The Real Cost of Payday Lending (June 2014) the case was made for reform to payday lending at all three levels of government. The potential for non-profits and mainstream financial institutions to participate in needed reform was also highlighted.

The Government of Alberta is expected to release a provincial poverty reduction strategy in 2015. Payday loan businesses counteract poverty reduction initiatives through the targeting of low income individuals as the primary client. The clustering of payday loan businesses in low income areas is a clear indicator of this trend. Due to the high fees or interest that lenders can charge, many people become trapped in a cycle of debt that can be difficult to escape. More than one in five payday loan customers in Alberta take out a loan at least once per month.[1] If Alberta is serious about reducing poverty then one area in which to look is payday lending.

With the Government of Alberta expected to release a provincial poverty reduction strategy early in 2015 and the provincial Payday Loan Regulation of the Fair Trading Act coming up for review in March 2016, a window to affect change to payday loans to better protect consumers will open shortly.

The Real Cost of Payday Lending report called for provincial reform in two ways:

- Repeal the Alberta Payday Loans Regulation and revert to the federal criminal code interest rate of 60% per year.
- Reduce maximum interest rate levels to below the 60% federal maximum.

Momentum, a Calgary based community economic development agency, recognizes that such drastic changes are unlikely to happen and, if they occur in isolation, will further limit access to credit for people living on low incomes. This brief focuses on measured reform options that have been successful in other jurisdictions.

WHAT IS A PAYDAY LOAN?

A payday loan in Alberta is a short-term loan of up to two months to a maximum amount of $1500 that is legally available to consumers. Payday lenders can charge up to $23 per $100 borrowed. Should the loan not be repaid on time other fees can be charged.

FEES VS. ANNUAL INTEREST

The $23 per $100 borrowed may seem like a 23% interest rate. It is not. Financial products are generally calculated using an annual rate of interest or annual percentage rate (APR). This allows consumers to better compare their borrowing options and make an informed decision when seeking credit. All financial products use an annual rate of interest. Think of your credit card at 20% or your car loan at 7%. So what happens when you annualize the interest on an average payday loan? A $300 loan taken out for 14 days at that maximum cost of borrowing results in a 600% APR. When compared with other financial products, payday loans are excessively expensive.

1. Parliament of Canada (2006). *Payday Loan Companies in Canada: Determining the Public Interest.* http://www.parl.gc.ca/content/lop/researchpublications/prb0581-e.pdf, 3.

WHO USES PAYDAY LOANS?

Payday lending customers are predominantly the working poor. The majority of those taking out payday loans are also doing it to cover ordinary or day-to-day expenses; only 28% of borrowers say they need the loan to cover an emergency or unexpected expense. This is troublesome as loans for routine expenses are temporary fixes which can result in repeated use of expensive credit. This perpetuates a cycle of debt that is difficult to exit.

WHAT SHOULD THE ALBERTA GOVERNMENT MAINTAIN IN ITS PAYDAY LOAN REGULATION?

While the Payday Loan Regulation is in need of significant reform, there are areas of the current regulation that help consumers and should therefore be maintained.

Use of Annual Percentage Rate (APR)

Payday lenders dislike the use of APR as payday loans are not meant to last for a year. In truth, consumers need a straightforward way to compare financial products. The ability to educate oneself about financial options and compare is a basic tenet of financial literacy.[2] APR is a standard method to measure and compare the cost of financial products and should therefore be retained. The Alberta Payday Loan Regulation requires lenders to include a sign showing the APR on a $300 loan taken out for 14 days (600%). This should become a more prominent piece of the regulation.

Cooling off Period

The current Regulation allows for a two business day cooling off period after a borrower commits to a loan. During this time the borrower can return to the location and pay back the full amount borrowed. Lenders cannot charge fees for the cancellation of a loan.

WHAT CAN THE ALBERTA GOVERNMENT DO TO BETTER PROTECT CONSUMERS?

The Government of Alberta is the primary regulatory authority for payday lenders. The province has the power to adjust the fees, composition, or length of loans.

Reduce the Maximum Borrowing Cost of a Payday Loan

While Alberta is at the higher end of interest costs when compared to other provinces, most Canadian provinces allow much higher fees to be charged compared to American states. Payday loans are illegal in 14 U.S. states. States such as Oklahoma and Colorado offer a tiered system of interest charges. Colorado caps interest and fee charges at 20% on the first $300 loaned but only 7.5% on anything above $300.[3] Maine is even more restrictive, allowing only $5 to be charged on loans up to $75, $15 for loans up to $249, and $25 for loans above $250.[4] While still an expensive form of credit, the tiered system reduces the cost to consumers and therefore reduces APR to a more acceptable level.

Create an Alberta Payday Borrowers' Financial Literacy Fund

Manitoba has established a fund to improve the financial literacy of payday loans borrowers. Payday lenders pay into a fund via a financial literacy support levy. Lenders are also required to pay a $5,500 annual license fee, much higher than every other province and territory in Canada. Alberta could charge fees necessary to fund similar financial literacy education opportunities.[5]

Promotion of a Complaint Mechanism

While a mechanism exists to complain to Service Alberta about predatory, unfair, or unlawful payday lending practices, borrowers are not aware of how to complain. BC's Consumer Protection website,

2. Hudson, C.A. (2014). *Poverty Costs 2.5: Investing in Albertans.* Calgary: Vibrant Communities Calgary and Action to End Poverty in Alberta, 25
3. The Pew Charitable Trusts (2014). *State Payday Loan Regulation and Usage Rates* http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/state-payday-loan-regulation-and-usage-rates
4. Ibid, 10.
5. Government of Manitoba (2009). *The Consumer Protection Amendment Act (Payday Loans)* http://web2.gov.mb.ca/laws/statutes/2009/c01209e.php. Section 161.6(1).

for example, provides an easily accessible link to the complaint process on the front page of its payday loan portal. Information on filing a consumer complaint should be made more prominent on Service Alberta's website and other material. This mechanism and contact information should appear prominently on the payday loan agreement provided to borrowers by the lender and should be accordingly mandated in the Regulation.

