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Consultation on Fighting Predatory Lending by Lowering the Criminal Rate of Interest

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About Momentum

Momentum is a change-making organization located in Calgary, Alberta that works with people living on low incomes and partners in our community to create a thriving local economy for all. Momentum has worked with over 50,000 Calgarians since 1991 to get a good job, start a business and build their assets.

Momentum made a strategic decision to increase its investment in systems level change initiatives to address the root causes of poverty. This work is grounded in both participant and community experience, from which the issue of payday loans and other forms of high-cost credit (e.g., installment, pawn, rent-to-own, title and car loans) emerged as a priority issue. Since 2012, Momentum has worked to identify the negative impacts of high-cost credit, recognizing it as a systemic barrier to poverty reduction, researched and advocated for public policy reforms with the Government of Alberta, and worked with mainstream financial institutions, community organizations, and philanthropists to create safer and more affordable short-term credit alternatives.[1]

Momentum has collaborated with key stakeholders in advance of this consultation and appreciates the opportunity to respond to the questions posed in the Government of Canada's consultation paper. Momentum consents to the disclosure of these comments in whole. For more information about this submission or Momentum, contact the Manager of Policy, Research & Evaluation at Momentum: publicpolicy@momentum.org or 403-204-6180.

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

We recommend a maximum limit of 35%.[2] The maximum rate, or ceiling, must be inclusive of all associated lending costs, such as fines, fees, penalties, insurance, and any other related costs, otherwise the exercise in setting a maximum is ineffective.[3]

[1] An evaluation of this work can be found at https://files.momentum.org/wp-content/uploads/2022/02/Creating-Change-Momentums-Contribution-to-High-Cost-Credit-Reform-in-Alberta-web.pdf
[2] Momentum is supportive of Senator Ringuette's recommendation and rationale that the criminal rate of interest be set at 20% plus the Bank of Canada (BOC) rate but we feel strongly that a ceiling must be set to prevent harmfully high interest rates. Parliament of Canada (June 2021). https://sencanada.ca/en/senators/ringuette-pierrette/interventions/563562/31
[3] National Consumer Law Centre (June 2022). Predatory installment lending in the states. https://www.nclc.org/uncategorized/predatory-installment-lending-in-the-states-2022.html

A fixed rate would ensure that the fluctuating rate never approaches the harmfully high rates we see in the market today.

Setting a fixed cap is an important indication of our values as a nation and an important policy lever for responsible lending and economic fairness. Quebec has capped consumer lending at 35%.[4] In the US, the 36% rate has been reaffirmed at the state and federal levels in recent years. Congress and three federal agencies have endorsed this rate, with strong public support.[5] For a $2,000, two-year installment loan, 43 states cap rates at a median of 32% Annual Percentage Rate (APR). Currently 19 states and the District of Columbia cap the APR at 36% or less.[6] Seventy-six countries, representing 80% of global GDP and financial assets, impose restrictions on lending rates[7] and consumer protection concerns are cited as the main reason for interest rate ceilings.[8] Canadians deserve an interest rate cap that is as ethical and fair as other democratic economies around the world.

A fluctuating rate with a ceiling would enable the lowest possible rate for vulnerable, often low-income, borrowers. Borrowers who utilize high-cost credit out of urgency, necessity, and scarcity without the luxury of considering the cost, terms, or conditions. Lowering the interest rate ceiling can help reduce further financial hardship of an already vulnerable and struggling consumer group.

