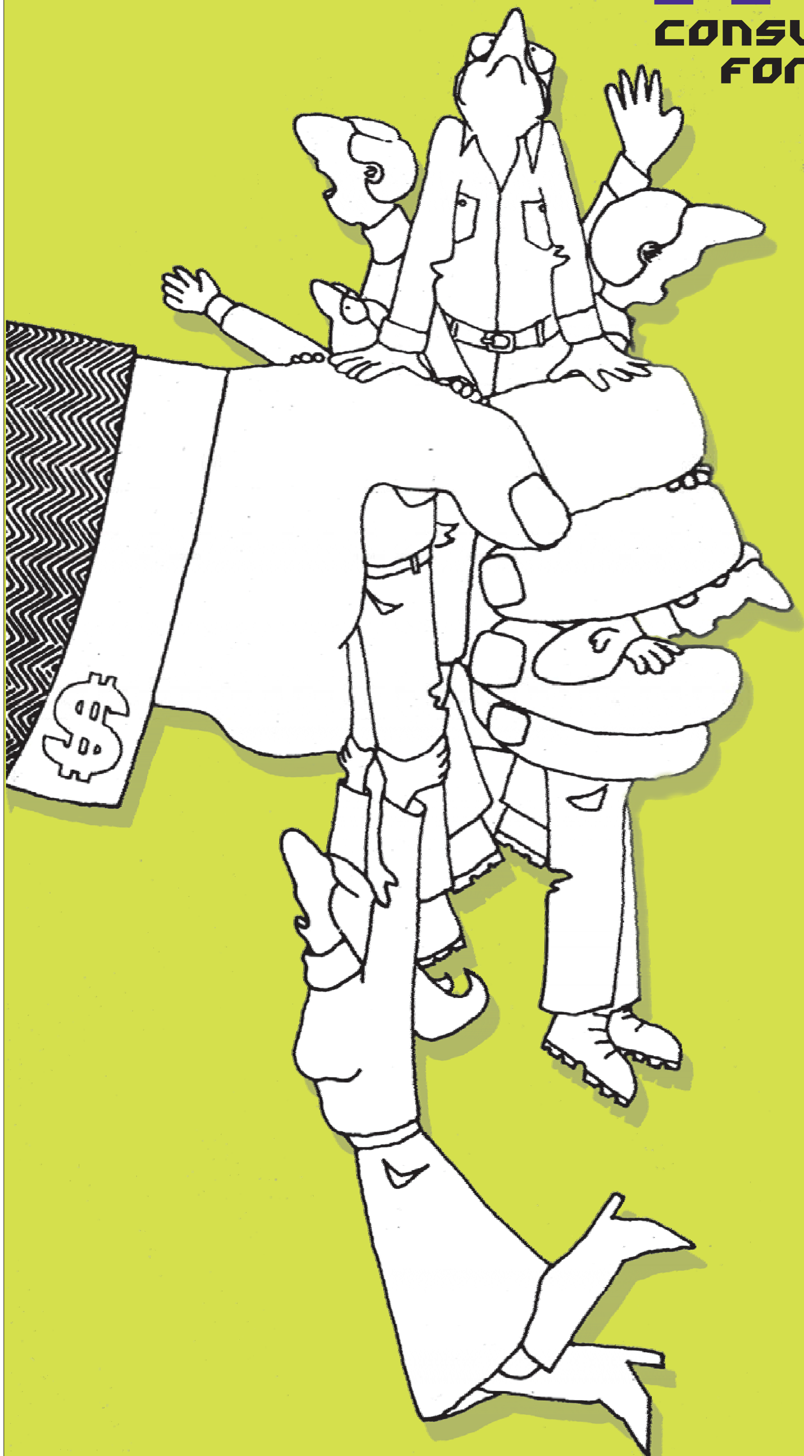
SMART MONEY

CONSUMER SELF-DEFENCE FOR TIMES LIKE THESE



Scavengers in the Debt Crisis: Payday Loans

national union

Payday loans

Scavengers in the debt crisis

PAYDAY LOAN companies are part of a relatively new trend in Canada. In 1993, these companies were virtually non-existent; today, the country now has over 1,350 outlets. It is estimated that about two million Canadians borrow about $2 billion a year.

