A report based on the Proposed Regulations for Payday Loan Establishments Public Consultation March 21, 2018.

Consumers

Payday loan borrowers are mostly financially challenged consumers that cannot qualify for a line of credit because they do not fulfill the requirements and their credit records are not sufficient. They apply for payday loans because these companies help them solve their immediate needs for cash when they are facing financial difficulties. It works as a bridge to help consumers between pay cheques. Overregulating this industry might quash the activity or prohibit it absolutely denying consumers access to credit, limiting their ability to maintain formal credit standing, or forcing them to seek costlier and unregulated alternatives.

Zoning Regulations

Through Bill 59, the Legislative Assembly of Ontario delegated to the Municipality of Toronto the power to prohibit the operation of a Payday Loan office in a defined area and to limit the number of offices that may operate in a defined area when the limit has been reached.

By allowing the Municipalities to establish zoning rules for payday loans, these businesses will be restricted and they will stop growing. This will affect the industry deeply, forcing companies and organizations to close their stores, fire employees, and terminate contracts.

Due to the effects this type of regulations can cause, the proposed rules shall clearly express the limits and details of the regulatory scheme. Some authors as Morgan,[1] have stated the negative effects of these zoning regulations. Big companies would be able to control pricing by reducing the consumers' choices based on market competition. This will enable local monopolies for the big companies while small competitors will be forced to close their stores because they cannot compete. Morgan explained this phenomenon by using automobile dealerships as a comparison. Each automobile brand has one dealer per city and it gets the local monopoly. In contrast, where there is a higher density of payday loan stores, there are lower prices, and thus the market is more competitive.

This measure leaves borrowers with less choice and gives existing lenders a local monopoly. Capping the number of stores might decrease the number of payday loans, but it will not help consumers and it will quash the payday loan industry forcing lenders to close the stores and creating more unemployment. Brian Dijkema[2], Program Director at Cardus, reached a similar conclusion as Morgan when analysing the new Hamilton rules for payday loan outlets. According to his studies, these measures will not help consumers it would just give one high-cost lender a monopoly on the area.

Small Businesses

The government and the people of Ontario have recognized that businesses and, in particular small businesses, are the foundation of the economic prosperity and the creation of jobs and wealth within the province. Policymakers should regulate businesses only to the extent necessary to protect human life, human health, the natural environment and the fair treatment of employees. While it is necessary for the government to make regulations dealing with businesses, too often governments pass regulations that harm businesses and damage Ontario's prosperity and economic competitiveness.

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[1] Donald P. Morgan, *Defining and Detecting Predatory Lending* (Federal Reserve Bank of New York Staff Report 2007)

[2] Retreat from: https://globalnews.ca/news/3959280/ontario-gets-f-for-capping-payday-loan-interest-rates/, and also, http://www.cbc.ca/news/canada/hamilton/payday-loans-1.4475152

Small businesses represent 95% of all employers in Ontario, and they employ 28% of Ontario's workers.[3] Businesses as an economic activity organized for the production of goods and / or provision of services are an economic, social and legal reality, which presents undeniable effects within the community. Even though the province has not recognized a Bill of Rights for small business, regulations should be reasonable, non-discriminatory, and neither vague nor overly broad.

Overregulated Industry

Bill 59 delegated more legislation to different authorities, including the Municipality of Toronto. One of the main concerns of this bill is the overregulation of this industry and the effects it could cause. Regulations as a form of law are legally binding. Members of the public are almost certainly impacted more often by executive rules, regulations and bylaws than by primary legislation; therefore, these interim regulations shall be meticulously considered.

Court decisions and many authors in Canada have discussed theories about delegated legislation. Even though this delegation of power might compromise participatory rights, this practice is authorized in Canada. Parliament delegates this power, so experts can actually analyze and consider each scenario carefully before passing the regulations that will affect and impact the public. In this case, the Municipality must regulate this activity with the attempt to legislate, structure or confine the practice of the business. They should not use this power to quash the activity or prohibit it absolutely.