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

It appears that high-cost credit lenders charge as much as they possible can, without an assessment of the creditworthiness of borrowers.[9] The Pew Charitable Trusts has also found that fringe lenders price their loans as high as the law allows, and that the same credit—from the same payday lender—is available to similarly situated people at lower prices after states lower rates and reform their payday loan laws.[10]

Industry argues that the high rates are necessary to cover the costs of higher risk lending. The claims fall short when you examine the growth of much more affordable payday loan alternatives in the marketplace, including small dollar loan programs at credit unions across the country, the launch and growth of the Canada Post MyMoney Loan, and small dollar loans in the Fintech sector – aimed at payday lending and installment lending customers but at a much

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[4] Consumers Council of Canada (December 2019). What are legal interest rates on loans? https://www.consumerscouncil.com/what-are-legal-interest-rates-on-loans/

[5] The National Consumer Law Centre (2021). Why 36%? The history, use, and purpose of the 36% interest rate cap. https://www.nclc.org/images/pdf/high_cost_small_loans/IB_Why_36.pdf

[6] The National Consumer Law Centre (2022). How well do the States protect consumers against high-cost installment loans? https://www.nclc.org/uncategorized/predatory-installment-lending-in-the-states-2022.html

[7] Ferrari, A., Masetti, O., & Ren, J., (April 2018). Interest rate caps: The theory and the practice. World Bank Group Policy Research Working Paper 8398.

[8] Calice, P., Diaz Kalan, F., & Masetti, O., (October 2020). Interest rate repression: A new database. World Bank Group Policy and Research paper 9457

[9] This assessment is based on Momentum participant experiences and our past research https://momentum.org/publications/policyandresearch/

[10] PEW. A Wealth of Evidence Backs High-Cost Loan Reform (Feb 2020). https://www.pewtrusts.org/en/about/news-room/opinion/2020/02/11/a-wealth-of-evidence-backs-high-cost-loan-reform

fairer and affordable rate (as low as 9.48% in the Canada Post example).[11] The incredible profitability of the industry also does not support their claims of necessarily high interest rates. Goeasy Financial, one of the few publicly traded high-cost credit lenders, boasted a net annual income of $244.9M in 2021, 25 times their profits in 2011.

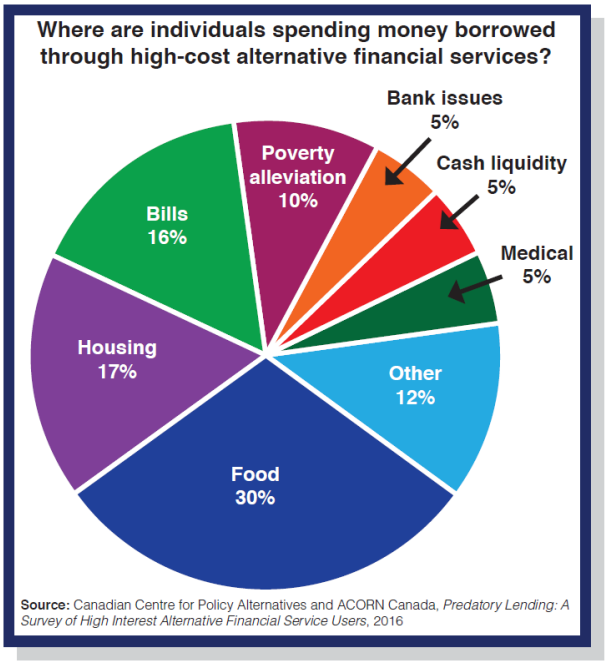
High-cost lenders make a profit by lending to people who may be better served through basic needs assistance, credit counselling, debt consolidation, affordable housing, or other community supports. Many lenders accept social assistance and Employment Insurance cheques, as well as Canada Pension Plan and disability insurance, as proof of income. These examples suggest a fixed income, meaning that if an individual currently needs a loan they are unlikely to have the money to repay it next month. If high-cost or fringe lenders were interested in a customer's creditworthiness then they would be assessing ability to repay, and likely not be lending to someone who is unemployed or on government support. Momentum has long argued that assessment of one's ability to repay would be an improvement to high-cost credit regulations and is an important principle of responsible lending.

The evidence is clear. Lower interest rate caps encourage responsible lending and align the interests of lender and borrower, ensuring a win-win, whereas high rates caps encourage predatory lending.[12] Simply put, there is no rationale for dangerously high interest rates. Someone who is in such deep financial trouble that they would turn to a 59% loan is not likely to improve their financial circumstances with a high-interest loan.