While payday loan storefronts started in primarily disadvantaged neighbourhoods targeting lower income customers, we now find them on major street corners, many outside the door of major banks. Now with rising unemployment and a slowing economy, more and more middle income families are being squeezed and need to rely on various means to stretch each paycheque. In 2007, the Canadian Centre for Policy Alternatives found that 49% of Canadians reported being one or two paycheques away from being poor.

Big banks themselves have also had a role in growing this phenomenon. Over the last decade, big banks have cut back on hours and tellers not to mention, in some cases, closed branches entirely in what they consider to be less profitable areas. These decisions played into the hands of these gouging money lenders. Some companies are open 24/7 or have on-line applications which allow almost instant access to needed funds. Convenience and relaxed lending rules are attractive to many people who are not served well by major banks.

It does not help that banks find it unprofitable to provide short-term loans at all, let alone to people considered "high risk" - people who don't own homes, who make a modest salary or who don't have a long and clean credit history. It has driven people to riskier alternatives and sometimes to financial ruin.

As the recession continues and the economic pressure builds on families, people will have no choice but to continue to keep on looking to find assistance wherever possible.

What is a payday loan?

PAYDAY LOAN companies offer various services including cheque cashing, wire transfers, advances on tax refunds, foreign currency exchange, bill payments and pre-paid credit cards. But most of what they do is make "payday loans."

A payday loan is a short-term cash advance based on your next paycheque. Many lenders allow up to half of the next paycheque to be borrowed generally over a two week period. All that is required to receive a loan is personal identification, evidence of employment and income and in most cases a bank account. Repayment can be made either by post-dated cheque or automatic debit withdrawal on or before the due date.

The major problem with these types of loans is the excessive interest rates and fees that are charged on top of the money borrowed. In a 2004 Toronto Star investigation, the newspaper found that loans carried an annualized interest rate of between 390% and 891%. Some customers report interest rates of up to 1000% annually.

For example, on a two week loan of $300 the customer would be charged, in some cases, $93 in interest, much more than what a bank or credit card company would charge.

Paying back the loan plus the enormous interest rates can eat up the minimal disposable income the customer has, often pushing them into taking another loan (back-to-back loans) or "rolling over" the loan until the next payday. Extra fees are always charged for these services and interest continues to climb. The credit spiral continues to shoot upward with some people taking out multiple loans from various lenders.

Widening gaps

THE GAP between the rich and poor in Canada and the United States continues to widen. As it does, Canada becomes an even more attractive market to exploit for the payday companies from south of the border. The effects of our current recession continue to impact our daily lives. In May 2009, the unemployment rate inched up to 8.4% nationally, the highest it has been in 11 years.

Hundreds of thousands of workers have been displaced due to the decline in the forestry and manufacturing sectors while others have watched as their workplaces have been closed down and their jobs shipped out of the country. It is nearly impossible to find comparable work on a shrinking landscape. Many are forced to take on several part-time jobs, forgo benefits and start from scratch.

When layoffs occur, expenses and debts don't disappear. People struggle to make ends meet and often have to make difficult choices. The idea of taking out a small short-term loan, even at high interest rates, to stave off a cheque bouncing or going over the limit on a credit card which will increase the card's interest rate or to cover an emergency expense, seems like a small price to pay at first. Without a secure way to repay these loans, the debt spiral is easily started.

Making matters worse

THE PAYDAY LOAN industry has had virtually no regulation since it appeared on the Canadian scene. The only regulation, originally designed to target loan sharks, is contained with the federal Criminal Code. Section 347 stipulates that interest rates cannot exceed 60% annually. In 2006, the federal government amended the Code to transfer responsibility to the provinces for regulation of the industry. Once the regulations are established, payday loan companies are exempt from this Criminal Code provision.

Slowly, provinces began to create legislation to curb many of the lending practices but even after legislation has been introduced regulations have been slow to take effect.

