CARDUS | 905.528.8866
info@cardus.ca
www.cardus.ca

PROTECTIONS FOR USERS OF HIGH-COST CREDIT

Brian Dijkema and Johanna Lewis

March 2021

Introduction

The Government of Ontario is considering establishing new protections for users of alternative financial services (AFS). AFS are high-cost financial services provided outside of traditional financial institutions like banks and credit unions. Common AFS offerings include payday loans, instalment loans, lines of credit, and auto title loans. Ontario currently regulates payday loans. The government recently invited consultation on draft proposals and options intended to strengthen protection for borrowers and improve the regulation of high-cost credit agreements, other than payday loans.

This consultation is in addition to Ontario's comprehensive review of the Consumer Protection Act, 2002 (CPA), the law governing many personal and household transactions by consumers. The CPA's rules support a fair and competitive marketplace where consumers make their own choices without being subject to unfair business practices.

Cardus submitted the following responses to the questions posed in the consultation.

Question 1:

Do you agree that Ontario borrowers need stronger regulation of high-cost credit agreements?

Any new protections should be based on evidence that the regulatory changes will indeed benefit borrowers, and should include provisions for measuring their effects on users of high-cost credit agreements. When Ontario implemented changes to its payday-loan regulations in 2017, data on the new policies' impact on consumer behaviour was not collected or made available; as a result, it has not been possible to determine how these changes affected payday-loan users and their access to credit. Stronger regulation of high-cost credit agreement should be based on, and include provisions for collecting, evidence on how they affect consumers.[1]

1 "The Changing Face of Payday Lending in Canada," Cardus, June 2019, https://www.cardus.ca/research/work-economics/reports/the-changing-face-of-payday-lending-in-canada/.

Cardus Hamilton: 185 Young Street, Hamilton, ON L8N 1V9 | Cardus Ottawa: 45 Rideau Street Ottawa, Ontario K1N 5W8

CARDUS | 905.528.8866
info@cardus.ca
www.cardus.ca

In addition, regulations based on restricting high-cost, high-risk credit will not solve the underlying problem of inequality in access to affordable, safe credit. The demand for credit offered by AFS businesses will not be eliminated by stricter regulations on AFS. Government should focus instead on increasing the supply of safe and affordable credit for vulnerable borrowers who are currently underserved by mainstream financial institutions. Providing significant and sustained support for alternative credit products offered by financial institutions and their civil-society partners will make it possible for Ontario to build a better, more enabling, credit market.[2]

Question 2:

Do you agree with the proposal to establish new requirements for high-cost credit agreements, defined as credit agreements with an APR that exceeds the Bank Rate of the Bank of Canada by 25 per cent or more? If you recommend an alternative approach to defining high-cost credit agreements, please explain.

We agree that institutions offering lower-cost credit agreements should be free to innovate; removing barriers to those who are trying to build and offer sound alternatives to high-cost loans is excellent policy.[3]

Any official definition of high-cost credit agreements should be based on empirical evidence on consumer behaviour. Is there a data-based rationale for setting the definition of high-cost credit at an APR that exceeds the Bank Rate of the Bank of Canada by 25 per cent or more? Without evidence on how such a definition would affect borrowers and their access to credit, we cannot comment on whether this definition is appropriate.

Question 3 (a):

Do you agree that businesses that offer high-cost credit agreements should be required to be licensed? Why or why not?

---

2 "Banking on the Margins," Cardus, February 2016, https://www.cardus.ca/research/work-economics/reports/banking-on-the-margins/; "Lowering the Cost of Borrowing for Payday Loans in Ontario," Cardus, May 2016, https://www.cardus.ca/research/work-economics/reports/lowering-the-cost-of-borrowing-for-payday-loans-in-ontario/.
3 "Strengthening Protection for Consumers of Alternative Financial Services: Phase One," Cardus, August 2017, https://www.cardus.ca/research/work-economics/reports/strengthening-protection-for-consumers-of-alternative-financial-services-phase-one/.

Cardus Hamilton: 185 Young Street, Hamilton, ON L8N 1V9 | Cardus Ottawa: 45 Rideau Street Ottawa, Ontario K1N 5W8

Requiring providers of high-cost credit to be licensed might make it easier for government to collect industry data from providers. However, it is more important that the government collect and publish data on consumers, since the goal of policy changes is to improve the financial well-being of vulnerable borrowers.[4]

When considering a new licensing regime for AFS businesses, government should also consider the credit and financial services market as a whole. A major concern with licensing AFS businesses under their own set of regulations is that it will entrench a second-tier banking system in the policy framework. Creating an alternative regulatory regime for AFS risks further distinguishing AFS businesses from mainstream financial institutions, contributing to the creation of two separate banking systems: a low-risk, low-cost system for the wealthy, and a high-risk, high-cost system for the poor and marginalized. Trying to improve the second-tier system with borrower-protection regulations will not address the fundamental inequality of a two-tiered arrangement. Government should instead work to integrate vulnerable borrowers into the first-tier financial system by supporting mainstream financial institutions seeking to meet the needs of lower-income borrowers.[5]

Question 3 (b):

Should a licensing framework for high-cost credit businesses be integrated with the licensing framework for payday lenders? Why or why not?