Understanding The Cost of Borrowing

The Annual Percentage Interest Rate (APR) is a common currency for comparing the cost of credit. It equalizes the unit of time compared (one-year) and proportion of costs (percentage). However, this currency does not include the operating costs of the loan, risk

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3 Retreat from https://www.labour.gov.on.ca/english/atwork/smallbusiness.php

adjustments, or the short-term-versus long-term nature of the loan. [4] According to experts in this field, the APR is not an accurate measure to determine the cost of a short-term credit. It could be used to measure the cost and fees of longer-term loans such as mortgages, but it should not be used to measure payday loans. Small loans have different features. They have high fixed costs and are riskier than average loans. In order to regulate this industry, it is necessary to understand the figure and how this business operates. However, some policymakers and opponents mistakenly describe the loan cost in terms of an (APR).

The interest on a loan is designed to compound over the course of the loan's life. Thus, it is really important to determine if the loan is a short-term loan or a long-term loan. A payday loan, is a short-term loan against a future pay cheque. Regularly, the loan must be paid after two weeks or until the next pay cheque. The borrower has to pay the money within – weeks, but not years. This implied APR distorts the figure. It assumes payday loans are extended twenty-six times every two weeks during a year with the customer paying a new fee each time[5]. This is a flawed assumption.

Payday loan borrowers are mostly financially challenged consumers that cannot qualify for a line of credit because they do not fulfill the requirements and their credit records are not sufficient. They apply for payday loans because these companies help them solve their immediate needs for cash when they are facing financial difficulties. Unlike credit unions and banks, payday advances approval requirements are minimal; a recent pay stub or prove of employment and a photo identification are often enough for approval.

Payday lenders, like all lenders, are providing a service. Thus, a sum has to be charged to cover the full set of costs involved in the delivery of this service. The fees charged are a fair return given the risk payday lenders have to face. Because the application requirements are minimal and they are uncollateralized loans, it is almost impossible to recover the principal loan amount on a bad loan. Additionally, payday loan fees include per-loan processing costs, costs associated with credit scoring, costs of rent, utilities, and labour. These costs are independent of the loan volume and are higher than the costs for larger loans because these have greater revenue. For example; loan revenue per mortgage exceeds

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4 Jopei Shih, "Payday lending: a thin line between love and hate" (2011) 3:1 Faulkner L. Rev. 37.

5 William M. Webster, "Payday Loan Prohibitions: Protecting Financially Challenged Consumers or Pushing Them over the Edge?" (2012) 69:2 Wash Lee Law Rev. 1051.

loan revenue received per payday loan because payday loan dollar amounts are so small. Thus, payday loans do not earn excess returns; on the contrary, many studies show payday lenders are charging break-even prices in a competitive market for the services they provide.[6]

Legal Framework

The Payday Loans Act, 2008 delegates the power to determine the cost of borrowing a payday loan to the Government. To regulate this effectively, the regulatory body needs to understand the business and examine empirical studies that translate the total costs of borrowing.

Recent data and historical financial information is essential to calculate and determine the true cost of borrowing. For example, in 2015, Deloitte LLP collected data and other relevant information to release a report related to the cost of providing payday loans in the Province of Alberta[7]. This report estimated the cost of providing a $100 payday loan in Alberta to be $20.74. This is the most recent report and even though it is not based on Ontarian payday lenders, it gives a clear and complete perspective about the costs of borrowing a payday loan. It studies and reviews the total operating costs of this type of business based on recent data and information.

Despite these reports and the opinion of most consumers who have expressed their concern because banning payday loans is not going to resolve and settle consumers' debts and needs, the government reduced the maximum total cost of borrowing to $15 per $100 advanced for 2018. These regulations will stop the growing of these businesses completely, forcing small companies to close. Eventually, this will not allow payday lenders to make a profit, or even cover their costs. It seems that the government's true intent is to outlaw payday lenders. Once again, respectfully, we believe, the government should regulate this activity with the attempt to legislate, structure or confine the practice of the business. They should not use this power to quash the activity or prohibit it absolutely.

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[6] Victor Stango, "Are payday lending markets competitive? Despite their claims, credit unions seem unable to offer competitive payday loans" (2012) 35:3 Regulation Washington. 26.