BRITISH COLUMBIA

LEGISLATION PASSED

2007; effective November 2009

INTEREST RATE

23% ($23 per $100 borrowed)

HIGHLIGHTS

- License fees $1,500; plus $750 for additional offices
- Prevents lending more than 50% of next cheque
- Bans concurrent loans
- Bans roll-over loans
- Must post annual interest rates

ALBERTA

LEGISLATION PASSED

2009

INTEREST RATE

23%

HIGHLIGHTS

- Two day cooling off period to return money without fees
- Must use plain language contracts
- Must post costs
- Bans roll-over loans

SASKATCHEWAN

LEGISLATION

Introduced March 2007; law not proclaimed

INTEREST RATE

To be determined

HIGHLIGHTS

- License required
- Post notices that it is a high-cost loan
- 24 hour cooling off period without fees

- Post notices of all rates, fees, charges and penalties
- Bans concurrent loans
- Limits the amount of a loan

MANITOBA

LEGISLATION

Amendments to the *Consumer Protection Act* introduced April 2008 to establish the maximum interest; payday loan legislation passed November 2006

INTEREST RATE

17% for loans up to $500; 6% for loans up to $1,500

HIGHLIGHTS

- License required
- Must provide full information to borrower
- Government will start a financial literacy campaign

Note: The Manitoba Public Utilities Board instituted a regulation capping interest rates at 17% on loans of $500 and less for smaller loans. The Cash Store took the MPUB to court and the court ruled in the company's favour. The Manitoba government went forward with independent legislation.

ONTARIO

LEGISLATION

Legislation effective April 2009; July 2009 for some practices

INTEREST RATE

21%

HIGHLIGHTS

- License required
- Bans roll-over loans
- Cooling off period to cancel loans without fees

QUEBEC

LEGISLATION

Only consumer protection legislation

INTEREST RATE

35%

HIGHLIGHTS

- Office de la protection du consommateur licenses lenders
- No payday lenders legally operate in Quebec

NEW BRUNSWICK

LEGISLATION

Cost of Credit disclosure and *Payday Loans Act* passed April 2008

INTEREST RATE

To be determined. Set by the New Brunswick Energy and Utilities Board

HIGHLIGHTS

- Waiting period of 60 days between loans
- Show proof of employment
- Each office must be licensed
- Loans limited to $1,500
- Clear information on all costs and annual interest rate
- Statement that it is a high cost loan
- 48 hour cooling off period without fees
- no roll-over loans
- no concurrent loans
- limit on amounts payable on default

FIGHTING BACK

JUNE 2009

Settlement reached with Money Mart

• 264,000 borrowers freed of $43 million in charges

• receive $27.5 million in cash settlements

• receive additional $30 million in coupons for use in future dealings

NOVA SCOTIA

LEGISLATION

Amended *Consumer Protection Act*; November 2006

INTEREST RATE

31% over a two week period

HIGHLIGHTS

- Loans limited to $1,500 for 62 days or less
- Maximum default fees: $40
- $3,000 licensing fee
- no roll-over loans
- 24 hour cooling off period without fees
- clear information on all costs and annual interest rates

PRINCE EDWARD ISLAND

LEGISLATION

Passed April 2009

INTEREST RATE

To be determined

HIGHLIGHTS

- 48 hour cooling off period without fees
- no roll-over loans
- full disclosure of costs

NEWFOUNDLAND AND LABRADOR

LEGISLATION

Consumer Protection Act

INTEREST RATE

None

HIGHLIGHTS

- Full disclosure of costs
- Must be licensed

Fighting back

SINCE PROVINCES were slow to adopt any specific measures to regulate the industry, a number of court cases were launched arguing that the excessive interest rates and fees violate Section 347 of the Criminal Code.

In August 2006, the Supreme Court of British Columbia found A OK Payday Loans Inc. guilty of charging interest rates above the 60% maximum per year. The company was forced to repay fees. The judge described the company's actions as "unconscionable" and "inequitable."

On the other side of the coin, when the Manitoba government tried to put a cap on the maximum cost of credit at 17% for loans of $500 and 6% for loans of $1,500 the court sided with the industry and ruled that the industry had been unfairly treated. The government is now reconsidering its options.

Most recently, in June 2009, the two sides in one of the biggest cases in the country, reached a settlement. The class action lawsuit, launched in Ontario in 2003, accused Money Mart and its parent company Dollar Financial of charging illegal interest rates. In this agreement the 264,000 plaintiffs will have their debt of $43 million forgiven, will receive $27.5 million in cash and $30 million in coupons that can be used in future loan transactions. The parties are awaiting approval by the courts.