Yes. If the government does introduce a new licensing framework for high-cost credit providers, integrating it with the existing licensing framework for payday lenders would be the most efficient way to implement this change.

Question 4 (a):

Would high-cost credit agreements benefit from new disclosure requirements to ensure greater clarity, transparency, and simplicity? Please describe any requirements that you think are necessary to ensure that all costs and key loan terms are clearly presented to

4 "Banking on the Margins," Cardus, February 2016, https://www.cardus.ca/research/work-economics/reports/banking-on-the-margins/; "The Changing Face of Payday Lending in Canada," Cardus, June 2019, https://www.cardus.ca/research/work-economics/reports/the-changing-face-of-payday-lending-in-canada/.
5 "Testimony to Standing Committee on Social Policy on Putting Consumers First Act (Bill 59)," Cardus, February 2017, https://www.cardus.ca/research/work-economics/reports/testimony-to-standing-committee-on-social-policy-on-putting-consumers-first-act-bill-59/.

the borrower at the beginning of a high-cost credit agreement.

Question 4 (b):

Do borrowers of high-cost credit need greater clarity and transparency that they cannot be obligated to purchase optional products and services from a lender in order to enter into a credit agreement? Please describe any disclosure and information requirements that you think are necessary.

Question 4 (c):

Do borrowers of high-cost credit agreements need clearer and more prominent disclosures about the total cost, and cost per payment, of any optional products and services in a high-cost credit agreement? Please describe any requirements that you think are necessary.

Clarity, transparency, and simplicity are important, especially for larger, longer-term loans like the ones in question, where the interest may actually exceed the principal by the end of repayment. The focus for any new disclosure requirements should be clarity and simplicity, with an emphasis on simplicity.[6]

Our research on payday lending shows, however, that in most cases, increased disclosure has diminishing returns on the goal of affecting consumer behavior: most consumers are aware of the high cost of these agreements and are taking them out because they have no other options. Ontario already has strong disclosure laws, and more clarity on the cost of these loans does not solve the problem of customers being unable to access lower-cost alternatives. Onerous disclosure regulations may be counterproductive if they impose additional costs on the provider (costs that will in turn be passed on to the consumer in other areas) without meaningfully improving the financial well-being of the borrower.[7]

---

6 "Strengthening Protection for Consumers of Alternative Financial Services: Phase One," Cardus, August 2017, https://www.cardus.ca/research/work-economics/reports/strengthening-protection-for-consumers-of-alternative-financial-services-phase-one/.
7 "Payday Loan Regulations: A Horse Race between Red Tape and Innovation," Cardus, January 2018, https://www.cardus.ca/research/work-economics/reports/payday-loan-regulations-a-horse-race-between-red-tape-and-innovation/; "Testimony to Standing Committee on Social Policy on Putting Consumers First Act (Bill 59)," Cardus, February 2017, https://www.cardus.ca/research/work-economics/reports/testimony-to-standing-committee-on-social-policy-on-putting-consumers-first-act-bill-59/.

CARDUS | 905.528.8866
info@cardus.ca
www.cardus.ca

Question 5:

Do you agree with the ministry's proposal to establish a cooling-off period of at least two business days for high-cost credit agreements? Would you recommend a cooling-off period of longer than two business days and, if so, why?

Any decision on whether a cooling-off period is necessary to protect borrowers and, if so, how long this period should be, ought to be made on the basis of evidence related to consumer behaviour. Our payday-lending research suggests that there are some consumers who enter into high-cost credit agreements to make discretionary purchases, and while this group of borrowers might benefit from a cooling-off period, they are only a small subset of high-cost credit users. A cooling-off period will not benefit a borrower who is taking out a high-cost, high-risk loan from an AFS business because he or she has no other options. Rather than offering a last-minute "out" to consumers who enter a high-cost credit agreement because their choices are constrained, the government should focus on improving the supply of better credit, so that vulnerable borrowers have good choices available to them.[8]

Question 6:

The ministry is proposing to strengthen protections against harassing, misleading, or abusive collection practices for borrowers of high-cost credit. Do you agree that the requirements and prohibitions for lenders should be similar to those that are currently in place for payday lenders and collection agencies? Why or why not?

