Report Card

BANKING ON THE MARGINS

NAME: *Government of Ontario*

SUBJECT: *Payday Loan Regulations: A Horse Race Between Red Tape and Innovation*

DATE: *01/11/2018*

EVALUATED BY: *Brian Dijkema*

Ontario's new payday lending rules kicked in this year. They're supposed to strengthen the hand of consumers who borrow less than $1500 for terms of less than 60 days. But will the rules succeed?

Cardus graded the new regulations according to research drawn from our report "Banking on the Margins: Finding Ways to Build an Enabling Small-Dollar Credit Market". Here are the results:

INTEREST RATE CAPS:

In 2015, Ontario's rate cap was $21 per $100 borrowed. It's dropped to $15 per $100 on January 1. Reduced rates are the activists' darling, but research shows that if you need to borrow $300 for ten days to buy necessities and pay bills, its effect is limited or negative. The difference leaves a bit of extra money in peoples' pockets but not nearly enough to fix the cash flow problem that led to the loan. Under the old rate, if you borrowed $500, you would have to pay back $605 at the end of 10 days. Under the new rate, you will have to pay back $575. The difference of $30 is nothing to sneeze at, but the customer didn't take out a loan because they were $30.00 short. They took out a loan because they were $500 short. And the marginal difference between paying back $605 and $575 is not wide enough to significantly alter consumers' behaviour or reduce demand.

It is likely, however, to have a significant impact on the availability of credit. Our data show the new rates are likely to drive many lenders out of business or underground. As we showed using financial data from payday loan companies, the interest rate change will have a significant negative effect on the solvency of the most dominant providers in the market. A study conducted by the government in 2009 showed that the cost of provision of these loans was equal to or higher than what the government will allow lenders to charge. This means that the supply of loans is likely to dry up, leaving consumers dependent on more expensive options, or lead to the growth of illegal loan-sharking. Even if some lenders adapt, which is entirely possible, it is a risk, and the new cap is likely to mean less choice for consumers.

GRADE: F

All show, less dough for everyone, including consumers.

DISCLOSURE RULES:

Today, lenders explain loans costs in terms of fees. Now they'll have to express this as an annual percentage rate on a larger amount. The premise is that fees are deceptive and consumers rarely do the full math on their loan, leading them to be surprised at the actual, unaffordable, cost. This rule is a nudge that asks, "Can you afford this?" It's tough to argue against it. Interest of 391 percent on $500 sounds a lot more expensive than $15 per $100, and complete information held by both borrowers and lenders is essential for any transaction. But, while it will prevent some people from making bad loans, research suggests increased disclosure has limited effect on consumers' habits. It turns out that consumers are generally smarter than governments give them credit for.

GRADE: B+ *Complete information is the apple pie of finance; some nudges are overrated.*

REPAYMENT RULES:

The new rules require lenders to consider the ability of borrowers to repay. Long a mainstay in other lending markets (like mortgages), payday lenders may now not lend someone more than half their net pay. The new rules also introduce extended payment plans for people who've taken multiple loans. This is a positive change. The current system requires the borrower to pay back the principal and interest in one fell swoop, exacerbating cash flow problems. The new system provides a cushion from cash flow shocks that put the borrower on better footing. On its own, this is one of the best steps possible on this file.

GRADE: A *Cushions the consumers' cash crunch.*

FREEING CREDIT UNIONS:

Small is beautiful. This regulation simply says the Payday Loans Act "does not apply to a credit union." While simple, by a wide margin, this is the most significant move possible on this file. As we show in our research, the single biggest problem is that demand for loans is steady, but there is a lack of a supply of positive alternatives. Freeing credit unions – which are obligated to benefit their members and their communities – gives them space to try new things and to offer new products. We have already seen a few Ontario credit unions move to offer alternatives, but this will encourage them to try more.

GRADE: A++ *Government policy that enables institutions to do what they do best is gold.*

GIVING MUNICIPALITIES MORE POWER

The new regulations allow Ontario cities to "define the area of the municipality in which a payday loan establishment may or may not operate and limit the number of payday loan establishments." In other words, cities now have the power to determine where lenders may (or may not) locate their shops. Is this good or bad? Forbidding shops from being placed next to homes for people with mental illness, for instance, would be positive. But in general, cities should try to avoid acting in ways that encourage negative unintended consequences. The recent move by the City of Hamilton to allow only one lender per ward is a classic example of this. It puts far too much focus on lenders, while leaving borrowers with less choice and effectively giving existing lenders a local monopoly.

GRADE: D

Too early to tell, but recent use of this power to give payday lenders little regional monopolies suggests a likely D.

THE OVERALL GRADE depends on whether credit unions can innovate fast enough to provide alternatives to fill the gap left by current lenders who will respond to rate cuts by shutting down or going underground. The market share of current payday lenders in Ontario and the difficulty of innovation put the odds on a market that results in fewer, more expensive, choices for consumers. But idealists might look at the track record of credit unions and be justified in placing their bets on an improved market. If the government had left the rates at $18 per $100 it would have been a certain A. As things stand, results in 2018 could end up anywhere from an F to an A. Only time, and more research, will tell.