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

There are many reasons that a borrower may use high-cost installment loans, the most common being to acquire basic needs. Yet taking on high-cost debt to cover basic needs only exacerbates a person's situation and makes it harder to cover those needs in the future.

High-cost alternative lenders often target low-income individuals, recent immigrants who have not yet established credit history in Canada, unemployed individuals or those who have recently been laid off, and people who are generally strapped for cash. Ultimately, those who can least afford to borrow, end up paying the most.



[11] Canada Post MyMoney Loan https://www.canadapost-postescanada.ca/cpc/en/personal/mymoney/loan.page and Lamb, L. (October, 2021). The role of credit unions in providing alternatives to payday lending current products and future possibilities. The Canadian Credit Union Association https://dms.ccua.com/index.php/s/EAi4Qx2WJ4sJCEN#pdfviewer

[12] National Consumer Law Center (2016). Misaligned incentives: Why high-rate installment lenders want borrowers who will default https://www.nclc.org/resources/misaligned-incentives-why-high-rate-installment-lenders-want-borrowers-who-will-default/

Many people who hold high-cost debt do not have the capacity to repay that debt while also meeting other expenses. Those who use high-cost credit have encountered barriers to securing credit with mainstream financial institutions due to having a low credit score, feeling unwelcome in a mainstream bank, and may generally experience financial exclusion.[13] In contrast, high-cost lenders care less about ability to repay or the impact on financial health, but they are welcoming, have multiple locations with extended hours of operation in low-income neighbourhoods, and offer quick and simple applications to access credit.

Further, while there are few studies on the issue, available data suggests that there are certain factors that drive the usage of fringe loans among Indigenous peoples including low income, an absence of nearby mainstream financial institutions (FIs), a sense of lack of control over finances held in mainstream FIs, a preference for anonymous finances associated with fringe lenders, poor treatment by mainstream FI staff, and inadequate personal identification to access services.[14] Some studies estimate the rate of unbanked individuals in Indigenous communities to be as high as 15%.[15]

In short, high-cost credit is readily apparent and accessible (close in proximity, open late at night, welcoming, responsive) when it comes to a basic need emergency. They are the easiest and most obvious solution to a financial emergency, but they are the worst possible solution. The answer is to increase access to affordable credit, and other policy alternatives, such as a basic income, not to enable destructive, high-cost, credit.

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

Momentum participants (individuals living on low incomes) have reported significant stress caused by high-cost credit, an inability to get ahead or get out of debt, and their frustration that they felt they had no other choice at the time.[16] However, more affordable alternatives have entered the marketplace since Momentum first began researching this topic. For many, high-cost credit is difficult to pay off and can easily trap a borrower in a cycle of debt. Borrowers report a significant amount of direct soliciting to re-borrow, refinance, and to borrow more. Pawn shops undervalue items they received, and conditions on pawn loans make it difficult for a borrower to buy back a pawned item. People get trapped and people cannot get ahead.

In a recent study, 85% of those surveyed reported negative consequences of high-cost installment loans. The authors report that “the financial distress our participants described is

[13] Jerry Buckland (2012). Hard choices: Financial exclusion, fringe banks, and poverty in urban Canada (Toronto: University of Toronto Press).
[14] Buckland, J., McKay, D.; and Reimer, N. (2016). Financial inclusion and Manitoba Indigenous peoples. Manitoba: CCPA
[15] Prosper Canada (November 2015). Financial literacy and Aboriginal peoples https://www.prospercanada.org/getattachment/f988e655-6033-40b1-8445-cd539bfdcf09/Financial-Literacy-and-Aboriginal-Peoples.aspx#:~:text=Other%20studies%20estimate%20the%20rate,high%20as%2015%20per%20cent.&text=In%20Ontario%2C%20there%20are%20only,and%20more%20recent%20online%20research
[16]Momentum (June 2017). High-Cost Alternative Financial Services: The Customer Experience. https://momentum.org/wp-content/uploads/2018/02/Part-2-Experiences-with-High-Cost-Financial-Services.pdf

quite disturbing," and that "the bottom line is that high-cost installment loans tend to aggravate, rather than alleviate, existing financial challenges."[17]