[7] Summary of the 2015 Survey on the Cost of Providing Payday Loans in Alberta, Deloitte LLP (March 23, 2016)

United States Experience

Attempts to deal with payday loans without proper consideration, public scrutiny and objective criteria may be ineffective or even counterproductive.

All possible factors should be taken into consideration before repeating the same mistakes that affected numerous communities in the United States.

Evidence gathered in the United States after banning payday loans in some states, indicates payday loan usage declines following the bans; however, this reduction is offset by an increase in the amount of borrowing from auto-title loans and pawn shops.[8] Arguably, auto-title loans are more expensive and can cause more damages to consumers because title lenders can seize the car, even if the vehicle is worth more than the principal owed.[9] By reducing the cost of borrowing and also placing a cap on the number of establishments in Toronto, the usage of payday loans may decline at first, but the necessity that creates the demand for this business will continue to exist. This will force consumers to seek more expensive and unregulated alternatives. Additionally, these changes will force companies to close their stores. First, they will try to adapt to these changes by laying off employees and reducing their costs, but eventually, they will have to go out of business. As a result, thousands of people will lose their jobs and stability. Stores and offices will have to close. Tenancy, leasing, and many other agreements will have to be terminated.

This type of measures will not help financially challenged consumers. They will neither improve the consumers' financial situation nor will improve the province's economy. Indeed, this will damage communities that already have few options for financial services. Before eliminating options for consumers, the government should take advantage and learn from the United States' experience. They should not be looking to eradicate the service payday loans offer, but to improve it. Education should be the top priority for consumers who are facing financial difficulties.

[8] Neil Bhutta, Jacob Goldin, Tatiana Homonoff. *Consumer Borrowing After Payday Loan Bans.* Used data from the Population Survey and the Federal Reserve Bank of New York's Consumer Credit Panel. November 24, 2014.
[9] *Ibid*

The US Federal Reserve Bank released a report[10] in November 2007 that examined the effects after fee ceilings effectively banned payday lending in Georgia and North Carolina. The report showed that banning payday lenders forced borrowers to seek more expensive and less favorable alternatives for emergency funds, such as bank overdrafts that lead to more severe long-term problems. Households in Georgia also bounced more cheques, complained more to the Federal Trade commission about lenders and debt collectors, and had higher rates of filing for Chapter 7 bankruptcy protection than all other 50 states at this time.

Predatory Lending?

Critics affirm payday loans are predatory because they "prey" upon the poor and uneducated minorities; however, evidence suggests this statement is not accurate. The Financial Consumer Agency of Canada (FCAC) conducted a national study about payday loans. By October 25, 2016 this report showed payday loan use is not restricted to low-income Canadians.[11] Borrowers are not uneducated people who live on welfare or disability pensions. They are categorized as people who work all year, or at the minimum, work at least six months throughout the year. Nonetheless, their salary is not enough to cover their needs or sometimes their unexpected periodical financial emergencies forcing them to apply for credit or use some alternative financial mechanism.

Payday lenders are not "targeting or manipulating" minorities. Minority neighborhoods may attract payday lenders because they are working-class neighborhoods. These are the areas where the financially challenged people live and work. Payday lenders are not targeting them. As business owners, they are thinking strategically by locating their stores where markets exist. We cannot forget this is a business offering a service and not a charity.

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[10] Morgan, Donald and Strain, Michael. *Payday Holiday: How Households Fare after Payday Credit Bans.* Federal Reserve Bank of New York Staff Report. 2008. These effects were significant in Georgia, but mixed significance in North Carolina.

[11] Payday Loans Market Trends, The Financial Consumer Agency of Canada (October 25, 2016)

Source of Debt

Besides categorizing this industry as predatory, opponents have consistently argued that payday loans represent a significant source of debt within the community. Payday loans are being categorized as the responsible source of debt for households who have applied for bankruptcy. However, recent reports showed only 4% of Canadian Households resorted to a payday loan by 2014.[12] Additionally, this report showed most payday loans taken out were relatively small in value.[13] Twenty percent reported loans of $500 - $1,000, while only four percent reported loans of $1,001-$1,500. Lack of objectivity can lead to inaccurate assumptions that categorize this industry as malefic and predatory. Therefore, the importance of using objective criteria such as these studies and reports.