Yes. These practices are harmful to borrowers and should be restricted.

Question 7 (a):

Is there a need to consider new limits on the cost of borrowing of certain high-cost credit agreements? What would be the costs and benefits of establishing limits?

If it is true that the interest rate charged on the loan is not commensurate with the risks and

---

8 "Banking on the Margins," Cardus, February 2016, https://www.cardus.ca/research/work-economics/reports/banking-on-the-margins/; "Testimony to Standing Committee on Social Policy on Putting Consumers First Act (Bill 59)," Cardus, February 2017, https://www.cardus.ca/research/work-economics/reports/testimony-to-standing-committee-on-social-policy-on-putting-consumers-first-act-bill-59/.

Cardus Hamilton: 185 Young Street, Hamilton, ON L8N 1V9 | Cardus Ottawa: 45 Rideau Street Ottawa, Ontario K1N 5W8

CARDUS
905.528.8866
info@cardus.ca
www.cardus.ca

costs assumed by the lender, new limits may be warranted. However, if legal limits on the costs of borrowing are lower than the costs of providing the loan, businesses may stop offering these loans or stop operating altogether. There is evidence that the latter scenario resulted from lowering interest-rate caps for payday loans in Ontario and Alberta: in both provinces, the number of payday-loan outlets fell after the new caps were introduced. Most of the losses were sustained by independent outlets, leading large chains to increase their market share at the expense of consumer choice.[9]

Question 7 (b):

Should there be limits on interest and fees that lenders may charge on high-cost credit agreements that are in default? If yes, would limits similar to those currently in place for payday loans be appropriate?

Question 7 (c):

Is there a need to consider limits on the costs of some optional products and services, e.g., credit insurance, offered in association with high-cost credit agreements? If so, are there any optional products and services of particular concern? What would be the costs and benefits of establishing limits?

As we have noted in our previous publications, transparency and simplicity should rule. If lenders are using the sale of these products and not properly communicating the risks to consumers, then penalties should be put in place. But if credit insurance and other optional products do genuinely act as a means of mitigating consumer risk, they should not be unduly limited or capped.[10]

9 "The Changing Face of Payday Lending in Canada," Cardus, June 2019, https://www.cardus.ca/research/work-economics/reports/the-changing-face-of-payday-lending-in-canada/.
10 "Strengthening Protection for Consumers of Alternative Financial Services: Phase One," Cardus, August 2017, https://www.cardus.ca/research/work-economics/reports/strengthening-protection-for-consumers-of-alternative-financial-services-phase-one/.

Cardus Hamilton: 185 Young Street, Hamilton, ON L8N 1V9 | Cardus Ottawa: 45 Rideau Street Ottawa, Ontario K1N 5W8

CARDUS | 905.528.8866
info@cardus.ca
www.cardus.ca

Other Suggestions:

Several of the new regulations that the government is considering would improve protections for users of high-cost credit agreements. However, these policies do not address the larger underlying challenge for these borrowers: their lack of access to safe, affordable credit.[11] Building a better credit market requires government to look beyond restrictions aimed at suppliers of high-cost loans and focus on how it can enable innovative ways for financial and civil-society institutions to meet demand. Potential options for government to encourage this innovation include:

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.

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

3. Removal of regulatory barriers standing in the way of civil-society institutions, including charitable institutions such as churches, mosques, synagogues, temples, and community foundations, from providing capital and partnering with community-based financial institutions.

4. Consultation with financial tech firms and banks to discover where regulatory hurdles are preventing innovation.

In each case, the government's focus should be on assisting financially prudent, community-based, market-oriented alternatives to enter and change the market.[12]

Moreover, as we noted above, it will not be possible to determine whether the policy changes proposed here achieve their goal without including provisions to measure their impact. Any regulatory change should include plans to collect and analyze data on consumer behavior in order to ensure that these policies are working as intended—that is, improving the financial well-being of borrowers.[13]

---

11 "Banking on the Margins," Cardus, February 2016, https://www.cardus.ca/research/work-economics/reports/banking-on-the-margins/.
12 "Testimony to Standing Committee on Social Policy on Putting Consumers First Act (Bill 59)," Cardus, February 2017, https://www.cardus.ca/research/work-economics/reports/testimony-to-standing-committee-on-social-policy-on-putting-consumers-first-act-bill-59/.
13 "The Changing Face of Payday Lending in Canada," Cardus, June 2019, https://www.cardus.ca/research/work-economics/reports/the-changing-face-of-payday-lending-in-canada/.

Cardus Hamilton: 185 Young Street, Hamilton, ON L8N 1V9 | Cardus Ottawa: 45 Rideau Street Ottawa, Ontario K1N 5W8