This settlement is expected to have broad impact. Many other suits launched against payday loan operators are built on the same legal arguments used in this case.

Big banks eager to cash in

IN THE UNITED STATES, 93% of borrowers repay their loans. This evidence indicates that the borrowers are not high risk users and deserve to have access to some relief. Many people borrow these short-term loans to avoid major charges by the big banks. If the banks reconsider these charges and provide more flexibility, people would not be driven to such potentially financially damaging measures. In 2008, despite tough financial times, Canadian big banks made approximately $16 billion in profit.

Recently BHM Financial Group decided to provide smaller payday loan companies with the ability to offer larger loans than they normally offer. Companies can use BHM as a broker to access larger loans from $1,000 to $10,000. Payday loans are typically for small amounts, ones that banks may not offer over a short period of time. With companies now having access to higher amounts to loan out, we could see the industry start lobbying to remove any caps on loan amounts that currently exist. It is not likely any of the chartered banks will try to stop this. Even the big banks seem keen on covering the entire market when it comes to debt financing. For example, VCF Inc. is a company that provides high interest car loans mainly through dealerships. Who owns 99.9% of the stock? The Toronto Dominion Bank does.

Despite the addition of new regulations and the changing face of customers, the industry is still targeting vulnerable users who will have difficulty recovering from the cycle of debt they offer. Governments must go further to curb, what still remain, excessive fees and interest rates.

In the United States as of June 2009, 15 states had regulations governing the payday loan industry. Others are contemplating similar legislation.

In 2008, through the Federal Deposit Insurance Corporation, banks began a pilot program to offer small loans as a way to replace the payday lenders. The loans are restricted to under $2,500 and the interest rate is capped at 36%.

Early status reports indicate that in the four months 31 banks issued 3,140 loans, 1,535 of which were for under $1,000. The interest rate was less than the capped rate at 15.05% over ten months.

On June 11, 2009, in the U.S. Senate, a new bill made it to committee that would limit collection of high interest rate loans from consumers in bankruptcy court. The *Consumer Fairness Credit Act* covers a variety of high interest loans such as credit card agreements, payday loans, car title loans and overdraft fees.

The Act would create an interest rate threshold of 19.80%. The intention is to allow consumers to negotiate a better rate with the threat of filing for bankruptcy.

Ultimately, the crux of the issue is the excessive fees and interest rates companies are allowed to charge. Even with the provinces capping interest rates, the range of rates are considerably more than even what banks and credit card companies charge for borrowing.

Steps forward

GOVERNMENTS ARE eager to conduct financial education campaigns - but they have shown little or no desire to deal directly with what drives people to take out a loan from a payday lender in the first place.

When the Harper government gave the provinces the ability to regulate the payday loan industry, the provinces missed an opportunity to help people who are struggling in this economy. Instead of capping rates and fees at realistic levels, governments bent to the pressure of the lender lobby to maintain excessive rates.