One of the real impacts of high-cost alternative financial services is the reinforcement of the two-tiered banking system, and in the depletion of capital from low-income households and communities, both of which contribute to economic inequality and poverty.[18] Not only are such businesses detrimental to the financial, mental and physical well-being of residents, they also detract from efforts to alleviate poverty in lower-income areas. When high-cost lenders cluster in neighbourhoods with higher poverty rates, they drive away more desirable businesses or prevent those that do exist from thriving.

High-cost credit exacerbates poverty – for the individual, families, and communities. Short-term gain turns in to long-term pain as borrowers report regretting getting a loan.

5. 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?

A reduced prevalence of destructive high-cost credit will hopefully occur. People find better alternatives when high-cost credit is reduced or removed from the market.

The fringe financial industry makes claims that reducing allowable interest rates with leave consumers without options when they are short on cash. That has proven to be a false claim. Easy Financial's latest Annual Report shows they have reduced their weighted average interest rate from over 46% to less than 33%, and they are strategically increasing their presence in Quebec where there is a 35% interest rate cap.[19] The existence and growth of high-cost credit alternatives such as the Canada Post MyMoney Loan and others mentioned above, also point to the potential of other credit options offered at a much lower interest rate.

> The USA's National Consumer Law Center's extensive survey of research on the topic has found: "Once a state limits interest rates, what is the impact on consumers? In state after state, the impact is clear: consumers are better off and find better ways to cope with financial challenges."

The following conditions address concerns about access to credit, should current high-cost credit lenders exit the market:

[17] Center for Responsible Lending. (September 2022). Unsafe harbor: the persistent harms of high-cost installment loans https://www.responsiblelending.org/research-publication/unsafe-harbor-persistent-harms-high-cost-installment-loans

[18] Marnie Purciel-Hill et al., (2016). Drowning in debt: A health impact assessment of how payday loan reforms improve the health of Minnesota's most vulnerable (Oakland, CA: Human Impact Partners), 4, https://humanimpact.org/wp-content/uploads/2018/10/PaydayLendingHIA.ExecutiveSummary.pdf

[19] 2021 Annual Report for goeasy Ltd https://investors.goeasy.com/financial-information

1) The growth of affordable alternatives such as credit union small dollar loan programs and the Canada Post MyMoney Loan mentioned above, along with fintech companies, many of whom specialize in early wage access or bridge financing, means that consumers have more access to access to fair and affordable credit than they did even a few years ago.[20] The Government of Canada could promote the Canada Post MyMoney Loan as a safe alternative.
2) Elimination of high-cost credit is unlikely as evidenced in Quebec. Constriction of the market, and reduced prevalence of harmful credit is welcomed. Research in Alberta on payday lending shows that lower allowable interest rates did not result in decreased access to credit, nor did it result in more riskier borrowing such as online or pawn shops, for examples, even though the prevalence of high-cost credit was reduced.[21]
3) Decreased access to high-cost credit results in much better alternatives (not borrowing at all, reducing expenses, borrowing from friends and family, or accessing other supports and services to meet basic needs), not riskier alternatives as the industry suggests. The USA's National Consumer Law Center's extensive survey of research on the topic has found: "Once a state limits rates, what is the impact on consumers? In state after state, the impact is clear: consumers are better off and find better ways to cope with financial challenges."[22]
4) The availability of emergency supports, basic needs services, and credit counselling, provided by the charitable sector are a much more relevant and helpful solution for someone looking to meet their basic needs. Changing demand for these services could be closely monitored following an update to the criminal rate of interest.
5) There are also increasing calls for mainstream financial institutions to improve customers access to their own cash, and access to affordable credit for lower-income and more vulnerable borrowers. One promising example if the Fair Credit Benefit proposed by ACORN Canada and supported by a national coalition for fair financing.[23] The Government of Canada has the ability enable or mandate such an innovation.