Mandate a Payment Plan Option

Many borrowers are unable to repay their loan in full or do so and then immediately take out a new and larger loan to cover their expenses and the cost of the previous loan. To reduce what are technically 'rollover' loans, many U.S. states have implemented payment plan options where borrowers can repay a loan in a number of equal installments rather than one single payment. Payments are due on paydays and no additional fees or interest can be charged for those on a payment plan unless payments are missed.[6] States such as Colorado and New Mexico have found this to be an effective tool against 'rollover' loans. In the New Mexico example a borrower who cannot repay a loan is immediately offered a 130 day payment plan, with no new fees or interest. Once the loan is repaid a borrower must wait ten days before being eligible for another loan. Loan fees are capped at $15.50 per $100 plus a 50-cent administrative fee to cover the cost of verification that the borrower does qualify for a loan.

Restrict the Amount of the Loan to a Percentage of Income

New Mexico limits the size of loans to 25% of a borrower's net monthly income.[7] In Alberta, a loan need only be less than $1500. There is no government restriction on the size of a loan relative to a prospective borrower's income. In Canada, Manitoba limits the amount that can be borrowed to 30% of net monthly income. The Manitoba payday loan regulation also sets out the formula used to calculate this net income.[8]

Restrict Use for Fixed Income and Social Assistance Recipients

While some lenders voluntarily choose not to lend to people whose sole source of income is government assistance, government regulation would be required to universally restrict loan transactions based on this source of income. If people living on low incomes have difficulty exiting the payday lending cycle of debt then those on fixed social assistance income would find it impossible. Manitoba's Public Utilities Board (MPUB) recommended substantially lower borrowing charges for social assistance recipients. This has been done, not to reduce costs for borrowers but to discourage the industry from making these loans to begin with.[9] MPUB recommended a 6% ceiling on the cost of credit for social assistance recipients and for any loan over 30% of a borrower's net monthly income.[10]

In conclusion, this brief focuses on positive aspects and changes that can be made to the Payday Loans Regulation of the Fair Trading Act. Though not exhaustive, they would improve the Regulation to better protect consumers. Payday loans often lead to a cycle of debt that is difficult to exit. By implementing the recommendations above, this burden can be eased. The recommendations draw on best practices from other jurisdictions in Canada and the United States. Most other jurisdictions in North America place tighter regulations on the payday loan industry; currently regulations in Alberta appear to lag behind. Adopting the recommendations in this report would better protect Albertans, particularly vulnerable Albertans.

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6. Government of Colorado. *Colorado Uniform Consumer Credit Code* http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/1%20-%20UCCC%207-1-13.pdf, 136.
7. Government of New Mexico (2006). *New Mexico Small Loan Act* http://164.64.110.239/nmregister/xvii/xvii03/12.2.10.htm
8. Government of Manitoba, Ministry of Tourism, Culture, Heritage, Sport and Consumer Protection. *Payday Loan Information for Consumers* http://www.gov.mb.ca/cca/cpo/faq_payday_c.html#Q3
9. Government of Ontario (2009). *Capping Borrowing Costs: A Balanced Approach to Payday Loans in Ontario* https://www.sse.gov.on.ca/mcs/Documents/264305.pdf, 23
10. Ibid, 10.

POLICY OPTIONS FOR REFORM OUTLINED

Potential policy reform options exist for all orders of government as well as business and the non-profit sector.

Municipal Government

- Pass a land use bylaw setting a minimum distance between lenders and similar businesses and distance from residential zoned areas.
- Institute licensing bylaws that increase business licensing fees for payday lenders. Re-invest license fees in financial empowerment programs.
- Convene banking institutions to collaborate and offer appropriate banking products for the working poor.
- Encourage employers to use direct deposit rather than pay employees by cheque or cash.

Provincial Government

- Reduce the maximum borrowing cost of a payday loan.
- Create an Alberta Payday Borrowers' Financial Literacy Fund.
- Better promote the complaint mechanism to Service Alberta.
- Mandate a payment plan option for borrowers who cannot repay their loans.
- Restrict the amount of a loan to a percentage of monthly net income.
- Restrict use for people living on fixed income or income support.
- Continue use of APR for payday loans to allow consumers to compare financial products.
- Maintain cooling off period if consumers change their mind about a loan.

Federal Government

- Do not allow provinces to override the interest rate maximum of 60% annually outlined in the Criminal Code of Canada.
- Reduce the maximum interest rate to below 60% annually.

Non-profit Sector

- Provide financial literacy and empowerment supports to encourage savings, asset building, and direct deposit.
- Recognize the need for short-term, low dollar credit by providing small loans at low rates of interest.

Mainstream Financial Institutions

- Provide financial products that offer short-term, low dollar credit at reasonable interest rates.
- Financial products that encourage lower income earners to open accounts and begin direct deposit.