Testimony to Standing Committee on Social Policy on Putting Consumers First Act (Bill 59)

MONDAY, FEBRUARY 27, 2017 AT 4:20 P.M.

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Mr. Chair and members of the committee,

My name is Brian Dijkema and I am the Program Director for Work & Economics at the think-tank Cardus. I want to thank you for inviting me to share the research on payday lending which my colleagues and I have published in our report “Banking on the Margins” and in subsequent submissions to the government.

This is not a new problem. Charging high interest rates to those in desperate need of money, also known as usury, has been condemned throughout history. It was already decried by the prophet Ezekiel, circa 500 CE, in the Quran and the Old Testament. And for generations by parliaments of various political stripes starting in the 1900’s, again in 1967 when it was studied by the Federal Parliament under Pearson, and here again in the 21st century. The solution to usury has eluded so many, for so long, that one might be tempted to simply to give up and say there is no solution.

Friends, there is no solution. But that doesn’t mean we should give up trying to help those who need better small dollar credit alternatives.

I’m encouraged that the government’s work on Bill 59, and Bill 156 shows that you haven’t given up trying use appropriate legislative measures to enable a better market, and I want to thank you for that. I’m also very encouraged by the clear-eyed and collegial work being done by all parties on this important issue.

Bill 59 is best viewed as the twin of Bill 156 which addresses the interest rates that payday lenders can charge in this province. They represent two parts of a larger project and I would encourage this committee to view these changes in that way.

In our input on Bill 156, we noted that interest rate reduction does little to address the real challenge of payday lending to the consumer: its effect on cash flow. Our analysis of the financials of payday lenders suggests that the bottom rate, should be 17 percent, if there are no other changes. We encourage prudence in this regard. Rate reductions, overall, have little effect on the borrower’s cash flow and, especially in light of recent changes in Alberta, will very likely lead to a restriction on available credit without addressing demand. Don’t lean too heavily on rate reductions as a panacea.

Thankfully, Bill 59 goes some way to adding new planks that *do* stand to benefit borrowers. According to our research, we believe that three elements of this Bill will benefit borrowers, and three will be non-factors, or redundant. We recommend that the committee keep a tight focus on the former. In particular:

1. Reducing repeat borrowing and multiple loans to the same customer will limit the ability of borrowers to build a business model on dependence. As we note in our paper, and as can be seen from various lenders’ drug-dealer type offers of a “first hit for free,” the business structure of many lenders is built on encouraging repeat lending even if it would otherwise not be necessary. The parts of the bill that address this are prudent.

2. Likewise, requiring lenders to consider the financial situation of the borrower – and particularly their ability to repay the loan – encourages not only sound business practice, but discourages the movement of a necessary one-time loan from turning into a repeated loan and cycle of dependency.

3. Finally, the move to open space for instalment lending and away from lump-sum repayments should be pursued vigorously. As we note in our paper, the financial damage to the consumer comes most from the shock that paying both the principal and interest at once – so called "balloon payments" – gives to the consumer's cash-flow. As we note in our paper, paying attention to the consumer's cash flow (and ultimately growing it) should be in the forefront of policy-makers' minds. (More on this final point, in a moment.)

However, our research suggests there are items in Bill 59 that will either be unhelpful, redundant, or pose considerable risk for negative unforeseen circumstances.

1. First, the devolution of power to regulate where payday lenders can set up shop requires more thought. I know municipalities have called for this, and many will use this power well. However, it creates the very real possibility that lenders will be completely zoned out. As with gentrification and poverty the result will not be *less* borrowing, but a forced movement of the problem elsewhere. It also raises questions about the provinces' overall framework for devolving authority to municipalities.

    1. The sections of the bill aimed at advertising are redundant. There are already good laws in place on advertising and, as much as I loathe many of the ads that payday lenders use, it is unlikely to make any material difference to the market.

    2. Likewise, provisions aimed at disclosure and information are redundant. Ontario already has very strong laws in this regard. It is difficult to foresee how these provisions can improve on them, and easy to see how they will add just a bit more cost to providers in ways that don't achieve any particular, or unique, policy goal.

    3. On these particular parts of the legislation, it's important to remember that the vast majority of borrowers are, in fact, acting rationally given their options. There is evidence to suggest that some customers are borrowing without knowledge of the costs, but that has to be weighed against evidence that shows that those in this demographic are in general prudent, rational, money managers, and against already strong disclosure laws. Borrowers should not be considered more easily duped than anyone else. They are generally intelligent people who borrow because their choices are constrained. We should avoid legislation that would even hint otherwise. They're not out of their minds, they're just out of options.

Which leads me to my conclusion. We need a better market that increases these options. It is currently the case that payday loans are a terrible option, but better than the alternatives – NSF's, loan-sharks, arrears, loss of one's job, or banal things like hydro disconnection charges. A bad choice is better than a worse choice.

But don't interpret this as an approval of the status quo. The payday loan industry currently steps lightly on a borrower's neck when they're down and then applauds itself for allowing the borrower to breathe. Instead of this, we should want to give these people a hand up. To enable them. Our banks could do this, but they prefer to spend money purchasing the public's good will through CSR campaigns unrelated to their financial value chain. And their corporate structure, as well as our current regulatory framework for finance, encourages the wrong kind of conservatism on matters where innovation could provide real returns to those who need it. We can do better.

Which is why we would encourage this committee, and the government, to take the next step. As we note in our paper, building a better credit market requires government to look beyond *restrictions* aimed at suppliers of payday loans – as both Bill 156 and Bill 59 do – and focus on ways it can *enable* innovative ways for financial and civil society institutions to meet demand. That demand is real and, even with significant mitigation of income challenges via work or government transfers, it's not going to go away. Nor can government meet that demand. It *can*, however, assist those with the competency and jurisdiction to offer small sum credit alternatives. We've proposed a few ways to do this:

1. Creating social impact bonds that could provide capital for, and a return to, those who achieve a social policy objective – in this offering of small dollar loan alternatives, or the achievement of a defined social return associated with payday lending.

    1. Dedication of a small amount of funds to act as a backstop to loan losses for alternative start-ups, again tied to clearly defined objectives, and with a defined sunset.

    2. A removal of regulatory barriers standing in the way of civil society institutions, including charitable institutions like churches, mosques, synagogues, temples, and community foundations, from providing capital and partnering with community based financial institutions.

    3. Consultation with financial tech firms and banks to discover where regulatory hurdles a preventing innovation.

    4. In each case, the government's focus should be on assisting financially prudent, community-based, market oriented alternatives to enter and change the market.

We look forward to continuing to work with the government and all those trying to build an enabling credit market for Ontarians, and I thank you again for your time and dedication to this complex, but important issue.

Sincerely,

Brian Dijkema