It is important to note though that the maximum allowable rate must include all credit products, be inclusive of all associated costs and fees, and must be rigorously enforced. Otherwise, there is no effective maximum.[24]

When calculating all associated costs of loans Momentum found evidence of interest rates above the criminal rate of interest (see appendix A). This has been similarly reported by other

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[20] Instant Financial and ZayZoon are two Canadian examples of early wage access apps.
[21] El Hazzouri, M., El-Bialy, R., Main, K., & Fossen R. (2019). For better or for worse? Access to low-income borrowers to credit following regulatory changes for payday loans. Unpublished manuscript. Bissett School of Business, Mount Royal University: Calgary, Canada
[22] The National Consumer Law Centre (March 2022) After payday loans: Consumers find better ways to cope with financial challenges and The Pew Charitable Trusts (2012). Payday lending in America: Who borrows, where they borrow, and why http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/PewPaydayLendingReportpdf.pdf
[23] ACORN, PIAC, Momentum (December 2021). Revising the criminal rate of interest in Canada https://files.momentum.org/wp-content/uploads/2022/01/20152642/Revising-the-Criminal-Rate-of-Interest-in-Canada.pdf
[24] Pew Charitable Trust (2020). How Virginia's 2020 fairness in lending act reforms small-dollar loans law closes regulatory loopholes, caps interest rates, and provides lessons for other states https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2020/10/how-virginias-2020-fairness-in-lending-act-reforms-small-dollar-loans
and Hawkins, J. (January 2020). Earned wage access and the end of payday lending. 101 Boston University Law Review 706 (2021), U of Houston Law Center No. 2020-A-1 http://dx.doi.org/10.2139/ssrn.3514856

consumer advocacy groups and media reports. Enforcement must also therefore be clarified and resourced. We must remove the requirement of an actuarial certificate and approval of the attorney general to prosecute a criminal case of interest. Otherwise, borrowers who end up with credit contracts above the criminal rate will have no processes to seek justice, as is the current reality.

In short, high-cost credit does not solve problems. It creates problems. Enabling these destructive loans is not the answer.

6. What impact would lowering the criminal rate of interest have on credit products other than high-cost installment loans?

Our hope is that lowering the criminal rate of interest would make all consumer credit products in the marketplace today and in the future, safer and fairer.

Momentum community members have identified a wide range of high-cost credit products that are costly and problematic, including[25]:

- Auto loans
- Rent-to-own financing
- Title loans
- Instalment loans
- Pawn loans
- Cheque cashing services
- Medical product rentals
- Credit rebuilding services
- Buy now, pay later
- Payday loans

Lowering the criminal rate of interest and clarifying that all consumer lending falls under the criminal code maximum would prevent unfair and harmful credit products, with the exclusion of payday lending, given its exemption from the criminal code. It would also ensure that any new financial products and services, including those under development by Canada's growing Fintech sector, and new services such as buy now pay later, would be subject to the same interest rate limits, an important clarification and closing of any loopholes.

In summary, loopholes must be closed, including the invention of new products that attempt to skirt the definition of credit, and the sale of insurance products that drive up the costs for borrowers and that generally benefit the industry and not the borrower. Otherwise, we risk having no impact at all on improving access to fair and affordable consumer credit in Canada.[26]

While not officially in the scope of this consultation, we must repeal section 347.1 which provided an exemption to payday lending by transferring responsibility to the provinces. The Criminal Code maximum rate of interest must include all consumer credit in the market today or in the future, including payday lending.

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[25] Momentum (June 2017). High-cost alternative financial services: The customer experience https://momentum.org/wp-content/uploads/2018/02/Part-2-Experiences-with-High-Cost-Financial-Services.pdf

[26] National Consumer Law Center (nd). What states can do to help consumers: High cost loans https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/high-cost-loans-one-pager.pdf

7. 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?