Consumers are financially challenged, but they are not mentally challenged. They are not forced or tricked into taking the loan. As mentioned before the FCAC corroborates that payday loan usage is not restricted to low-income uneducated Canadians. In 2014, four percent of Canadian adults reported that their household resorted to a payday loan. Not all these consumers ended bankrupt after taking the loan. Not all of them represent the debt of this community. The majority use it to bridge emergencies and they would be worse off if they did not have this option. On the other hand, some consumers defaulted and filed for bankruptcy because they have consistent unrealistic expectations about their income. Education is the key. This should be included in the legislation: a way to educate people, especially those who irrationally use payday loans, but consumers that use payday loans rationally to overcome financial difficulties should not be punished. Even the Minister of Government and Consumer Services admitted, during the debates of Bill 59, that consumer groups have expressed to the government their concerns because payday loans represent an important community source of money for people who do not have access to other forms of credit.

Individuals facing financial distress prefer payday loans from other financial mechanisms such as pawnshops, bank overdraft protection, credit card cash advances and informal lenders or loan sharks. Payday loan borrowers choose this alternative because it meets their needs without too much paperwork and credit requirements. Borrowers are fully

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[12] *Ibid* p.2
[13] *Ibid* p.6

informed about the different alternatives they have and their correlated fees. They choose this because it is the best choice for them according to their short-term emergency cash needs. Indeed, under each provincial legislation for payday loans, lenders must clearly disclose the terms and fees of each payday advance.

Other Alternatives

The proposed regulations should be cautiously considered because they could actually ban and quashed this type of business as will be explained in more detail later. Banning, or severely restricting payday lending as proposed, may hurt the very consumers the government is trying to protect. The government introduced these changes to protect consumers. They want to decrease the demand for this kind of service in the community. Their long-term goal is to ban payday loans and promote short-term loans offered by credit unions and banks with lower rates. However, despite their claims, credit unions, and banks seem unable to offer competitive payday loans at lower rates. In fact, past experiences indicate this market is unattractive for credit unions and banks.

Despite attempts from regulators and other parties to encourage these institutions to offer such loans at no more than 36% APR, it does not appear that financial institutions may be able to do so in competitive terms because making the loan this way would not be profitable. Moreover, various other efforts implemented in Canada and United States, to develop innovative credit programs that can meet these consumers' needs have shown little or no progress. *Existing credit options, therefore, ought to be preserved, not reduced.*

Why banks and credit unions do not offer payday loans?

Most banking institutions and credit unions do not offer short-term, uncollateralized loans at below market fees and rates because it is too difficult to offset default risk. These financial institutions impose certain income and credit history requirements that applicants have to meet to obtain approval. Few of them may actually offer lower interest rates to consumers; however, due to the various fees and conditions of these services most of those consumers do not have access to these loans and the percentage of people that ends up being approved prefers payday loans for its special features.

According to the Canadian Bankers Association, banks are accessible to everyone and their objective is to help those in debt. However, when expense or income shocks arrive, banks usually do not provide these constrained borrowers with distress loans because they believe that providing additional credit to someone who already has trouble managing their debt will not help that person. Nonetheless, as a courtesy to those clients, they allow cheques to go through accounts which balances are insufficient to overdraw the account and charge customers' fees and interests for each transaction that goes through when the person does not hold sufficient funds in the account.

Denying access to these financially challenged consumers to "protect" them, but at the same time offer them costlier credit alternatives such as overdraft fees and credit cards makes their financial situation worse. This constitutes a real cycle of debt. Instead of helping distressed individuals bridge financial shortfalls by enabling them to smooth liquidity shocks, these temporary alternatives could limit and destroy their access to any kind of credit in the future. Creating more problems to manage their debt and recover.

Overdraft fees and Credit Cards

Most banks are reluctant to offer payday loans not only because of the risk, but also because they earn greater marginal returns on checking overdrafts. Indeed, overdraft revenue is one of the greatest components of non-interest income for banks.[14] Overdraft protection plans have higher interests rates and fees in comparison to payday loans. Their terms and conditions could cause serious repercussions for customers in the long run.