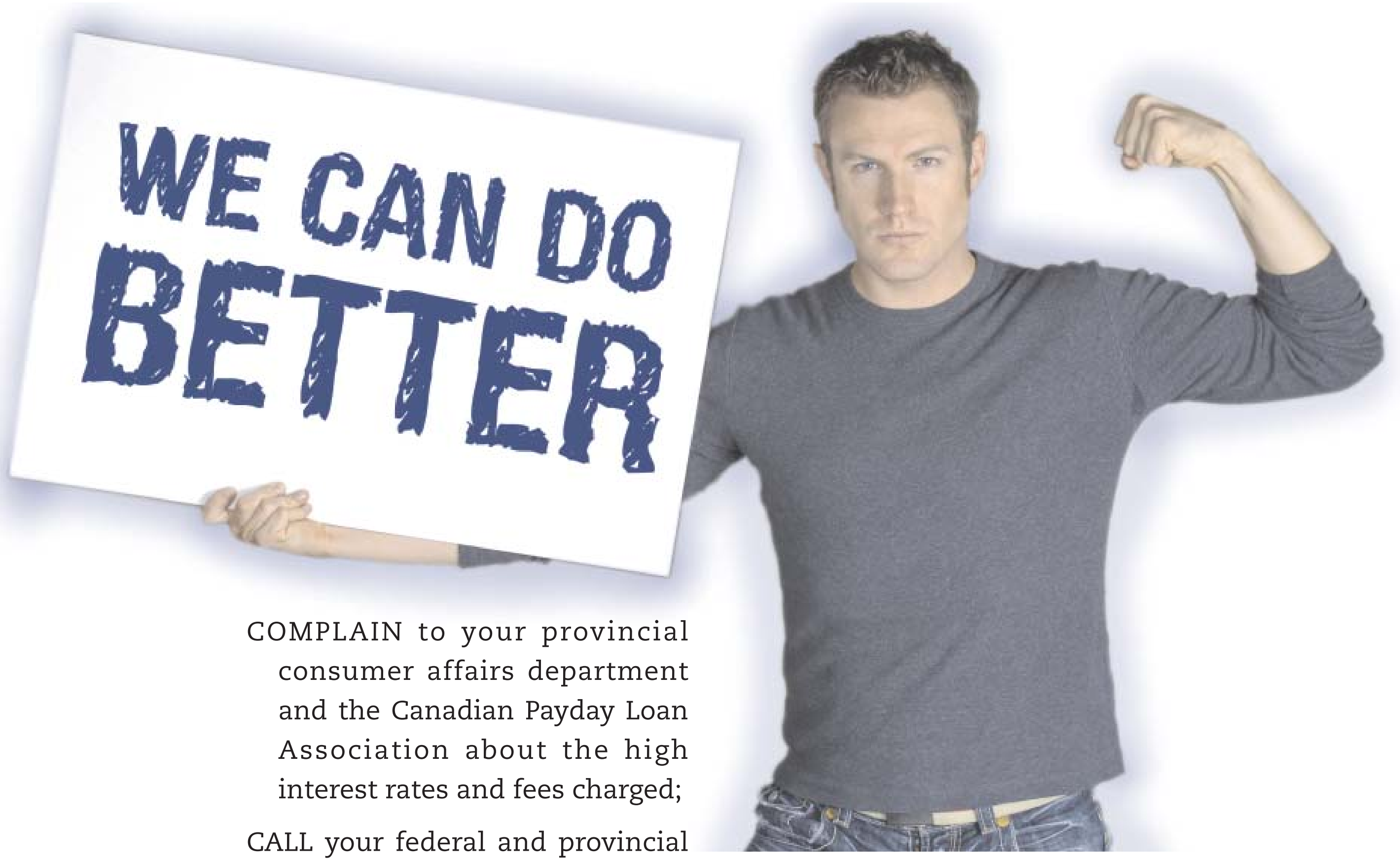
While limiting some of the conditions lenders can offer to customers, the worst offence is the high interest rates that make loans difficult to repay.

It was a mistake for the Harper government to so easily abandon its responsibility for governance of the industry. Provinces have been slow and/ or unwilling to take on the challenge of ensuring that every consumer is treated fairly no matter where they live. The federal government can work with the provinces to:

- Set a uniform ceiling for borrowing rates;
- Demand transparent disclosure of fees, rates and penalties;
- Develop effective financial education campaigns for consumers;
- Encourage banks to develop alternative small loan lending programs and re-examine industry barriers to credit;
- Address the underlying issues that force people into situations that require a short-term loan by:
  - ☑ create real full-time jobs;
  - ☑ fix Employment Insurance;
  - ☑ invest in retraining programs to help those out of work.

What we can do

In 2004, the Ontario Consumer and Business Services department received over 60,000 complaints with only six being about payday loans. It is not surprising that people who are juggling multiple jobs, family responsibilities and trying to make ends meet have little time to engage in a complaint process. This needs to change. Complaints can and should be lodged regarding abusive and predatory practices by any organization or company.



COMPLAIN to your provincial consumer affairs department and the Canadian Payday Loan Association about the high interest rates and fees charged;

CALL your federal and provincial government representatives to urge them to protect consumers from high interest rates and fees, create real jobs and invest in support programs that can replace predatory loans;

VISIT www.peoplesresponse.ca for more information about campaigns to improve our economy.