Consumer education cannot be a substitute for consumer protection. The criminal rate of interest must be updated and lowered, be inclusive of all associated costs, and be rigorously enforced.

Given the proliferation of high-cost lenders in lower-income neighbourhoods, evidence of lenders ignoring the current criminal rate, the targeting of more vulnerable borrowers, ease of borrowing, dire need of many of the borrowers, and the welcomeness and convenience offered by fringe lenders (and missing from mainstream financial institutions), high-cost credit requires a legal intervention to address the harms.

Momentum has offered life-changing financial empowerment programming since 1999, the benefits of which are well articulated and celebrated by program participants. However, financial empowerment can only take place in a safe, fair, affordable market and is most successful when an individual has their basic needs met. High-cost credit undermines financial education and empowerment programs. Financial education alone is unlikely to reduce the harms.[27]

Further more, high-cost credit borrowers are not making an informed decision. They are making impossible decisions, between food or rent, medication or a vehicle repair, and the presence of scarcity makes problem solving in these scenarios, extremely difficult. [28] A quick fix quickly turns in to a nightmare but for a brief period of time one is able to escape eviction, hunger, and other needs.

It would be an egregious oversight to rely on, or even advance consumer education, in lieu of improved consumer lending regulations and legislation.[29]

8. Additional Opportunities for Reform

The 2007 decision to exempt payday lenders from adhering to the Criminal Code's maximum interest rate, and the transfer of regulatory responsibility for payday and other high-cost lending to the provinces, resulted in patchwork of inadequate regulation and enforcement across the country and enabled payday loan interest rates to soar, topping 600% in some jurisdictions.[30]

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[27] Willis, Lauren E., (2008). Against financial literacy education. Iowa Law Review, Vol. 94, U of Penn Law School, Public Law Research Paper No. 08-10, Loyola-LA Legal Studies Paper https://ssrn.com/abstract=1105384

[28] Harvard economist Sendhil Mullainathan and Princeton psychologist Eldar Shafir pre-eminent studies on scarcity show that time or financial scarcity results in poorer cognitive performance, including poorer decision making. Their studies revealed that simply raising monetary concerns erodes cognitive performance even more than being seriously sleep deprived. Mullainathan & Shafir (2013). Scarcity: Why having too little means so much. New York: Times Books, Henry Holt and Company.

[29] See for example, Willis, Lauren E.,(June 2005). Decision making & the limits of disclosure: The problem of predatory lending. Loyola-LA Legal Studies Research Paper No. 2005-14 http://dx.doi.org/10.2139/ssrn.748286

[30] Momentum (2014). The real cost of payday lending. https://momentum.org/wp-content/uploads/2018/02/Real-Cost-Payday-Lending.pdf

Recent reforms to predatory lending in numerous provinces have improved consumer protection but these reforms do not go far enough. For example, changes to the payday loan rules in Alberta have saved Albertans an estimated $10M annually in interest payments. Yet payday lending interest rates still often exceed the Criminal Code maximum at an effective 391% maximum. Many lenders have also now turned to promoting installment loans instead of payday loans, which are more profitable to lenders following provincial policy changes. [31] The repeal of section 347.1 and the consequent re-inclusion of payday loans under section 347 of the Criminal Code should be pursued over a transition period in which the federal government prepares a federally backed low-income credit product and supports the creation of safe/affordable alternatives.

Appendix A: Actuarial evidence of criminal rates of interest in Calgary.

This is included as a confidential addendum to our submission for the Department of Finance and not for full public disclosure. The evidence provided shows criminal rates of interest, often driven up by add-on fees and insurance, and points to the importance of ensuring the maximum rate is inclusive of all associated costs, including insurance (or prohibiting the sale of insurance), and ensuring there is adequate enforcement of the maximum rate.

[31] Momentum (January 2021). Creating change: Momentum's contribution to high-cost credit reform. https://files.momentum.org/wp-content/ uploads/2021/01/25091028/Creating-Change-Momentums-Contribution-to-High-Cost-Credit-Reform-in-Alberta-web.pdf