Under these circumstances, the main alternatives to payday lending for individuals in distress are bank overdraft programs and bounced cheques. Bouncing cheques fees' range between $45-$50 dollars for each transaction. They add an implicit cost via a negative entry on one's credit history, which does not happen with payday borrowing. Bank overdraft

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[14] Stango, supra note 9 at p. 29

programs differ from bounced cheques in that banks pre-agree to clear the overdraft cheque(s) for a fee. Overdraft loans are cheaper for the borrower than bouncing cheques since the borrower gains more time to repay the debt. Nevertheless, the overdraft fees can be quite high in annual percentage rate (APR) terms, especially if the cheques overdrew were for small face values.

Unlike payday loans, which charge only a regulated flat fee for providing direct cash, bank overdraft programs work automatically with cheques and debit cards. Customers often don't even realize they have overdrawn their checking and savings accounts until they are notified by from the bank. The Canadian Imperial Bank of Commerce, for example, charges $5 for going into overdraft and an additional $5 every time another transaction is added to the account. It does provide the option of paying a $4 monthly fee to avoid multiple charges. Overdraft fees are in addition to interest charges on the outstanding overdraft amount.[15]

CIBC's interest rate is currently 21% per year and may vary from time to time. Interest will be calculated and debited monthly to the account based on the final daily indebtedness in the account throughout the calendar month. The interest rate set by CIBC will apply both before and after CIBC Overdraft Protection Service is terminated, and before and after judgment is obtained against the customer.

Under Canadian legislation, payday lenders are not allowed to make unauthorized withdrawals from the borrowers' account. On the contrary, banks are allowed to set off the account when a customer creates an overdraft with a debit card. They are authorized to repay the debt themselves immediately when the customer deposits funds into the account.

Deposits are immediately and automatically applied against the overdrawn balance, which must be paid within 89 days. This applies for both; the general costs and the overdraft fees. At least once every 90 days, the deposits must be sufficient to bring the account into a positive balance for at least one full business day.

[15] Retreat from https://www.cibc.com/content/dam/personal_banking/bank_accounts/pdfs/personal-acct-service-fees-en.pdf

The impact of this negative credit score can be devastating

Many of these low-income people get trapped into this large cycle of debt and fees to the point where they cannot pay them all. When this occurs, banks close the indebted accounts and it is extremely difficult for people to open accounts at other banks. They are effectively shut off from formal banking.

Banks are taking advantage of these working-class customers who live pay cheque by pay cheque. They manipulate customers stating this is a service that will protect them from occasional shortfalls given them peace of mind when in reality this could affect the customer's credit records and access to any kind of credit in the future. On the other hand, on payday lending, if the individual is not able to cover the cheque, he or she has the possibility to return to the payday store and refinance the loan or negotiate the payment by instalments and with no interests charged.

Consumer's reality

Most Canadians live pay cheque to pay cheque, and sometimes they need two jobs to support themselves and survive. The major problem of this financially challenged sector of the population is the absence of savings or financial liquidity that helps them meet their unexpected needs. The wages they earn are low, so they are unable to save money or accumulate any real collateral as real estate and other assets. During their lifetime, those individuals frequently experience some sort of personal emergency such as; a medical emergency or a car breakdown. Traditional financial institutions do not offer such consumers affordable, unsecured cash loans whether because this is not a profitable activity for them, or because the applicants do not meet the requirements based on their credit records and their lack of assets to secure the traditional loans.

The Municipality should consider the consequences of these restrictions and how could this affect consumers' needs in the future because banning payday loans is not going to resolve and settle consumers' debts and needs. Millions of consumers periodically need short-term small dollar loans to deal with unexpected or unbudgeted expenses. These customers' credit needs are immediate, so if actions to restrict the markets are going to be taken, policymakers need to create alternatives in lieu of these payday advances first.

Customers cannot wait for the development of other low-cost credit options at some later point.

As a payday loan company with years of training and experience within this industry, respectfully we want to submit this article to express our point of view based on recent data and studies conducted in the United States.

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